

## *Chapter 2*

# CHINA

### **Overview**

December 2006 marked five years since China acceded to the WTO. Upon its accession, China agreed to a set of obligations under the WTO agreements (including the WTO Accession Protocol). In line with its accession, the Chinese government reduced tariffs, and established and changed many laws and made efforts to expand foreign investment in line with WTO Accession Protocol. China has steadily implemented its commitments over the last five years. More specifically, in addition to reducing tariff rates, China has abolished foreign equity limitations in services such as retail and the nonlife insurance sectors. As a result, China has shown remarkable economic growth through the implementation of its commitments, becoming the world's third-largest trading country, surpassing Japan in exports of goods. (WTO Secretariat "International Trade Statistics 2006.")

However, from the viewpoint of full implementation, China still has not met all of its WTO commitments. There are many measures that still require improvement, including the lack of clarity of certain laws and regulations, insufficient enforcement of laws, the imposition of tariffs above bound rates and arbitrary trade restrictions.

Japan has consistently requested China to bring its practices into compliance with China's WTO commitments. Specific examples of cases in which China, due to Japan's requests, reformed practices inconsistent with WTO agreements include: the refund of value-added tax on semiconductors, value-added tax refunds to copper refineries and tariffs on photographic film. In addition, China abolished, at Japan's request, the ban on the dual sale of imported and domestic automobiles.

However, many problems remain. At the forefront is the protection of intellectual property rights. China is expected to improve its implementation of such by lowering thresholds for criminal prosecution and improving its enforcement of the IP laws. In addition, regarding subsidies, China submitted its notification in April 2006, for the first time after joining the WTO. It is necessary to monitor whether China's subsidies are consistent with the WTO ASCM. Moreover, there remain many problems that still seem to be inconsistent with WTO agreements. These include issues related to the system for

certifying finished vehicle characteristics, issues related to the implementation of anti-dumping measures, and the prohibition of imported second-hand clothes. There are also issues that China is not implementing despite its scheduled gradual liberalization. These issues include the approval of trade rights concerning publications and requirements establishing a local corporation.

Under the WTO Accession Protocol, China committed to gradually reduce tariff rates and to liberalize trade in services within five years of accession. Now that five years have passed, China is no longer a new member; it must now assume full responsibility for complete compliance with its commitments and all its WTO agreements. This view is widely shared with other countries. At the request of the U.S., the EU and Canada, a dispute-settlement panel related to the system for certifying finished vehicle characteristics was established (the first China WTO case) in October 2006. Subsequently, in February 2007, the U.S. requested consultations regarding China's subsidies under the WTO dispute procedure. Under the rights and obligations set forth in the WTO agreements, it is important that China be required to bring its measures into compliance with the WTO agreements. Moreover, it is important not only to resolve the issues of the unfair circumstances that foreign companies operating in China face, but also to solve trade conflicts before they become political issues. From this standpoint, it is admirable that Japan and China sought solutions regarding issues related to tariffs on photographic film under the WTO agreements.

Allowing for current trends, there is great concern, from the view point of the transparency of detailed regulations and standards and ensuring National Treatment, about introducing regulations for public safety and security, including Measures for Controlling Pollution by Electronic Information Products, expanding the range of substances under the, System for Environmental Management on the Import/Export of Toxic Chemicals, *etc.* In addition, the issues of discriminatory practices that are beyond the scope of the WTO agreements remain prominent. Examples include regulations that restrict the broadcasting of foreign anime and moves to limit foreign investment in manufacturing industries.

In principle, on the basis of requests based on the WTO agreements, Japan needs to urge China to end restrictive practices and regulations that are inconsistent with its WTO commitments as well as to establish processes that are both transparent and fair. Also, it is hoped that there will be a major breakthrough with legal stability regarding investments and ensuring predictability through the conclusion of Japan-China-South Korea investment treaty.

## &lt;Examples of issues mostly resolved in response to complaints by Japan &gt;

	Commitments on the WTO accession and status of compliance
Ban on dual sale of imported and domestic automobiles	Regarding the sale of automobiles in China, the "Automobile Industry Development Policy" of June 2003 included provisions that banned the sale of imported cars by domestic car dealers and the sale of domestic cars by imported car dealers. If such dual distribution is prohibited, many dealers may choose to sell only domestic automobiles, effectively putting imported cars at a disadvantage. As this would be a failure to provide "national treatment," a violation of GATT Article III:4, Japan raised this issue in bilateral talks with China. China responded that it would not prohibit the dual distribution. The "Automobile Trade Policy" published by the Chinese Ministry of Commerce on August 10, 2005, did not include any express provision banning the dual distribution of domestic and imported cars.
Refund of value-added tax on semiconductors	The Chinese government confirmed that, upon its accession to the WTO, it would conform its measures, including taxation and surcharges, to WTO rules. With regard to the refund of the value-added tax on semiconductors, China provided refunds only for semiconductors produced by domestic manufacturers in China. This means that imported semiconductors are subjected to a higher tax rate than domestic ones, a situation that may constitute a violation of GATT Article III:2 (national treatment). In March 2004, the United States invoked WTO dispute settlement proceedings, requesting consultations with China. The two countries held bilateral consultations in April of the same year, with Japan participating as a third-party. On July 14 of that year, the United States and China reached an agreement under which China would not qualify any more companies for the value-added tax refund system and would stop providing refunds on April 1, 2005. The agreement was notified to the WTO and publicly announced on September 12 of that year.

	Commitments on the WTO accession and status of compliance
Tariffs on photographic film	<p>Although China agreed to provide tariff concessions upon its accession to the WTO, it failed to apply the bound tariff rates to some photographic products and instead imposed significantly higher specific tariffs. In bilateral talks and in sessions of the Transitional Review Mechanism of China, Japan raised this issue and asked China to fulfill its WTO obligations on this issue.</p> <p>As a result, in its tariff revisions of 2006 and 2007, China reduced the specific tariff rates on most of the items at issue to levels similar to the bound-tariff rates.</p>
Value-added tax refund to copper refineries	<p>China maintained a system under which part of the value-added tax imposed on imported copper concentrate is refunded to domestic copper refineries. The system was not notified to the WTO as required by the WTO subsidy agreement. Japanese copper refinery operators became concerned that purchases of copper ore at high prices by Chinese copper refineries could lead to a price increase in the global copper ore market.</p> <p>Japan expressed its concern about this issue in bilateral consultations. China responded that it had decided not to maintain this system beyond December 31, 2005. It added that it was managing the value-added tax on copper in exactly the same way as the management of the taxes on other goods and therefore the issue of the import value-added tax did not exist.</p>

## **UNIFORM ADMINISTRATION, TRANSPARENCY, AND JUDICIAL REVIEW**

### **Commitments upon Accession**

Since its accession to the WTO, China now has obligations under the provisions of Article X of the GATT and Article VI of GATS. China has specifically committed in the Protocol to: (1) apply the WTO Agreement to the entire customs territory of China; (2) observe its WTO obligations not only within the central government but also in local governments; (3) apply and administer the laws, regulations and measures covering trade in goods and services, TRIPs and management of foreign exchange in a consistent, transparent, and reasonable way; (4) only implement laws, regulations, and measures which have been published and can be easily accessed by other WTO member countries; (5) have all administrative actions affecting trade subject to review by a judicial body independent of the agency entrusted with administrative enforcement; and (6) establish a mechanism for the petitioning of complaints in cases of inconsistent application of trade-related systems and regular official publications with an inquiry point to ensure transparency.

### **Status of Implementation and Points to be rectified**

Among the Japanese companies that have entered China, an extremely large number have been calling for greater transparency of policies and measures, as well as for consistent and fair implementation of all trade-related policies and measures. Japan strongly hopes that China will properly fulfill this commitment in a timely manner.

#### **a) Transparency**

Many laws and regulations remain unpublished and those that are published, particularly regulations at the local level, are difficult to obtain. Moreover, in many cases, the time from promulgation to implementation is so short that companies cannot adequately prepare to respond to the new systems. Recently, China has made considerable efforts to improve the transparency of trade-related policies and measures, such as: (i) the active disclosure of laws and regulations through the Internet and the Official Gazette; (ii) the establishment of “the World Organization Notice Enquiry Center (World Trade Organization Notification Enquiry Center)” at the Ministry of Commerce; and (iii) the promulgation of Orders by the State Council in December 2001, to introduce a comment period and to allow the holding of a public hearing prior to the actual promulgation of laws and orders. However, China, including its local governments, needs to further improve transparency in policies and measures.

According to the December 2003 Shanghai WTO Administration Center questionnaire, “transparency” ranked first in reforms sought by foreign companies in the

investment sector. Specifically, companies cited ambiguous interpretations of legal rights and duties in “trial phases”, lack of regulations relative to the application of laws already put into effect and applications of guidelines and other interpretations in lieu of applicable laws. In particular, companies indicated problems in the stability and predictability of policies and the transparency of government approval procedures. In some instances, local governments had adopted their own systems instead of the uniform systems applied in other parts of China. It is necessary to further improve the transparency of policy and measures.

In addition, the following problems have emerged in recent years.

**(1) Eviction Issue in Shanghai's Jiading District**

There have been activities related to the implementation of a new area development plan for some time in the Jiading District, yet administrators continued to invite companies to set up operations in areas where eviction could become necessary. In October 2006, the administrators of Shanghai's Jiading District notified companies operating in the district to move out for the purpose of implementing such a plan with no further explanation.

**(2) Short Notice of Changes in Export Value-Added Tax Refund Rate and Provisional Tariff Revision concerning Imports/Exports**

China has frequently adjusted the rate of the value-added tax refund at the time of exports; for example, a notice issued on September 14, 2006 reduced the refund rate from more than 10% to zero, effective the following day. Meanwhile, a notice of a revision of export tariff rates issued on October 27, 2006, took effect on November 1.

As such sudden changes in the regulations and measures undermine business predictability and could produce a serious impact on corporate management, there is growing awareness of this issue as an investment risk. Japan raised this issue in the Japan-China Economic Partnership Consultations in December 2006. Japan believes that China's economic and trade policies should be conducted in ways to secure transparency and predictability.

**b) Uniform Administration**

For the purpose of administrative unification, China needs to develop laws and orders that are consistent between the Ministries, Committees and Governments of central, provincial and local levels. Even under consistent laws and orders, foreign-owned companies may find barriers against inter-regional business development due to discretion in the application of laws and orders or inconsistency in their interpretation, and the selective application of orders. Moreover, due to the greater autonomy of local government in China, foreign-owned companies often face regulations and costs imposed only to a certain locality. It is strongly anticipated that China will correct such inconsistencies in the application of laws and orders among local governments.

Nevertheless, a "social security fund scandal" broke out in Shanghai in August 2006 as it came to light that the local government used social security funds for high-risk investments in real estate and toll-road construction without permission by ignoring the central government's relevant directives.

In addition, there is widespread inconsistency among Chinese administrations with the same level of authority. For example, according to the construction law of 1998 and a document specifying the extent of the jurisdiction of the Ministry of Construction established by the State Council (issued in 1998), the Ministry of Construction has integrated control over the determination of qualification requirements for construction companies. However, the Ministry of Communications and the Ministry of Information Technology and Telecom Industries have established different qualification criteria obligating companies to meet their qualification requirements in addition to those of the Ministry of Construction, thus creating restrictions on market entry.

Construction companies failing to obtain qualification from these Ministries are prohibited from participating in construction bids even if they hold legal qualification certificates issued by the Ministry of Construction.

### **c) Judicial Review**

Some improvement was seen in the judicial review systems, as China incorporated a rule, designating that administrative decisions could be the subject of judicial review (for example "Anti-Dumping Regulation" and "Patent Law" *etc.*), and established the Chinese International Economy and Trade Arbitration Committee (CIETAC) as a court to arbitrate any disputes over commerce. However, WTO member countries expressed their strong concern at the Accession Working Party on the neutrality and precision of Chinese legal judgments, as well as the sound and steady execution of judgments and rulings and called for the continued observation of their practices in the future.

## **IMPOSITION OF EXPORT TAX**

### **Commitments upon Accession**

Under Item 3, Article 11 of its WTO Accession Protocol, China committed itself to abolishing all taxes and surcharges imposed on exports except in the case of taxation on products listed in Annex 6 or in the case where taxation is allowed under GATT Article VIII.

### **Status of Implementation and Points to be rectified**

On November 1, 2006, China put into effect a table of provisional export tariff rate adjustments. Of the 110 items listed in the table, only 13 (including but not limited to ferromanganese, ferrochrome, crude steel, anode copper for electrolytic refining and copper and aluminum scrap) are included in Annex 6 of the WTO Accession Protocol, which is a list of products exempted from the ban on taxation on exports under Item 3, Article 11 of the Protocol. Therefore, the measure may be in violation of Item 3, Article 11 of the WTO Accession Protocol.

## **RIGHT TO TRADE (APPROVAL SYSTEM FOR TRADING)**

### **Commitments upon Accession**

The right to trade, awarded by approval from the Chinese government, restricted to some Chinese enterprises, prohibiting foreign companies, in principle, from trading. Within three years of accession, China committed to permitting all companies in China (including foreign companies) to obtain rights to trade. However, some items subject to state trading, such as grain, vegetable oil, cotton, sugar, tobacco, crude oil, processed oil and chemical fertilizer, will continue to be restricted to Chinese companies.

During the three-year transition, China committed to the following: (1) to eliminate its rules for Chinese and foreign companies to obtain and maintain rights to trade, including the requirements concerning export track record, balance of trade, foreign currency balance, and past experience in exporting and importing; (2) to reduce the minimum registered capitalization requirement for 100 percent Chinese-invested enterprises to RMB 5 million Yuan in the first year, RMB 3 million Yuan in the second, and RMB 1 million Yuan in the third, as well as eliminate the review and approval system at the end of the transitional period; and (3) to grant full rights to trade one year after accession to joint-venture enterprises with minority share foreign-investment (it will grant the same two years after accession to majority share foreign-invested joint ventures, and finally will grant full rights to trade to all enterprises in China within three years after accession.)<sup>1</sup>

Such rights, however, do not permit importers to distribute goods freely within China. China has made specific commitments with respect to a limited distribution of goods in its schedule on services.

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<sup>1</sup> Foreign-invested enterprises would not be required to establish a particular form or a separate entity to engage in importing and exporting; nor would new business licenses encompassing distribution be required to engage in importing and exporting.

### **Status of Implementation and Points to be Rectified**

In July 2004, China revised for the first time in 10 years the “Foreign Trade Law.” The revised Foreign Trade Law is based on China’s accession commitments that the foreign trade approval system should be abolished within 3 years of China’s WTO accession. As revised, only registration is required for foreign trade operations; the application and approval process has been abolished. Japan will continue to monitor Trading Right issues.

However, publications (*i.e.*, books, newspapers, magazines, audio, video products) are allowed to be imported only by state-owned enterprises authorized by the State Council under the Council's ordinance concerning control on publications. Under Article 5 of China's WTO Accession Protocol, the country is due to: (1) grant all domestic companies rights to trade concerning all goods (except for some agricultural products) within three years after the accession; and (2) provide fair treatment to all foreign people and companies compared with domestic companies. Therefore, the import restriction on publications is deemed inappropriate. Japan will continue to watch the status of implementation of the commitments concerning trade rights.

## **NATIONAL TREATMENT**

### **Commitments on Accession**

China is subject to the requirements of GATT Article III and GATS Article XVII on national treatment. In its accession Protocol, China committed to offering treatment to foreign companies, foreigners and foreign investment companies no less favorable than that accorded to Chinese companies. China must now treat foreign businesses the same as Chinese businesses with respect to the procurement of goods and services, establishing requirements relating to product manufacture and marketing, and with respect to the prices and availability of goods and services supplied by the national and sub-national authorities or state enterprises in sectors such as transportation, energy and telecommunications.

### **Status of Implementation and Points to be Rectified**

In China, there has been widespread discriminatory treatment against imports, suppliers of imports and foreign businesses regarding the licensing systems and the setting of utilities charges.

Reportedly, local governments have started to amend or repeal over 190,000 local laws, regulations and other policy measures to comply with the WTO agreements and China’s accession commitments. However, it seems that there still remain regulations that do not conform with the policies of the central government.

**1) Restriction on the Selling of both Imported and Domestic Automobiles**

(See “4. Major Cases” of “National Treatment” in Part II - Chapter 2)

**2) Value-added tax on semiconductors**

(See “4. Major Cases” of “National Treatment” in Part II – Chapter 2)

**NON-TARIFF MEASURES (IMPORT RESTRICTIONS)****Commitments on Accession**

China committed to eliminating import restrictions (import quotas, import licensing and specific import tendering requirements) which do not conform to the WTO Agreement by 2005 and to not reintroduce them. The schedule of elimination for each item for existing measures is shown in Annex 3 of the Protocol. For example, quantitative import restrictions on automobiles were to be eliminated by 2005, and in the interim, quotas would be expanded from \$6 billion in the first year (the level prior to the introduction of an industrial policy for automobiles) at a rate of 15 percent per year. China also committed to instituting simplified and transparent procedures for the administration of import quotas and approvals during the transitional period.

**Figure 1-1****Schedule of Elimination of Import Quotas and Approvals for Main Items**

<b>Main Quota Item</b>	<b>Initial quota Volume/Value</b>	<b>Annual Growth Rate</b>	<b>Phasing-out Period</b>
Motorcycles and key parts	\$286 million	15%	2004 <sup>2</sup>
Automobiles and key parts	\$6 billion <sup>2</sup>	15% <sup>3</sup>	2005
Air conditioners apparatus	\$283 million	15%	2002
Video recording apparatus	\$293 million	15%	2002
Cameras	\$14 million	15%	2003
Wrist Watches	\$33 million	15%	2003

<sup>2</sup> Restrictions on motorcycle engines were eliminated in January 2003.

<sup>3</sup> The amount and rate of increase includes engines and chassis, as well as fully assembled automobiles.

## **Status of Implementation and Points to be Rectified**

The WTO requires that quotas and permits, under import restriction measures, be implemented in a transparent, fair and rational way until their removal.

Since January 1, 2002, China has applied the “List of commodities under import permit control for the year 2002” and the “List of electric appliances under import restriction for the year 2002.” The reduction of items under import restriction was implemented in accordance with the commitment under China’s accession Protocol and, for some items, the restrictions were abolished even in advance of the agreed time limit. For example, restrictions on motorcycle-related items were abolished in advance (protocol Annex 3 requested the abolishment by 2004). Overall, the elimination of import restrictions has been implemented steadily in accordance with the commitments under China’s accession Protocol, including the elimination of the import quota system for automobiles on January 1, 2005. Since that date, the number of goods subject to the import license system has been reduced to three categories (supervised and controlled chemical products, toxic chemical products and ozone layer depleting substances) for 83 items; no change was made in 2006. Furthermore, quantitative restrictions on machinery and electric appliances have now been completely lifted, with the elimination of import quota control over 35 items of machinery and electric appliances as of January 1, 2005.

On the other hand, China also has implemented import bans on a broader range of items under Article 16 of the “Foreign Trade Law” to: (1) safeguard the state security, public interests or public morals; (2) protect human health or security, animal and plant life or health or the environment; (3) implement measures relating to the importation and exportation of gold or silver; (4) address domestic shortage in supply or the effective protection of exhaustible natural resources; (5) address limited market capacity of the importing country or region; (6) address the occurrence of serious confusion in the export operation order; (7) establish or accelerate the establishment of a particular domestic industry; (8) address the necessity of restrictions on the import of agricultural, animal husbandry or fishery products in any form; (9) maintain the State’s international financial status and the balance of international payment; (10) address situations where laws and administrative regulations so provide; and (11) comply with obligations under international agreements. The banned items have been made public and enforced as “import banned cargo lists” (No.1 - No.6) categorized according to the purpose for regulating imports. These rules appear consistent with GATT Articles XX (general exceptions) and XXI (exceptions for national security). However, the items listed under the “import banned items for used electric appliances” include questionable items, such as electronic game machines. Japan will verify the consistency of this ban with the exception clause of GATT.

## **1) Prohibition of Imported Second-Hand Clothes**

### **<Outline of the measure >**

In 1985, the Chinese Government prohibited imports of second-hand clothes via notification from the Ministry of Foreign Trade and Economic Cooperation. Moreover, on July 3, 2003, China added second-hand clothes to the fourth list of items subject to import prohibitions under the Import and Export Ordinance.

### **< Problems under international rules >**

The measures taken by the Chinese Government violate Article XI of GATT because they represent a *de facto* prohibition or restriction other than tariffs or other surcharges. China justified its import prohibitions by insisting that the measures are ‘necessary to protect human, animal or plant life or health’ and, therefore, are permitted under Paragraph (b) of GATT Article XX (General Exception). The Chinese Government, however, failed to fully explain why a general prohibition on imported second-hand clothes was necessary to protect life or health and why protection could not be guaranteed through other unrestrictive means (required criteria under paragraph (b) of GATT Article XX, which was established by WTO jurisprudence). Thus, the restriction is not considered to be justified by GATT Article XX.

### **<Recent developments>**

Japan has on several occasions insisted that, since the measures are ‘highly likely to be in violation of Article XI of GATT, and damaging to Chinese consumers, they should be abolished.’ Japan raised this issue during the regular meeting with the Department of Commerce of China in April 2003 and the Japan-China Textile Dialogue in November 2005, respectively, as well as during governmental negotiations. In addition, the issue was raised at the Market Access Committee in September 2005. In the Japan-China Textile Dialogue, China replied, as a response to Japan’s assertion regarding inconsistency with the WTO rule, that they will develop domestic laws generally concerning second-hand products including second-hand clothes, and after that will develop rules concerning imported second-hand products. However, at the Japan-China Textile Dialogue held in September 2006, China explained that partly because it is not the common practice for the Chinese to wear second-hand clothes, China currently is not at the stage of developing domestic laws governing second-hand clothes. This issue was also raised at the TRM of the Market Access Committee held in October 2006, but China again failed to give a specific reply.

Japan will continue to monitor developments and urge China to eliminate the measures.

## **EXPORT LICENSING AND RESTRICTIONS**

### **Commitments on Accession**

In the past, China applied export licenses and restrictions on a broad range of products for reasons of: (1) maintaining national security or public interest; (2) protecting against shortage of supply in the domestic market or exhaustion of natural resources; and (3) obligations stipulated in international treaties, *etc.*

During the accession process, some Members noted the need to ensure that these measures conformed to GATT Article XI (general elimination of quantitative restrictions) and Article XX (general exceptions). There were particular concerns expressed over tungsten ore concentrates, rare earths and raw and intermediate manufacturing materials. China committed to abide by WTO rules in this area from the date of accession and to apply export licensing and restricting measures only when justified.

### **Status of Implementation and Points to be Rectified**

On January 1, 2002, China issued a “FY 2002 Catalog of Issuance of Licenses Based on Classification of Products Controlled with Export License” and a notice for related issues, which established an institute for issuing export licenses, as well as 54 product categories subject to export licenses. The Catalog was reissued in 2003 and the number of products subject to the export license system was adjusted to 52 items. When the “2006 Catalog of Issuance of Licenses Based on Classification of Products Controlled with Export License” was published, the number of such products was reduced further to 46 items. Also the “Goods Export and Import Management Ordinance”, “Export Goods Quota Management Regulations” (both implemented on January 1, 2002) and “Freightage Export License Management Ordinance” (implemented on January 1, 2005), which prescribed the conditions for applying for export licenses went into effect. This system reflects the requirements for general exemptions in the GATT.

However, after its accession to the WTO, China continued to require export licenses and impose restrictions on exports of raw and intermediate materials; it is unclear whether it has in place the “restrictions on domestic production and consumption” that are prerequisite to exemptions for the purpose of conserving exhaustive natural resources granted under GATT Article XX(g). Japan will need to continue to monitor this area for conformity to the WTO Agreement.

## **1) Export Restrictions of Coke**

### **<Outline of the measure >**

The Chinese Government imposes export controls on coke through a licensing system. In 2003, China issued licenses for the export of 13 million tons of coke. In 2004, coke exports licensed by the Government covered 2.33 million tons (as of mid-March). The shortage in export licenses and resulting premiums on export licenses, caused coke prices to skyrocket. Consequently, the Chinese Government issued additional export licenses for 5.4 million tons of coke (or another 0.4-0.6 million tons). After Japan and the EU indicated that the licensing system may violate the WTO Agreement, the Chinese Government issued additional export licenses for 4 million tons of coke at the end of July. In total, China issued export licenses for 12 million tons of coke in 2004. China issued export licenses for nearly 14 million tons of coke in both 2005 and 2006.

Also, while China closed down some coke production facilities due to environmental concerns, domestic coke production has doubled over the last five years (In 2002, while China produced 115 million tons of coke in 2002, China produced 226 million tons in 2006.)

### **< Problems under international rules >**

The Chinese Government justifies coke export controls under Paragraph (g) of GATT Article XX by citing a need to ‘conserve exhaustible natural resources.’ While this provision permits export controls as an exception to GATT obligations, it states that the exception shall only be applicable ‘if such measures are implemented in conjunction with restrictions on domestic production or consumption.’ China claims that its coke production is controlled; however, no provisions exist to restrict domestic consumption. Given a lack of domestic control and the fact that total coke production in China is increasing, it appears that China’s export controls violate Article XI and Paragraph (g) of Article XX of GATT.

### **<Recent developments>**

Japan expressed its concerns and urged China to implement an appropriate licensing system at the Energy Ministerial Meeting, the regular meeting with the Department of Commerce of China, and the Japan-China Steel Dialogue, which were held from June 2004 through April 2005.

Japan also raised questions concerning the consistency with the WTO Agreement during the TRM of the Market Access Committee in September 2005 and the WTO Council on Trade in Goods (CTG). However, the Chinese Government insists that its export licensing system complies with the WTO Agreement.

## **(2) Export Control on Rare Earth**

### **<Outline of the Measure>**

The Chinese government controls exports of rare earth elements through a licensing system. In 2001, about 57,000 tons were licensed for export, but the amount has declined since then, falling to about 49,000 tons in 2005 and about 45,000 tons in 2006.

The use of rare earth elements plays a crucial role in the production of components for products with high value added, such as automobiles and IT-related products, and global demand for them is expected to grow in the future.

China accounts for approximately 93% of the global production of rare earth elements, and Japan depends on imports from China for about 90% of its domestic needs. There is concern that Japan will face a shortage in rare earth supply if China continues and strengthens its rare earth export control.

### **<Problems under International Rules>**

It is not clear whether China is implementing restrictions on domestic production or domestic consumption, a measure required as a precondition for the approval of an exceptional measure for the conservation of exhaustible natural resources under Article 20 (g) of the GATT, and there is doubt as to the consistency of China's export control with Articles 11 and 20 (g) of the GATT.

### **<Recent Developments>**

In regular consultations with the Chinese Ministry of Commerce in April 2006 and the Japan-China Economic Partnership Consultation in July of the same year, Japan called for the abolition of the export control based on the licensing system. China responded by explaining that the export control is intended mainly to conserve natural resources and the environment and that the licensing system is notified to the WTO annually and is consistent with the WTO agreements.

## **TARIFFS**

### **Commitments on Accession**

Following negotiations with Japan, the United States and the EU, as well as within the Working Party, China submitted a schedule of tariff concessions on accession which reduces tariffs on a broad range of items.

In the past, it was thought that Chinese reduction of tariffs was not very meaningful because China was a non-market economy in which the state had exclusive control over all trade. However, the degree of state interference in trade is steadily diminishing in China under the principle of a “socialist market economy.” Upon

accession, China committed to abolish, in principle, quantitative restrictions on imports and adhere to WTO disciplines on state trade. Tariffs will therefore be the main tools by which imports are regulated, and the significance of tariff reductions will indeed be large.

China's tariff reduction schedule is outlined. (Please *see* the table "Tariff Reduction Schedule".) China's commitment is to reduce the tariff rate on all bound items (7,151 items) and to reduce the simple average tariff rate of 13.6 % (at the time of accession in 2001) to 9.8% by 2010. The reduction is scheduled to be conducted line-by-line, from 19.3% to 15% on agricultural products (977 items) and from 12.7% to 8.9% on mining products (6,174 items).

In addition, China committed to join the Information Technology Agreement (ITA) and to reduce tariffs on almost all chemicals and chemical products to the harmonized level.<sup>4</sup>

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<sup>4</sup> The Chemical Tariff Harmonization Agreement established tariff reductions on chemicals and chemical products (in principle HS 28~39 types) (final tariff rates of 0-6.5%) for participating countries, including Japan, the United States and the EU. This was agreed to as a part of the tariff negotiations during the Uruguay Round.

**Tariff Offer Reduction Schedule upon China's Accession to the WTO**

	1998	Date of accession	1.1.2002	1.1.2003	1.1.2004	1.1.2005	1.1.2006	1.7.2006	1.1.2010
All items (7,151 items)	17.5	13.6	12.5	11.4	10.6	10.1	10.0	10.0	9.8
Agricultural products (977 items)	22.7	19.3	18.7	17.5	16.3	15.7	15.7	15.7	15.0
Mining products (6,174 items)	16.6	12.7	11.5	10.5	9.7	9.2	9.2	9.2	8.9
Main industrial products									
(Home appliances)									
Air conditioners / window and wall installed / for automobiles	25.0	21.0	19.0	17.0	15.0				→
Refrigerators (500 l)	40.0	33.3	30.0	26.7	23.3	20.0			→
Vacuum cleaners	30.0	24.0	21.0	18.0	15.0				→
Color TVs	35.0	26.7	22.5	18.3	14.2	10.0			→
(General machines)	35.0	31.7	30.0						→
Fork lifts	18.0	14.4	12.6	10.8	9.0				→
Printing machines (plate making machines)	16.0	12.5	10.8	9.0					→
(IT)									
Computers	25.0	16.7	12.5	8.3	4.2	0			→
Automatic data processing machines	9.0	3.0	0						→
Mobile data processing machines	15.0	7.5	3.8	0					→
Displays, printers	15.0	7.5	3.8	0					→
Keyboards, mouses	12.0	6.0	3.0	0					→
Fax machines	12.0	6.0	3.0	0					→
Copiers	22.0	17.0	14.8	12.4	10.0				→
(Automobiles)									
Buses / 30 passengers or more / 29 passengers or less	50.0	41.7	37.5	33.3	29.2	25.0			→
Passengers cars	70.0	55.0	47.5	40.0	32.5	25.0			→
Trucks / less than 5 tons	100~80.0	51.9	43.8	38.2	34.2	30.0	28.0	25.0	→
Passenger car chassis	50.0	40.0	37.5	30.0	29.2	25.0			→
Passenger car bodies	60.0	40.0	36.8	31.4	26.1	20.7	15.4	10.0	→
(Motorcycles)	70.0	46.0	42.1	35.7	29.3	22.9	16.4	10.0	→
Motorcycles (less than 250cc)	60.0	52.25	48.75	45.0					→
Motorcycle parts	25.0	19.6	17.2	14.6	12.0				→
(Iron & steel and non-ferrous metals)									
Flat rolled iron & steel products	8.0	6.0							→
Iron & steel tubes and pipes	10.0	6.0	4.0						→
Refined copper tubes and pipes	6.0	4.0							→
Aluminum sheeting	12.0	8.0	6.0						→
(Precision instruments)									
Cameras	25.0	21.7	20.0						→

Note: The deadline for application of this tariff schedule for almost all items is 1 July 2006. Items with an application deadline beyond July 2006:

1.1.2008: Terephthalic acid, some dyes, some cosmetics, polyethylene, propylene, styrene, vinyl chloride, polyester, polyamide, polyurethane, plastic scrap, some plastic tubes, some plastic boards and sheeting.

1.1.2010: Some fruits and fermented fruit drinks, and some synthetic fibers.

## **Status of Implementation and Points to be Rectified**

From January 1, 2002, China reduced tariffs by an amendment to the Tariff Law on 73% of all bound items (over 5,300 items). The simple average tariff now is 12%, including 11.6% on industrial products, 15.8% on agricultural products, and 14.3% on fishery. In addition, the tariffs on about 300 items related to the ITA has been reduced to 5% (this includes 0% for over 100 items). However, higher final bound tariff rates still exist among some items, including photographic films (maximum 47%), projectors (maximum 30%) and motorcycles (maximum 45%).

China is generally reducing its tariffs in line with its schedule of concessions, but while China committed to impose *ad valorem* tariffs on all items, some items are subject to specific duties that are higher than the bound tariff rate. Therefore, corrections of these tariffs have been sought.

On January 1, 2007, China released the sixth revision of its tariff schedule since accession. In this revision, the amount of tariff reduction and the number of tariff reduced articles are less than in previous years because China has already fulfilled the majority of its tariff reduction commitment. However, while China reduced tariffs in line with the schedules of concessions in the last implementation year, the problem of specific duties that are higher than bound tariff rate remains unsolved and must be rectified immediately.

With regard to China's commitment to participate in the Information Technology Agreement (ITA), the ITA committee continued to examine China's participation. However, China had been unable to become a full signatory party because of strong concerns expressed by some Members regarding the obligation in China to obtain "end-use" certifications from the Ministry of Finance and Ministry of Information Industry before the ITA tariff rate can be applied. China modified this system in January 2003 and shifted to a system similar to that used by other Members in which decisions for application of ITA tariff rates are made upon confirmation of end-use by customs authorities. Therefore, China's participation in the ITA was approved in April 2003.

### **1) Failure to fulfill tariff concessions for photographic film**

#### **<Outline of the measure>**

In the goods tariff concessions provided by China when it joined the WTO, there is a commitment to reduce tariffs on photographic products (HS 37) to 0-53.5% *ad valorem* as of 2002. However, for 35 items which are about a half of whole photographic products (including ordinary photographic film), the government of China has failed to apply the concession rates committed to at the time of WTO accession and instead imposes a specific duty of 9-170 Yuan per square meter. When translated to *ad valorem* rates, this specific duty is extremely high (for example, the concession rate for finished 35 mm color negative film is 42%, while the specific duty is over 120%, *ad valorem*). Since 2002, Japan has raised this problem and urged China to fulfill its

WTO obligations on numerous occasions, including bilateral talks such as the regular vice-ministerial level talks held between the Ministry of Economy, Trade and Industry and MOFTEC (Ministry of Foreign Trade and Economic Cooperation), the Ministerial-talk at the APEC Trade Ministers' Meeting, as well as during the Chinese Transitional Review Mechanism (TRM) of the WTO Market Access Committee. Accordingly, on October 1, 2002, China implemented a provisional measure that reduced tariff rates for two items of dry film resist until the end of 2002. Each year since 2003, tariff rates were reduced through tariff revisions. However, specific duties that are much higher than the bound tariff rates had been maintained, and the Chinese government clearly had been violating tariff concessions. In their tariff revision of January 2005, China reduced tariffs on several items, but still maintained the specific duties (ranging from 2.1 to 128.6 Yuan M<sup>2</sup>). For example, 35 mm color films with a bound tariff rate of 24% had their *ad valorem* duties reduced from 120 Yuan M<sup>2</sup> to 96 Yuan M<sup>2</sup>, but, calculated in equivalent *ad valorem* duties, the tariff rates on these products continue to stay at levels about 2.6 times higher than the concessional rate.

In consideration of this, Japan raised these problems at Vice Minister-level meetings with the Chinese Ministry of Commerce in April 2005 and during a Japan-China expert meeting in August 2005, the Chinese TRM in October and other meetings. At the same time, deputy-level meetings were held in Beijing in October and November, and Japan concretely pointed out the problems of this case under the WTO Agreement and strongly requested correction of the measures.

As a result, in the revision of tariff rates published in January 2006, while specific duties were maintained, *ad valorem* duty equivalent rates on most of the items were reduced to close to the level of the bound tariff rates that China had committed to. For example, the duty on 35mm color films was reduced from 96 Yuan M<sup>2</sup> to 30 Yuan M<sup>2</sup>. However, on some of the items, rates that are more than twice the *ad valorem* duty equivalent rates that China had committed to continued to be levied.

#### <Problems under international rules >

This setting of tariff rates is clearly in violation of GATT Article II, which requires that "Each contracting party accord to the commerce of the other contracting parties treatment no less favorable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement."

#### <Recent developments>

Japan had renewed discussions with China regarding these issues at the Japan-China Economic Partnership Consultation held in Beijing in July 2006 and during the Chinese TRM of the WTO Market Access Committee in October 2006. In November

2006, the Japanese Embassy in Beijing submitted written requests to Ministry of Finance tax officials and the Department of WTO Affairs at the Ministry of Commerce requesting resolution.

As a result, in the 2007 revision of tariff rates, while specific duties are maintained, the duties on eight photographic film products were reviewed and tariff rates were reduced to tariff concession levels (for example, the specific duties on semi-processed film for printing (HS37024229) were revised from 3.7 Yuan M<sup>2</sup> to 1.6 Yuan M<sup>2</sup>).

## **2) Issues related to the Measures Affecting Imports of Automobile Parts**

### **<Outline of the measure>**

In June 2004, China announced its Automobile Policy Order. For the purpose of increasing the production capacity of automobile products, China implemented a new tariff system that provided that if imported automobile products are certified as having features of finished automobiles rather than those of auto parts, or, more specifically, if they fall under any of the following situations, they shall be subject to the 25% tariff rate for finished automobiles instead of the 10% tariff rate for auto parts (the final bound rates as of July 1, 2006):

- (i) Where they contain knockdown parts;
- (ii) Where they consist of a combination of designated auto parts (*e.g.* bodies, engines); or
- (iii) Where the total CIF price of imported parts accounts for 60% or more of the total value of the finished automobile.

At the WTO Market Access Committee meeting in October 2004, Japan requested that China not introduce the system for certifying finished vehicles because the system might violate the WTO Agreement and China's WTO commitment.

However, China implemented its "Administrative Measures for the Import of Automobile Components Fulfilling the Characteristics of a Whole Vehicle" in April 2005. China revealed in the Rules that the tariff rate for finished automobiles shall apply to imported complete knockdowns (CKD) or semi-knockdowns (SKD) parts.

During many discussions with China in 2005, such as the regular meeting between METI Japan and MOFCOM China (April 21, 2005), the WTO Market Access Committee (October), the WTO Council for Trade in Goods (November) and the Japan-China Economic Partnership Consultation (December 1), Japan expressed concern that the system for certifying finished vehicles might violate the WTO Agreements and requested correction, but China's answer remained the same, stating it did not consider the system to be in violation of the WTO Agreements.

### <Problems under international rules >

In regard to the compatibility of the system with the WTO Agreements, if a higher tariff rate for finished automobiles is applied to auto parts such as bodies and engines for which the concession rate is lower, it may violate GATT Article II (Concession Schedule).

China has confirmed that there is currently no tariff line for CKD and SKD for automobiles, and has made a commitment that if China created such tariff lines, the tariff rates would be no more than 10% (see Paragraph 93 of the Report of the Working Party on the Accession of China). From this perspective, there is the possibility that the system for certifying finished vehicles might violate China's WTO commitment.

Furthermore, the imposition of the tariff rate for finished automobiles where the total CIF price of imported parts accounts for 60% or more of the total value of the finished automobile, might constitute a local content requirement and therefore violate GATT Article III (National Treatment on Internal Taxation and Regulation) and the Trade-Related Investment Measures (TRIMs) Agreement.

China has also made a commitment that it would completely observe the TRIMs Agreement and abolish the local content requirements, without applying Article V (Transitional Measures) of the Agreement (also see Paragraph 203 of the Report of the Working Party on the Accession of China).

### <Recent developments>

Besides Japan, the United States, the EU and Canada are also highly concerned about this issue. In March and April 2006, the countries requested consultation with China in conformance with the WTO dispute settlement procedures; a consultation was held in May 2006. Japan participated in the consultation as a third party. In addition Japan had unofficial bilateral discussions on the issue twice outside the WTO and continued to consult with the Government of China to achieve a resolution of the problem in the Japan-China Economic Partnership Consultation (July and December 2006), the WTO Market Access Committee (October 2006), and the WTO Council for Trade in Goods (November 2006)

As a result of these efforts, China issued Customs General Administration Joint Bulletin No. 38 on July 5, 2006, and clarified that measures pertaining to item (3) of the measure (where the total CIF price of imported parts accounts for 60% or more of the total value of the finished automobile) would be extended until July 1, 2008. However, even if that measure is extended, if it is not completely removed and the temporary extension puts undue pressure on automobile industry companies to increase the ratio of local company procurement by 2008, Japan will continue to request that China completely remove the measure.

Japan, the US, the EU and Canada remained concerned about the above-mentioned extension and requested that a panel be established to help enforce the measure. The panel was approved at the meeting of the DSB in October 2006. Japan

participated as a third party and plans to continue to request improvement of the situation.

### **3) Tariff Classification**

#### **<Outline of the measure>**

In China, there are 42 customs districts as subordinate organizations of the Customs General Administration Bureau and about 150 thousand registered importers. One of the problems with customs operations in China is that the same product may be classified differently in different districts because individual importers apply for tariff classification at individual districts.

There are problematic cases in many individual districts. The tariff classification notified orally by officers in charge may change suddenly and a high tariff may be imposed. On one occasion, audio-visual devices imported to the Shanghai customs district were found duty-free there, but 30% duty was imposed on them after investigation by another organization in the same district. In this case, filing of a protest was impossible because the tariff amount direction was not in writing.

There are systems of “administrative ruling” and “advance decision” under which the customs authorities give written notification in advance of the tariff classification for imported products upon importers’ application. However, there are problems with these systems and their application.

Under the “administrative ruling” system, authorized importers registered at the customs bureau apply for advance rulings on tariff classifications and the customs notify the results in writing within 60 days to the applicants. The notifications are announced on a nationwide basis and have the same legal effect as the rules. They are also applied to all importers. There are similar systems in Japan, US, and European countries. However, there are problems in China. For example, in practice, Chinese authorities are reluctant to notify the results of tariff classification rulings, and confidentiality of information about details of traded freight is not institutionally guaranteed.

The advance decision also lacks systematic rationality, because a decision is valid only for one year in one district and only concerns one importer’s individual imported product. If there are several importers, they will have to file applications for each import in their respective districts. Separate applications have to be filed for changes of products or importers or for long-term (over one year) contracts. Another problem is that the period within which an advance decision should be made is not determined. In fact, there are cases of applications left unattended for long periods of time without any decisions.

#### **<Problems under international rules >**

As mentioned above, there are problems under international rules in the operations of the Chinese customs regime. Tariff classification decisions are different according to districts and individual officials in charge. Confidentiality of information about details

of traded freight submitted in applications is not institutionally guaranteed. Advance decisions are valid only for one year, and the period of decision is not determined. These may be in violation of GATT Article X:(3)(a) that stipulates that each Member must implement all statutes, judgments and decisions listed in (1) in a uniform manner that is fair and rational. It is to be desired that these problems should be fixed.

#### **<Recent developments>**

The system of administrative ruling started in January 2002. However, it has rarely been utilized because all imports including Japanese companies find it too heavy a burden to submit detailed information about freight and transactions in applications for administrative ruling. In addition, confidentiality of such information is not institutionally guaranteed. It is desired that China should start efforts toward the improvement of the administrative ruling system and its application so that importers could utilize it as easily and extensively as in Japan, US and Europe.

Regarding the advance decision system, there are cases where importers' applications have been left unattended for a long time without any decisions. An application for audio-visual devices was left unattended for more than six months, and the applicant Japanese company was compelled to pay a large amount of bond for customs clearance.

There is a project called "Customs H2000", which aims to facilitate information exchange between all customhouses in China by linking them by means of electronic system. The project has been partially implemented. It is hoped that the project will make it possible to apply tariff classifications on individual products uniformly at all customhouses in China.

## **ANTI-DUMPING AND COUNTERVAILING MEASURES**

### **Commitments upon Accession**

Upon accession, China committed to bring its regulations and procedures on anti-dumping and countervailing measures into conformity with the Anti-Dumping (AD) Agreement and the Agreement on Subsidies and Countervailing Measures.<sup>5</sup>

It was agreed that for 15 years following its accession, China, as a non-market

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<sup>5</sup> Article 18.3 of the AD Agreement states that "the provision of this Agreement shall apply to investigations, and reviews of existing measures, initiated pursuant to applications which have been made on or after the date of entry into force for a Member of the WTO Agreement." With regard to China, it is interpreted that the AD Agreement will not apply to investigations based on applications before accession. However, there has been a clear commitment that the AD Agreement will be applied for measures concerning petition prior to accession for reviews based on the procedures of Article 9.3, as well as Article 9.5, 11.2 and 11.3 of the AD Agreement.

economy, would receive special treatment regarding price comparisons and subsidies amounts when another WTO Member conducts an investigation concerning anti-dumping or countervailing measures on Chinese products. (For instance, sales prices and production costs of an appropriate third country can be used for the calculation of the normal value. . Another example is that, for calculation of the amount of a subsidy in terms of the benefit to the recipient, the benefit can be calculated by considering the conditions offered in an appropriate third country and not those of China.)

## **Status of Implementation and Points to be Rectified**

### **1) Rules and Regulations**

In March 1997, China adopted the “Regulations of the People’s Republic of China on Anti-Dumping/Countervailing Measures” (hereinafter “the old regulations”) which established domestic legislation regarding AD measures and Countervailing measures.. In line with the commitment noted above, China promulgated the “Anti-dumping Regulation” and “Anti-Subsidy Regulation” in November 2001, which took effect on January 1, 2002 (the old regulations were abolished). Subsequently, the Anti-dumping Regulation was revised to comprise 59 articles; it took effect in June 2004. The Anti-Dumping Regulation stipulates in detail, in conformity with the AD Agreement, definitions of terms (dumping, injury to domestic industry), methods for calculating the margins of dumping, methods for injury determination, procedures for AD investigations, procedures for imposing anti-dumping duties, price undertakings and producers for notifications. The following implementation rules and procedures have been enacted in addition to the Anti-Dumping Regulation:

### **Status of Enactment of Implementation Rules and Regulations**

#### **Ministry of Foreign Trade and Economic Cooperation (MOFTEC)**

- Provisional Rules of the Ministry of Foreign Trade & Economic Cooperation on Public Hearings in Anti-dumping Investigations: Effective January 22, 2002.
- Provisional Rules of the Ministry of Foreign Trade & Economic Cooperation -- Initiation of Anti-dumping Investigations: Effective March 13, 2002.
- Provisional Rules of the Ministry of Foreign Trade & Economic Cooperation on On The-Spot-Verifications in Anti-dumping Investigations: Effective April 15, 2002.
- Provisional Rules of the Ministry of Foreign Trade & Economic Cooperation on Questionnaire in Anti-dumping Investigations: Effective same date as above.
- Provisional Procedures of the Ministry of Foreign Trade & Economic Cooperation on Sampling in Anti-dumping Investigations: Effective same date as above.
- Provisional Procedures of the Ministry of Foreign Trade & Economic Cooperation on Disclosure in Anti-dumping Investigations: Effective same date as above.
- Provisional Procedures of the Ministry of Foreign Trade & Economic Cooperation on Access to Non-Confidential Information in Anti-dumping Investigations: Effective same date as

above.

- Provisional Procedures of the Ministry of Foreign Trade & Economic Cooperation on Price Undertakings in Anti-dumping Investigations: Effective same date as above.
- Provisional Procedures of the Ministry of Foreign Trade & Economic Cooperation on New Shipper Review in Anti-dumping Investigations: Effective same date as above.
- Provisional Procedures of the Ministry of Foreign Trade & Economic Cooperation on Refund of Anti-Dumping Duty: Effective same date as above.
- Provisional Procedures of the Ministry of Foreign Trade & Economic Cooperation on Interim Review of Dumping and Dumping Margin: Effective same date as above.
- Provisional Procedures for Determining Product under Investigation: Effective January 13, 2003.

#### **State Economic & Trade Commission (SETC)**

- Rules on Public Hearings with regard to Investigations of Injury to Industry: Effective January 15, 2003

#### **Ministry of Commerce (MOFCOM)**

- Rules on Investigations and Determinations of Industry Injury for Anti-dumping: Effective November 16, 2003

The Anti-dumping Regulation contains some provisions in which there are inconsistencies with WTO Agreements, including: “an anti-circumvention provision” (Article 55) which could easily be used in an abusive manner (it states, “The Ministry of Commerce may take appropriate measures to prevent the circumvention of anti-dumping measures.”); as well as a provision on “retaliatory measures” (Article 56), which states that “Where any country (region) discriminatorily applies anti-dumping measures on the exports from China, China may, on the basis of the actual situations, take corresponding measures against that country (region).” In response to these provisions, Japan and a number of other WTO Members raised questions at the October 2002 meeting of WTO Committee on Anti-Dumping Practice (Review of New Legislative Notification), primarily on how they relate to the AD Agreement. China provided its response as follows:

- In regard to Article 55: “China has never applied measures to prevent circumvention so far, but is aware that the matter has long been the subject of discussion within the WTO and will implement any new rules established by the WTO in the future.”
- In regard to Article 56: “China has never applied Article 56 so far and, if China considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member, China will request consultations pursuant to the Understanding on Rules and Procedures Governing the Settlement of Disputes.”

The Countervailing Measures Regulation defines “subsidies” and includes provisions relating to “countervailing measures”. Implementing rules have also been put into practice, including “Provisional Rules for Initiation of Countervailing Investigation”, “Rules on Investigations and Determinations of Industry Injury for Countervailing Measures”, “Provisional Rules for Questionnaire in Countervailing Investigation”, “Provisional Rules on Conduct of Public Hearing in Countervailing Duty Investigation and Countervailing Regulation” and “Provisional Rules for On-the-spot Verification of Countervailing Investigation”. During the China TRM of 2002, Japan requested that China notify these laws and regulations to the WTO. The notification of some laws was made by China in 2003.

China revised the Foreign Trade Law, its basic law on the control of foreign trade, for the first time in 10 years on April 6, 2004; the law took effect in July. With respect to AD and CVD measures, two chapters covering “Foreign Trade Investigation” and “Foreign Trade Remedies” were added. These chapters clearly define and detail criteria for investigations and procedures, as well as the types of relief measures that may be applied. The Anti-dumping and Anti-Subsidy Regulations that took effect in January 2002 are subordinate to the Foreign Trade Law. The revised Law and regulations are consistent.

## **2) Enforcement of the AD measures**

### **<Outline of the measure>**

In China, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) used to be in charge of dumping investigations and the State Economy and Trade Committee (SETC) was responsible for the injury investigations. Under the structural reform undertaken in March 2003, MOFTEC and SETC were consolidated to form the Ministry of Commerce. In this Ministry, “Bureau of Industrial Injury Investigation” is responsible for investigations of injury and the “Bureau of Fair Trade for Import and Export” is in charge of enacting laws and regulations related to trade remedy such as anti-dumping, countervailing and safeguard measures, as well as investigations of dumping and subsidies.

Under the administration of the old regulation, China initiated 33 anti-dumping investigations through January 2001, including Newsprint from the US, Korea and Canada; and Cold-Rolled Stainless Steel Products from Korea and Japan. Anti-dumping investigations against Japan were initiated on Cold-Rolled Stainless Steel Products, Acrylic Ester, Polystyrene and Caprolactam.

After its accession to the WTO through December 2006, China initiated 113 investigations based on the “Regulations of the People’s Republic of China on Anti-Dumping” that was put into effect in January 2002 (revised in June 2004). The rapid

increase in the number of investigations compared to the several years prior to accession is worth noting. Most of the 113 cases involve raw materials industries, while 87 cases involve chemicals. This trend underscores the concentration of the application of AD measures in a small selection of industries. Products from Japan became targets in 25 cases, and in 15 of these cases, definitive duties were imposed as a result of final rulings (*see* reference data attached at the end of Part II - Chapter 5). In some of these cases, five years have passed since the imposition of the AD duties. In one case (Acrylic Ester), the measure was terminated because of expiration, while in another case (Stainless Cold-rolled steel sheet products), the measure was extended by five years as a result of a sunset review.

#### <Problems under international rules>

Japan requested China to improve its procedures and practices accordingly at the regular meeting between METI and MOFCOM and the WTO Anti-Dumping Committee. Japan also submitted comments to MOFCOM where Japan found inappropriate practices and inconsistent procedures with WTO Agreement in each case.

As a result, for example, in a recent investigation, MOFCOM properly notified the respondent of the initiation of an investigation. However, there remain the following problems:

(1) MOFCOM uniformly applied unfair margins based on “Facts Available” to unknown exporters and producers.

(2) In a provisional determination against Spandex (issued in May 2006), MOFCOM made a determination of injury based on the volume of imports from all countries and territories under investigation including imports from a country that were treated as *de minimis* margins and not considered to be “dumped imports”.

(3) In a provisional determination against electrolytic capacitor paper (issued in October 2006), MOFCOM made a determination of injury based on insufficient examination of the impact of imports from countries other than Japan.

Note: The Appellate Body report (DS184) concerning the AD measure against Hot-rolled Steel Products determined that: a) the investigating authority must “separate” and “distinguish” the injurious effects of other causal factors from the effect of dumped imports; and b) the injuries caused by these factors must not be attributed to the dumped imports.

(4) MOFCOM made a determination based on “facts available (Article 6.8)” without providing the interested parties with the reason for the rejection, or full opportunities for comments.

### <Recent developments>

When Japan asked questions concerning Items 2 and 4 above at a session of the China Transitional Review Mechanism process at the Anti-Dumping Committee in October 2006, China responded as follows.

Regarding Item 2: The final determination of the injury in the spandex case did not include data of dumped imports, market share or import price of the subject product of those producers or exporters whose dumping margin was *de minimis*.

Regarding Item 4: The anti-dumping regulation of China allowed 20 days for potential respondents to express their intention to participate in a given investigation. This 20-day registration procedure did not count against the 37-day time-limit for answering the questionnaire. It was further explained that MOFCOM made the questionnaires available on its official website for all the interested parties, including those that did not express interest in a 20-day registration procedure, to have easy access to them and to participate in a given investigation by answering and submitting their questionnaire replies. If a company did not respond to the questionnaire, MOFCOM based its determination on the best information available.

Japan will continue to closely monitor actions by the Chinese investigating authority and ensuing measures to be consistent with the AD Agreement. If Japan sees no improvement, it will continue to strongly urge China to work toward alternatives under the WTO Agreements.

Most recently, in May 2006, China published a draft of “The Regulation concerning investigations of dumping and penalties” and solicited public comments. This regulation represents a partial revision of “The Provisional Regulation concerning penalties against dumping,” established in 1996, and provides for the imposition of criminal sanctions and surcharges, based on investigations by the Chinese authorities, against exporters engaged in exporting dumped products from China. There is concern about the consistency of this regulation with Article XI of the GATT with regard to export restrictions. After the introduction of this regulation, which has not yet been promulgated, Japan will need to keep a watch on the enforcement thereof.

## **SUBSIDIES**

### **Commitments on Accession**

During accession negotiations, China argued that, “since China is still a developing country and therefore should have the right to enjoy all differential and more favorable treatment accorded to developing country Member pursuant to the WTO Agreement (Article 27 of the Agreement on Subsidies and Countervailing Measures (ASCM) and Article 6 of the Agreement on Agriculture), it does not need to incur the same obligation to reduce subsidies as developed country WTO members do.” But

some members of the Working Party indicated that China differs from an ordinary developing country due to the significant size of its economy. Ultimately, upon accession, China committed to eliminate export subsidies and subsidies favoring the use of domestic over imported products stipulated under Article 3.1(a) and 3.1(b) of the ASCM. China reserved rights to apply each of the provisions of Article 27.10, 27.11, 27.12, and 27.15 of the ASCM, but committed not to seek application of each of the provisions of Article 27.8, 27.9, and 27.13 of the ASCM.

China committed not to maintain or to introduce any export subsidies on agricultural products. Further, some subsidies, which under the Agreement on Agriculture developing country members may exempt from domestic support reduction commitments (Article 6.2), would be subject to China's reduction commitments. China also committed to implement a *de minimis* exemption figure, the ceiling for subsidies which would normally be subject to reduction but can be deducted due to the small sum of the subsidy, of up to 8.5 percent of the value of China's total agricultural production (in the Agreement the *de minimis* exemption percentage is up to 5 percent for developed countries and up to 10 percent for developing countries).

### **Implementation Status and Points to be Rectified**

Some members of the Working Party expressed strong concerns that, since China has many state-owned enterprises, there is a strong likelihood that government financial support will have adverse effects on trade. In addition, because China had failed to notify its subsidy programs in accordance with ASCM, the developed country members strongly urged China to submit subsidy notification to the ASCM. Subsequently, China submitted its notification in April 2006, for the first time after joining the WTO. That notification included subsidies that were highly likely to be among those it had promised to eliminate upon joining the WTO (*i.e.*, export subsidies and subsidies contingent upon the use of domestic over imported goods. For that reason, Japan, the US, the EU and others questioned whether the notified subsidies were compatible with the ASCM at the October 2006 meeting of the Committee on Subsidies. However, China repeatedly insisted that its subsidy system was in accordance with the WTO, and responded that answers to individual questions were being prepared. Deliberations will continue during the April 2007 meeting of the Committee on Subsidies.

On February 2, 2007 the US requested bilateral consultations on WTO dispute settlement proceedings, claiming that the Chinese subsidies reported to the WTO included export subsidies and subsidies contingent upon the use of domestic over imported goods, prohibited by the ASCM. Japan, the EU and Australia requested participation in this consultation as third parties. Furthermore, Mexico requested bilateral consultations with China. Most of the subsidies that are subject to requests for consultations are preferential tax measures that are part of preferential policies for foreign-invested enterprises.

Currently the Chinese Government is starting to review its preferential tax policies for foreign-invested enterprises, and it is possible that China will abolish the subsidies at

issue on its own rather than wait for WTO dispute settlement proceedings.

It is necessary for Japan to continue to request through the WTO and bilateral discussions, in cooperation with other Member countries, that China keep the promises it made upon joining the WTO and not maintain subsidies in violation of the WTO ASCM.

### **1) Value-added Tax Refund to Copper Refineries**

#### **<Outline of the measure>**

This measure is a system by which China refunds a part of value-added tax on imported copper concentrate to domestic copper refineries specified by the Chinese Government. Japanese copper refineries were concerned about potential adverse effects under this system. Specifically, Japanese refineries believed that Chinese refineries would be inclined to purchase copper ore at high prices which could trigger increases in global copper ore prices and negatively impact operations of non-Chinese refineries. US and European refineries industries had raised similar concerns.

#### **< Problems under international rules >**

China did not notify this measure to the ASCM until 2005, so details of the system were not clear and concern spread within the relevant industries concerning this measure. The Japanese Government expressed its industries' concerns to China during the May 2004 and April 2005 vice-ministerial meeting between the Ministry of Economy, Trade and Industry of Japan and the Ministry of Commerce in China. At the meeting in May 2004, China responded that it was examining the issue, including possible partial elimination, and that it would submit relevant documents regarding the regime. However, Japan did not receive any documents from China.

Therefore, during the October 2005 TRM in the Committee on SCM in cooperation with the EU, Japan expressed its concerns over the regime and urged China to submit relevant information on its tax refund regime for the purpose of transparency. In response, China stated that it was prepared to submit the full subsidy notification to the SCM Committee by the end of 2005. Since then, when a request was once again made at the Japan-China Economic Partnership Meeting in December, China stated that it had been delayed, but as of December 31, 2005, it no longer would need any extensions.

#### **< Recent developments >**

The Notification Pertaining to the Problem of the Collection and Refunding of Import Value-Added Taxes on Copper Raw Materials by the State Administration of Taxation, Ministry of Finance announced in 2005 expired on January 1, 2006, and a new

law has not yet been announced. From this it can be surmised that China has abolished its value-added tax refund for copper ore and refined copper. In the above mentioned meeting in July 2006, when Japan asked China to confirm whether the measure had been abolished or not, the response was, “at this time the refund problem pertaining to import value-added taxes does not exist.” However, it is necessary to pay close attention to future developments.

## **SAFEGUARDS**

### **Commitments on Accession**

In relation to safeguard measures, China is obligated to comply with the General Agreement on Tariffs and Trade (GATT) and the Agreement on Safeguards. Previously, China had no domestic laws and regulations in place to apply safeguard measures and, therefore, committed to formulating new systems that are consistent with the WTO Agreement.

So-called gray area measures, such as voluntary export restrictions on Chinese products, are not permitted under the Agreement on Safeguards. All member countries have committed to eliminating all such measures in agreements between China and importing Member within a certain period (Annex 7 of the Protocol).

#### **(1) Outline of temporary safeguard measure against China**

Based on Article 16 of China’s WTO Accession Protocol and the relevant provisions in the Working Party Report, Member countries are allowed to exercise a “transitional product-specific safeguard mechanism” for Chinese products. These are special safeguard measures that apply to Chinese products only, as opposed to ordinary safeguard measures which shall be applied to an imported product irrespective of its source. This special measure can be applied for 12 years after China’s accession. When Chinese products are being imported into another Member’s territory in such increased quantities and under such conditions as to cause disruption or threaten disruption to the market of a WTO Member’s domestic industry that is producing similar or directly competitive products, the affected importing Member may apply this measure. (The Member may request consultations and agree on actions to remedy the market disruption within 60 days. If no agreement is reached, the affected Member may withdraw concessions or otherwise limit imports.)

The US International Trade Commission (ITC) initiated the first and second investigations for transitional safeguard measures against imports of pedestal actuators in August 2002 and of wire hangers in November 2002 respectively. Although ITC determined injury to the domestic industry in both cases, the President declined to

impose safeguard measures. India initiated an investigation on needles for industrial knitting machines from China in August 2002, but no safeguard measure was imposed. In June 2003, ITC initiated an investigation on brake drum rotors but found no market disruption. With regard to the investigation of water work fittings initiated in September 2003, the ITC found services injury and recommended application of safeguard measures to the President and USTR, but the President declined to impose safeguard measures. In August 2005, ITC initiated an investigation on welded non-alloy steel pipes. In October, the authority found serious injury to the domestic industry caused by increased imports, but the President declined to impose safeguard measures.

### **(2) The Special Measure on Chinese Textiles and Clothing Product**

Moreover, another special safeguard measure against imports of Chinese textiles and clothing product is permitted on an exception basis until 2008. Specifically, if imports of Chinese textiles or clothing products are found to cause or threaten to cause disruption to the market or to impede the orderly development of trade in these products, the affected Member may request consultations with China. Upon receipt of the request for consultations, China must restrain its export to a level no greater than 7.5 percent (6 percent in wool products) above the volume of exports during the first twelve months of the most recent fourteen months preceding the month in which the request for consultations was made. If no mutually satisfactory solution can be reached during the 90-day period, the affected Member is permitted to restrain imports of Chinese textiles and clothing products to the amount noted above for one year.

With respect to the special safeguard measure for Chinese textiles, the US Department of Commerce (DOC) determined in November 2003, to invoke the special measure for three textile products, knit fabric, dressing gowns and robes and brassieres imported from China. In December 2003, the US Government officially requested consultations with China, triggering a 12-month import restriction on the above three products. In October 2004, the US also requested consultations with China over cotton, wool and man-made fiber socks which triggered a 12-month import restriction.

At the end of 2004, with the expiry of the import framework based on the WTO Agreement on Textiles and Clothing, imports of Chinese-made clothing products increased dramatically in most countries. In May 2005, the US determined to invoke the Special Measure on Chinese Textiles for a total of seven products including cotton knitted shirts and blouses and cotton knitted trousers. In September, two additional items, including brassieres, were subjected to the measure. While the US continued to consider the imposition of safeguards on further products, bilateral consultations between the US and China on textiles were initiated in June 2005. They led to the signing of the US-China Comprehensive Bilateral Textile Agreement on November 8, 2005, which set quotas for a three-year period until the end of 2008. Under this Agreement, 34 products became subject to import quota measures, including cotton knit shirts. The US agreed to refrain from application of additional safeguard measures. In addition, the EU agreed with China on import quotas from June 11, 2005 to the end of

2007. China will refrain from exporting ten items of clothing products, including cotton fabrics, and the EU has undertaken not to impose safeguards on T-shirts and linen products.

(With regard to developments following the expiry of the Textiles Agreement, please refer to the Column entitled “Expiry of the Agreement on Textile and Clothing and its Effects” in Chapter 7, Section 2)

## **Implementation Status and Points to be Rectified**

### **(1) Regulations on Safeguards**

On October 31, 2001, China adopted Regulations on safeguards that incorporate basic rules of its safeguard measure under the Foreign Trade Law; it took effect on January 1, 2002. After that, four detailed regulations (considered “by-laws”) relating to the investigation procedure were also enacted for the implementation of the Regulations. In addition, related amendments to the Foreign Trade Law were also enacted in July 2004.

### **(2) Problems**

Japan believed that, some parts of this legal framework were inconsistent with the Agreement on Safeguards. In addition, the preliminary and final safeguard measures on steel products applied in April 2002 were also questionable in terms of consistency with the WTO agreements. Therefore, in April and again in October 2006, in the Committee on Safeguards, Japan questioned the consistency of a Chinese provision for countermeasures under Article 31 of the Chinese regulations on safeguards with the WTO agreements, as well as certain matters concerning China’s legal framework (unforeseen developments, securing of public interests when applying safeguard measures, clarifying the provisions of compensation and lack of a moratorium provision). The Chinese government responded that China’s legal framework is fully consistent with the WTO agreements and that (even though there is no explicit provision) Chinese authority implements its investigations in an appropriate manner in accordance with the WTO agreements and its domestic laws.

Japan believes that it is necessary to continue to seek adequate explanations from China and keep a close watch on its future implementation on safeguards with regard to their consistency with the WTO agreements.

## **TRADE-RELATED INVESTMENT MEASURES (TRIMs)**

### **Commitments on Accession**

China has committed to comply fully with the TRIMs Agreement upon accession. China has also made commitments above and beyond the TRIMs Agreement regarding the trade-related conditions imposed on foreign investment. To that end, China has agreed to eliminate all measures prohibited in the TRIMs Agreement. For example, China agreed to eliminate local content requirements (mandating the use of designated percentages of locally-produced items), which are in violation of GATT III, and foreign-exchange balancing requirements (permission to import raw materials and capital goods only in proportion to export earnings and volumes), which are in violation of GATT Articles III and XI. In addition, China also agreed to eliminate export performance requirements, transfer of technology, or any other performance requirements on the permission or rights for import and investment.

In other areas China will maintain the category-by-category approval system for authorizations for motor vehicle producers. However, within two years after accession, China has committed to eliminate restrictions on the categories, types and models of vehicles permitted for production, and to raise the limit within which investments in motor vehicle manufacturing could be approved at the provincial government level. At accession, the level of investment was set at \$30 million, but China agreed to raise the level to \$60 million one year after accession, to \$90 million two years after accession, and to \$150 million four years after accession. Finally, China committed to removing the 50 percent foreign equity limit for joint-ventures regarding the manufacture of motor vehicle engines.

### **Implementation Status and Problems under international rules**

From October 2000 to March 2001, in line with the above commitments, China amended the Law on Foreign Capital Enterprises which applies to 100 percent foreign-owned companies. Also, China amended the Law on Chinese-Foreign Contractual Joint Ventures, applying to joint ventures where equity participation by all parties is not required but is determined pursuant to the joint venture contract, as well as the Law on Chinese-foreign Equity Joint Ventures, applicable to joint ventures where equity participation by all parties is required. For instance, in the Foreign Capital Enterprises Law, the wording export requirements “must employ the forefront technology and facilities and export all or the major proportion of the product” has been amended to “the government encourages exports of manufactured goods and high-tech companies.” In addition, the wording “the production and management plans of the foreign-invested companies are to be notified to the supervisory division” has been removed. On local content requirements, the wording “under equal conditions procurement in China is to be given priority in China wherever possible” has been removed, as has the wording

“foreign-invested companies must themselves strive to achieve foreign-exchange balance” concerning foreign-exchange balancing requirements.

The Detailed Rules for Implementation of the Law on Foreign Capital Enterprises were amended in April 2001 and the Detailed Rules for Implementation of the Law on Chinese-foreign Equity Joint Ventures in July 2001. Both involved revisions and deletions to eliminate export requirements and foreign-exchange balancing requirements.

In addition to the above three foreign investment laws, the new “Company Law,” which was amended and implemented in January 2006, applies to foreign-owned companies. This law provides for a relaxation of regulations concerning the establishment and management of companies which will benefit from foreign-owned companies. However, some provisions are inconsistent with the above three foreign investment laws. Since in principle the three foreign investment laws are special laws and the Company Law is a general law, the three foreign investment laws will very likely be given precedence when the three foreign investment laws and the Company Law are not in agreement, and thus foreign-owned companies must be cautious. (*See* <Figure-3> concerning the three foreign investment laws and the Company Law; and <Figure-4> for details of deregulation under the Company Law and disparities with the three foreign investment laws.)

In order to appropriately apply the Company Law (amended and implemented in 2006), the “Company Registration Administration Regulations” (amended and implemented in 2006) and the three foreign investment laws, the National Commerce Administration Bureau, the Ministry of Commerce, the Customs Bureau, and the National Currency Administration Bureau jointly announced the “Opinion on the Resolution of Issues Concerning the Application of the Examination and License Control Law for the Registration of Foreign-Owned Companies” (“Resolution Opinion”) as guidelines for application of these laws to actual cases.

Prior to the promulgation and enactment of the “Auto Industry Development Policy” (AIDP) of June 2004, local content requirements for the automobile industry were covered under the March 1994 “Industrial Policy for the Automotive Sector” (IPA). In the Transitional Review Mechanism (TRM) of the TRIMs Committee in September 2002, Japan indicated that local content requirements under the IPA had not been removed and that China had not kept its promise to eliminate performance requirements in exchange for authorizing foreign investment after its accession to the WTO. Moreover, during the TRM of the TRIMs Committee in October 2003, we requested that a new automobile industry policy should be developed and implemented consistent with the TRIMs Agreement and China’s WTO commitments. The new AIDP does not contain provisions regarding local content requirements. The AIDP stipulates that automobile parts with characteristics of completed cars should be subject to taxation at the same rate as completed cars. With regard to this, the “Measures for the Administration of Imports of Automobile Companies with Characteristics of Completed Cars” issued on February 28, 2005, stipulates that if the total amount of imported parts reaches 60% of the total price of completed cars of the same type, customs duties and

additional import taxes should be imposed at the rate of completed cars. These measures might be deemed as substantial local content requirements (as for this system, *see* “Customs Duties” “(2) Problems related to the system for certifying finished vehicle characteristics”).

In August 2006, the China Customs Office and the Ministry of Commerce postponed the date on which the article, “Application of finished car tariff rate when the total price of imported parts reaches 60% of the total price of a finished car of the same type,” was scheduled to enter into force from July 1, 2006 to July 1, 2008 (Customs Office Announcement No. 38, 2006). The reason for the postponement of the regulation, which applies the finished car tariff when 60% of the total cost of a finished car meets the requirement of 40% to be local content, was that western Member countries strongly opposed such application in violation of WTO free trade principles. At the end of March 2006, the EU and the US jointly requested China to engage in bilateral consultations pursuant to the WTO’s dispute settlement procedures, and consultations were held concerning this issue. However, the EU and the US were dissatisfied with the above concessions by China, and in September the EU, US and Canada requested the establishment of a dispute panel in the WTO. A panel was established in October.

China's demand for local content and performance are evident in the rapidly-developing mobile communications sector. In 1998, China’s Ministry of Information Industry and the former National Development Planning Committee jointly announced the “Opinion Concerning Promoting the Development of the Mobile Communications Industry” (Statement No. 5). This statement not only provided that the import of foreign mobile communications products would be severely restricted beginning in January 1999, but that if less than a certain percentage of the cellular phones produced by foreign-owned companies were not exported, import quotas on related products and parts could not be obtained. Although the effective period of Statement No. 5 was to end in 2005, to date there have been no specific laws or ordinances to revoke the statement and some of the provisions continue to be enforced. At the present time, the percentage of cellular phone products exported by foreign-owned companies operating in China is high and thus a major issue has not developed. Japan intends to closely monitor developments of this issue.

**Figure 1-3**  
**Major Measures of Trade-Related Investment Measures Amended after**  
**China's Entry to the WTO**

	<b>Amended statute</b>	<b>Amended item</b>
Investment	Land and Resources Department document. (December 2000)	Opening of non-oil and gas minerals development to every type of foreign invested enterprises include wholly foreign-invested enterprises, equity joint venture enterprises and contractual joint venture enterprises.
Foreign-invested enterprise establishment, performance requirements	Regulation for Administration of Foreign Investment in Commercial Fields (June 2004)	Establishment of foreign invested commercial enterprises is permitted for wholly foreign-invested enterprises, equity joint venture enterprises and contractual joint venture enterprises. Foreign invested enterprises other than foreign invested commercial enterprises are also permitted to change their business extent (adding commercial business).
	The Law on Foreign Capital Enterprises, the Law on Chinese-foreign Equity Joint Ventures (amended October 2000), the Law on Chinese-foreign Contractual Joint Ventures (amended March 2001)	<ul style="list-style-type: none"> <li>• Abolishment of regulation to “notify to the supervisory division of production and management plans.”</li> <li>• Elimination of regulation to “have to strive to achieve foreign-exchange balance.” Foreign currency for paying for raw materials, parts, wages, and dividends can be procured from banks or withdrawn from foreign currency accounts.</li> <li>• Elimination of the regulation “to prioritize procurement of raw materials, fuel, and other goods in China wherever possible”. Same autonomy to procure as domestic companies.</li> <li>• Elimination of the regulation to “have to export above a certain percentage of products.”</li> <li>• Same autonomy to sell products as domestic companies. However, equity joint ventures with foreign companies are encouraged to export. <ul style="list-style-type: none"> <li>• Liberalization of the regulation on insurance taken out by companies from “to be purchased from Chinese insurance companies” to “to be purchased from insurance companies in China.”</li> </ul> </li> </ul>
	Company Law (January 2006)	<ul style="list-style-type: none"> <li>• Relax regulations governing investment methods and investment periods concerning the establishment of companies.</li> <li>• Allow the establishment of sole proprietor limited liability companies.</li> <li>• Relax restrictions on external investment by companies operating in the country.</li> </ul>
	Company Registration Control Regulations (January 2006)	Shareholders cannot invest by means of credit.

	<b>Amended statute</b>	<b>Amended item</b>
Regionality	List of Favored Business Types for Foreign Commercial Investment in Central and Western Regions in China (amended June 2000)	<ul style="list-style-type: none"> <li>• Deregulation of restrictions on sectors for foreign investment, rules for establishing enterprises, and ceilings on foreign equity ratios.</li> <li>• If foreign-invested enterprises established in western and central regions in China are in favored business types or restricted business types, preferential corporate income tax treatment is applied and for three years corporate income tax is reduced to 15 percent.</li> <li>• If foreign equity share is 25 percent or more in a project re-invested, preferential treatment on a level with foreign invested enterprises can be obtained.</li> <li>• Encouragement to re-invest for mergers and acquisitions with state-owned enterprises.</li> </ul>

**Figure 1-4**

**Disparities between the Company Law and the  
Three Foreign Investment Laws**

Deregulation under the new Company Law	<ol style="list-style-type: none"> <li>(1) Limited liability companies can be established by natural persons or corporations as the sole shareholder. When the shareholder of a sole-proprietor limited liability company cannot certify that company property is independent from individual property, the shareholder can undertake joint and several liability with respect to company debt. (In the past, foreign-owned companies were permitted to adopt the sole-proprietor limited liability company method, but there were no clear provisions in law. )</li> <li>(2) Abolishes the restriction that the total amount of the company’s external investment cannot exceed 50% of the company’s net assets.</li> <li>(3) Concerning the examination of the qualifications of foreign-owned companies to invest within China, the “Resolution Opinion” eliminates the examination of investment qualification certifications (certification of payment of registration capital, certification of profitability, certification of legitimate records, certification that cumulative amount of investment does not exceed 50% of net assets).</li> <li>(4) The establishment of offices of foreign-owned companies previously subject to authorization and registration can be implemented freely without authorization and registration. (Since, registration for extension or change for an existing branch office is not accepted, either the offices must be changed to a divided company (gongsi: corresponding to a Japanese branch office) or a registration for the cancellation of a previously registered branch office must be carried out).</li> <li>(5) Restrictions on investment methods have been substantially relaxed. Investment methods are not limited to currency, material, land-use rights or industrial property rights, <i>etc.</i>, and the scope has been expanded to include property that can be valued by currency and property that can be transferred under law. With respect to the percentage allowed for each investment method, the existing provision stipulating that the technical investment ratio cannot exceed 20% has been</li> </ol>
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	eliminated.
Disparities between the new “Company Law” and the three foreign investment laws	<p>(1) As stated in (5) above, the new Company Law substantially relaxes regulations concerning investment methods and percentages. However, the “Rules for Implementation of the Foreign-Owned Company Law” limit investment methods by foreign investors to currency, machinery and equipment, industrial property rights and independent technology, and provide that the percentage of investment through industrial property rights and independent technology may not exceed 20%.</p> <p>(2) The new Company Law provides that capital payments from shareholders may be no less than 20% of the company’s registered capital for the first installment, and that the remaining portion must be paid within two years of the day the company was established. However, the “Rules for the Implementation of the Foreign-Owned Company Law” provide that capital payments from shareholders must be no more than 15% of the company’s registered capital for the first installment and that the remaining portion must be paid within three years of the day the company was established.</p> <p>(3) The new Company Law contains provisions concerning corporate governance; the three foreign investment laws have no detailed provisions. Consequently, the “Resolution Opinion” stipulates the following in accordance with the type of foreign-affiliated company:</p> <ul style="list-style-type: none"> <li>• Chinese-foreign joint limited liability companies and Chinese-foreign cooperative limited liability companies must establish a board of directors based on the “Rules for Implementation of the Chinese-Foreign Joint Law” and “Rules for Implementation of the Chinese-Foreign Cooperative Law,” respectively. However, other organizations may follow their company articles of association.</li> <li>• However, the Foreign-Owned Company Law and its implementation rules have no provisions concerning corporate governance. Therefore, the organizations of exclusively foreign-owned limited liability companies and foreign stock limited companies are subject to the provisions of the Company Law and must establish a shareholder meeting and a board of directors.</li> </ul> <p>(4) Under the new Company Law, limited liability companies and stock limited companies are required to establish a board of auditors. In addition, small limited liability companies with few shareholders may be exempted from establishing a board of auditors if they appoint two auditors. However, since there are no related provisions in the three foreign investment laws, all types of foreign-owned companies must follow the provisions of the Company Law and establish an auditor system.</p>

Although the above listed amendments have been made to bring domestic laws in China into conformity with the WTO Agreement, non-conformance with the agreement and restrictive measures on investment still exist and should be rectified speedily.

For example, China categorizes investment into incentive, approval, restrictive and prohibited business types, and only approves foreign investment in the incentive,

approval, and restricted category types. In conjunction with accession, China committed to relaxing restrictions on the services sector and the automotive engine manufacturing industry, among others. Also, it did in fact amend the Provisions on Guiding Foreign Investment Direction that provide the legal rationale for the categorizations in February 2002 and the Catalogue for Guidance of Industries for Foreign Investment in March. Both amended provisions came into force in April 2002 and increased the incentive business types from 186 to 262, while reducing restricted business types from 122 to 75 (but increasing prohibited sectors from 31 to 34). Automotive engine manufacturing, wholesaling and retailing sectors were moved from the restricted to the incentive categories in line with its commitments at the time of accession. After that, for securing continuity and stability of policies for introducing foreign investment, the “Catalogue of the Guidance of the Foreign Investment Industry” was revised and published again in November 2004, and was put into force in January 2005. Specifically, the Catalogue newly includes industries that need to be developed immediately in China and commodities (such as production of key components for large-screen color displays, diethanol, automobile electronic equipment, 300,000 kilowatt large circulation sulfide floor boilers, and copying of read-only disks). It also adds production and issuance of radio and TV programs and production of movies as areas open to foreign companies in order to accelerate opening up of the service industry. Meanwhile, responding to the necessity of macro control, for preventing undesirable and low-level investment in a part of an industry, industries and commodities which had already shown such negative influences (such as production of thick plates, galvanized plates, iron scraps, ammonia fiber, and polyester) were eliminated from the incentive category or newly classified into the restrictive category.

The table below (Figure 1-5), details businesses currently designated as restricted and subject to foreign ownership limitations.

Article 10 of the ‘Provisions on Guiding the Direction of Foreign Investment’ as amended in February 2002 provides that those permitted projects that export all their products directly shall be deemed as encouraged projects, and that restricted foreign investments may be deemed as permitted foreign investment projects with approval from the government of provinces, autonomous regions, municipalities directly under the Central Government or cities of direct planning by the State, if the export sales of the products amount to over 70% of the total sales of the product. This may constitute a requirement to export which is in violation of China’s WTO commitments.

**Figure 1-5****Businesses Restricted/Prohibited from Foreign Investment As Listed in the  
'Catalogue for the Guidance of Foreign Investment Industries'**

	<b>Restricted Business Type</b>	<b>Prohibited Business Type</b>
Agriculture, forestry and fisheries	Development and production of foodstuffs; cotton and vegetable oil, (Chinese majority); processing and export of rare woods (limited to J/V)	Cultivation of rare and fine varieties, production and development of genetically recombined varieties, fishing in territorial and domestic waters
Mining	Prospecting and mining of tungsten, tin, antimony, molybdenum, spar, fluorite and other minerals (limited to J/V); prospecting and mining of precious metals (gold, silver, platinum); Prospecting and mining of valuable non-metallic minerals such as diamonds; Prospecting and development of unique and rare coal (Chinese majority); mining of boron magnesium and boron magnesium steel ore, mining of celestine	Prospecting and mining of radioactive minerals, prospecting and mining of rare earths
Food processing	Production of Huang Jiu and famous-brand Bai Jiu; Production of saccharin and other synthetic sweeteners for foreign-brand carbonated soft drinks, edible oil processing	Processing of green tea and specialties which are traditional Chinese crafts
Tobacco processing	Production of cigars and filters	
Spinning	Synthetics, wool spinning, threads	
Printing and copying	Printing of publications (Chinese majority, printing of packaging excluded)	
Petroleum and coke	Construction and management of oil refinery plants	
Chemical raw materials and chemical products	Seven items, including production of ionic membrane caustic soda; Production of photo-sensitive materials, production of potentially toxic chemicals	
Pharmaceuticals	Six items, including production of chloromycetin, addictive narcotics, psychological drugs and blood products, production of disposable needles	Processing of nationally protected medicinal herbs (musk, licorice, jute <i>etc.</i> ), manufacturing of traditional herbal medicines
Synthetic fibers	Three items, including production of fibers less than 400 t/day	
Rubber products	Production of low-function industrial rubber, <i>etc.</i>	
Dark metals	Smelting and separation of rare earths (limited to cooperatives)	Smelting and processing of radioactive materials
Arms and munitions		Manufacturing of arms and ammunition
General industrial machinery	Production of containers, production of small and medium-sized ordinary bearings, production of cranes for automobiles under 50 t (limited to cooperatives)	
Specialized	Production of type-B CT machines at medium	

	<b>Restricted Business Type</b>	<b>Prohibited Business Type</b>
industrial machinery	and low levels; production of machinery for ordinary synthetic fibers, production of bulldozers under 320 HP, <i>etc.</i>	
Other manufacturing		Ivory carving, tiger bone processing, lacquerware production, Chinese ink production, carcinogenic products and durable organic pollutants production
Telecommunication product	Production of satellite antennas and their core components	
Electric power, gas, water production and supply	Construction and management of thermoelectric plants under 300,000 kilowatts (transmission excluded)	Construction and management of electric power supply networks
Transportation, storage and telecommunications	Road passenger transport services, export/import freight services, water and land transport services, rail freight transport services, rail passenger transport services (Chinese majority); airplane services for photography, mineral prospecting, or industrial purposes (Chinese majority); telecommunications services	Air-traffic control services, postal services
Wholesale, retail, trading	Commercial companies; wholesaling, retailing, distribution, delivery of materials for agricultural production; distribution of audiovisual products (excluding films); merchandise auctions; Freight leasing services; agency services (shipping, freight transport, foreign shipping, advertising <i>etc.</i> ); wholesaling of processed oil; construction and management of gasoline stands; foreign trading services wholesaling and retailing of books, newspapers and magazines	
Financial services	Banking, financial services; trust and investment services, securities brokerages; securities investment fund management services, financial leasing services, foreign-exchange brokerages, insurance brokerages	Futures trading
Real estate	Large-scale land development (limited to cooperatives), construction and management of luxury hotels and resorts; high-grade office buildings, international exhibition centers, developing and running of large-scale theme parks	

	<b>Restricted Business Type</b>	<b>Prohibited Business Type</b>
Public services	Construction and management of networks for combustible gas, heat, water and sewer services in large and medium-size cities (Chinese majority)	Development of nationally protected wild animal and plant resources, construction and management of animal and plant protection zones, gambling, sexual services, social research
Information and consulting	Legal consulting services, market research (limited to cooperatives)	
Health and recreation	Construction and management of medical institutions (limited to cooperatives) and golf courses	
Education, culture, art, broadcasting	Construction and management of high school-level educational institutions (limited to cooperatives) and movie theaters (Chinese majority); production and distribution of television programs, production of movies (Chinese majority)	Mandatory educational institutions; publication, issuing, import and export of books, newspapers and magazines; production, publication, issuing, import and export of audiovisual materials and electronic publications; news institutions, broadcasting stations on all levels, television stations, broadcast television networks, publication and broadcast of television programs, video broadcasting companies
Scientific research and general technology services	Surveying services (Chinese majority), inspection, appraisal and certification services for exports and imports	
Other		Activities that threaten the safety or effectiveness of military facilities

Note: The criteria for categorizing business types is based on the Catalogue for Guidance of Industries for Foreign Investment (implemented on January 1<sup>st</sup>, 2005).

In November 2006, the National Development and Reform Commission promulgated the “Foreign Investment Utilization ‘115’ Plan” (11<sup>th</sup> 5-year), which established the following guidelines for China’s foreign investment utilization policies over the next five years.

- The overall strategic objective of foreign investment utilization is to further promote a radical shift from quantity to quality, with the emphasis of foreign investment utilization shifting from supplementing funds and foreign exchange shortages to advanced technology and the introduction of high-quality people experienced in management, and greater importance will be placed on foreign

investment aimed at ecological improvement, environmental protection, and conservation and comprehensive utilization of resources and energy.

- The principal policy measures for establishing a fair and balanced foreign investment environment include simplifying administrative examination and permit procedures through the amendment and promulgation of the “Company Income Tax Law” and the “Anti-Trust Law” which apply uniformly to Chinese local companies and foreign-owned companies, and establishing and strengthening the enforcement of laws and regulations for the protection of intellectual property rights in order to exercise stronger control over the infringement of rights by pirated versions of copyrighted material.
- The principal policy measures for promoting independent reform using foreign investment include the establishment of comprehensive incentive policies to facilitate the relocation of organizations that perform advanced process manufacturing and research and development to China, particularly those of large multinational corporations; the provision of incentives to encourage multinational corporations to establish bases for manufacturing, services, and training; and the establishment of incentive policies encouraging cooperation in research and development between foreign-owned companies and Chinese local companies in order for foreign-owned companies to achieve further advances in value-added technology.

## **STANDARDS AND CONFORMITY ASSESSMENT SYSTEMS**

### **Commitments on Accession**

China committed to: (i) implement regulations and procedures in conformity with the TBT Agreement upon accession; (ii) treat imported products such that they will not be disadvantaged against domestic products, including in matters relating to charges and inspection times; (iii) adopt international standards wherever possible and remove inspections of imported products which are not conducted on domestic products; (iv) simplify inspection procedures for products which have been certified through an inspection body conducting mutually approved inspections; and (v) allocate the duties of each of the inspection bodies within 18 months of accession and report the details to the TBT Committee within 12 months of accession.

Upon accession, China committed to ensuring non-discriminatory treatment and transparency by integrating laws, ordinances and standards to deal with the issue of applying different laws, ordinances and standards for domestic products as compared to imported products. Also upon accession, China committed to making improvements on issues extremely important to Japanese industry, such as the first import registration system for chemical products (enactment of laws meeting international rules), the dual mark system for electrical home appliances (simplification of procedures for obtaining

the so-called CCIB mark and “Great Wall mark”), certification of automobile standards (integration of laws, ordinances and standards for domestic and imported automobiles), safety and quality approvals for boilers and pressure vessels (assure non-discriminatory treatment and adopt international standards).

### **Implementation Status and Points to be Rectified**

China has begun to try to harmonize its standards and certification systems. In April 2001, China consolidated the State Bureau of Quality and Technical Supervision and the State Administration for Entry-Exit Inspection and Quarantine into the new Bureau of State General Administration for Quality Supervision and Inspection and Quarantine (hereafter “AQSIQ”). In August 2001, the Certification sections of the Technical Supervision Bureau and the Entry-Exit Inspection Bureau were integrated into the Certification Accreditation Administration of the People's Republic of China (hereafter “CNCA”). The responsibilities of the CNCA stipulated by the State Council include: (i) drafting legislation on certification and approvals; (ii) assessing qualification, safety and quality approvals and health and hygiene registration; (iii) publishing implementing rules and organizing and overseeing the system; (iv) making proposals on product lists for state level compulsory certification and the safety and quality approval system, and formulating certification standards, qualification assessment procedures and technical regulations; (v) inspecting the technical capabilities of the coordination, inspection, measurement and inspection testing sections; (vi) administering certification of qualifications, internationalizing certification, approvals and qualification assessment; and (vii) coordinating certification and approvals activities nation-wide.

In December 2001, AQSIQ and CNCA announced that they would implement a four-pronged integration program (integration of lists, integration of standards, technical regulations and qualification determination procedures, integration of marks, and integration of cost standards) to achieve national treatment for foreign products. Subsequently four statutes were promulgated on December 3, 2001, which became effective on May 1, 2002. These are: Rules on Compulsory Commodities Certification, Rules on Compulsory Product Attestation Mark, Product Catalogue of the 1<sup>st</sup> Batch Commodities to be Certified Compulsorily, and Notification on Implementing Certification System on Compulsory Commodities. These rules and measures will establish a system for conducting certification of domestic and imported products through consistent lists, standards, marks, and methods of collecting costs.

Arrangements are being made to improve transparency by providing information *via* the internet (<http://www.tbt-sps.gov.cn>).

However there remain several instances where China has not fulfilled its commitments *e.g.*, the CCC Mark system. As for the import registration system on chemicals, since enforcement in February 1995 of the “Regulations for Environmental Management on the First Import of Chemicals and the Import and Export of Toxic Chemicals” (published in March 1994), foreign companies have been obligated to

obtain registration certificates with discriminatory and excessive charges. In November 2002, the State Council abolished the “Import Registration System on the First Import of Chemicals” as one of the 789 first-stage administrative review items that were determined to be abolished. In September 2002, the State Environmental Protection Administration (SEPA) published the “Draft of Regulations for Registration Management on the Import and Export of Dangerous Chemicals”, which included provisions to abolish the “System for Environmental Management on the Import and Export of Toxic Chemicals”. However, as of February 2007, there had not been any progress in national coordination and the regulations have not yet been issued. Even now, the “System for Environmental Management on the Import and Export of Toxic Chemicals” still remains valid.

### **1) Administration of the CCC Mark to Electric Appliances**

#### **<Outline of the measure>**

Two safety certification regimes co-existed in China: one was the CCIB Mark designated by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Administration for Entry-Exit Inspection and Quarantine (SAIQ), and the other was the Conformity Certification of Electrical Equipment ‘Great Wall’ Mark designated by the State Economic and Trade Commission and the China State Bureau of Quality and Technical Supervision. The former applied to the export of products listed in the Compulsory Certification List, while the latter applied to products distributed in China. Although the conditions for obtaining the ‘Great Wall’ mark were the same for both foreign-made and domestic-made products, certification of the CCIB Mark was compulsory only for foreign companies. China pledged to unify its double certification system before acceding to the WTO. China introduced the Compulsory Certification and CCC Mark in May 2002; the CCIB and Great Wall marks were abolished at the end of April 2003.

#### **<Problems under international rules>**

Although the double certification system was improved, it still takes from six months to one year for some factories located outside of China to acquire the CCC Mark. The period required to acquire the CCC Mark has not yet been shortened. One of the reasons for this is that China does not permit the implementation of the initial factory inspection by a foreign Conformity Assessment Body (CAB). Among other problems, China requires applications for the purchase or printing/stamping of stickers for labeling products after the certification is acquired. Also, China does not provide adequate transitional measures for products that meet the existing standard when a GB Standard (China’s national standard applicable to the CCC system) is newly established or revised. In addition, the CCC system requires an annual factory inspection for all covered items, even for items with low risks. These problems might pose unnecessary obstacles to international trade and violate the TBT Agreement.

### <Recent developments>

Japan raised the above-mentioned problems at the Trade Policy Review Mechanism (TPRM) held in April 2006 and the Transitional Review Mechanism (TRM) of the WTO/TBT Committee held in November 2006. The United States and the European Commission also have pointed out the same problems. China continued to repeat its previous arguments, including that it is necessary to conclude a Mutual Recognition Agreement (MRA) for China to permit an inspection to be carried out by a foreign Conformity Assessment Body; that China has been making efforts to make the certification process simpler and more efficient in order to shorten the period required to acquire the certification; and that China has been striving to improve the administration of the certification system on an ongoing basis. The CCC Mark continues to pose a trade barrier for Japanese industry, and Japan needs to urge China to continue to improve the situation.

## 2) Measures for Controlling Pollution by Electronic Information Products

### <Outline of the measure>

China's Management Measures for Controlling Pollution by Electronic Information Products (hereafter referred to as the "Controlling Measures"), notified to the TBT Committee as of September 28, 2005 and amended thereafter by reflecting comments from Japan and other countries to a certain extent, was promulgated on February 28, 2006 and put into force on March 1, 2007. In order to: (i) control and reduce environmental pollution by waste electronic information products; (ii) save resources; and (iii) promote the sustainable development of the electronic information industry, the Controlling Measures are designed to regulate lead, mercury, cadmium, hexavalent chromium, polybrominated biphenyl (PBB) and polybrominated diphenyl ether (PBDE), *etc.*, as toxic chemicals contained in electronic information products that are registered in the "Electronic Information Products Classification and Explanations". Also, the Controlling Measures is designed to control such substances with a two-stage approach. In the first stage, electronic information products for sale within China cannot be put on the market unless the toxic chemicals meet the industry standards; their content, the expiration date for environmentally friendly use, *etc.*, are labeled on products; and explanatory booklets and packaging materials are included. In the second stage, those products that can be produced: (i) by using lesser amount of the designated six toxic chemicals than that set forth in the industry standards; (ii) by using alternative substances; or (iii) without using the designated six toxic chemicals, cannot be put on the market unless they are registered in the "Catalog for Priority Controls of Pollution by Electronic Information Products" (hereafter referred to as the "Catalog for Priority Controls") and acquire the Compulsory Certification (the CCC certification). The parties subject to the Controlling Measure are producers, importers and distributors. Electronic information products registered in the Catalog for Priority Controls are

subject to compulsory certification control by the CNCA. The State Administration for Import and Export Inspection and Quarantine (SAIQ) is to conduct port inspections and landing inspections for electronic information products to be imported, and customs clearance is to be granted under cargo clearance permits issued by the SAIQ.

#### **<Problems under international rules>**

China's Measures for Controlling Pollution by Electronic Information Products are similar to the RoHS Directive of the EU, but cover products that are not included in the RoHS Directive, such as electronic radar, electronic measuring instruments, electronic materials, electronic units and parts, and computer software, and that have no specific industry standards or national standards. Importers are required to undergo an inspection by the SAIQ when importing goods and to acquire compulsory certification from the CNCA after that. However, the criteria and methods of these inspections are not specified, and it is also unclear whether there is fair and transparent administration of the system with due consideration to international standards and international technical levels.

Continuous monitoring of these problems is necessary as they are likely to be more trade-restrictive than necessary to fulfill a legitimate objective (Article 2.2 of the TBT Agreement).

#### **<Recent developments>**

At the TRM of the WTO/TBT Committee held in November 2006, Japan pointed out that industry and national standards have yet to be notified to the TBT Committee despite the imminent scheduled enforcement date of March 1, 2007 and requested that China postpone the enforcement of the system if it could not notify the TBT Committee of the new standards and provide producers and importers with sufficient time to prepare for the new system. China responded that (i) the industry standards are still under consideration and the progress can be confirmed by accessing the website of the Chinese Ministry of Information Industry ([www.mii.gov.cn](http://www.mii.gov.cn)); and (ii) though China will set up a one-year transitional period before the enforcement of the industry standards, it has no intention of postponing the enforcement date of the Controlling Measures. In the meantime, on November 8, 2006, China announced three industry standards—"requirement for the restriction of use of toxic chemicals (the threshold level of content)," "indicator and requirement for controlling pollution" and "method of examining chemicals subject to restricted use"—but China has yet to notify them to the TBT Committee.

Japan will continue to urge China to notify the industry and national standards to the TBT Committee and request for China's further clarification of this new system.

### **3) System for Environmental Management on the Import and Export of Toxic Chemicals**

#### **<Outline of the measure>**

Foreign companies that export to China chemicals listed in the “List of Toxic Chemicals Severely Restricted in the People’s Republic of China” are obligated to pay charges of 10,000 US dollars to SEPA for each registration and apply for issuance of “Registration Certificate for Environmental Management on the Import and Export of Toxic Chemicals”. Chinese companies that import relevant chemicals have to pay 2,000 RMB for each landed cargo and apply for issuance of a “Transit Certificate for Environmental Management on the Import and Export of Toxic Chemicals”. They are also required to submit the Transit Certificate to customs when clearing relevant chemicals. When Chinese companies produce and sell relevant chemicals in China, they are not obligated to apply for registration for each sales contract.

In order to strengthen regulations for the import and export of toxic chemicals, SEPA announced a revision of the List of Toxic Chemicals on December 28, 2005, which would be put into effect on January 1, 2006. SEPA added 158 chemicals to the 31 items listed in February 1995, when the original List was put into effect. These added chemicals include ones widely used for industrial use such as dichloromethane, chloroform, trichloroethylene, tetrachloroethylene, *etc.*

#### **<Problems under international rules>**

This system stipulates that the characteristics of industrial chemicals and agrichemicals should not include chemicals designated as toxic chemicals, and imposes obligations such as registration on imports of other products. Therefore, it can be interpreted as a technical regulation within the scope of the TBT Agreement. Import registration and import permits are imposed only on imported goods for each contract, and the collected charges seem to be higher than necessary for examination for an import registration certificate and import certificate. These points pose questions of consistency with Article 2 of the TBT Agreement, which stipulates provision of national treatment and a ban on trade-restrictive operations. Furthermore such discriminatory treatment and collection of excessive charges might be inconsistent with the GATT and in the Import License Agreement. China failed to notify this revision of the “List of the Restricted Toxic Chemicals” to the WTO/TBT Committee in advance, and did not provide an opportunity for Member countries to make comments. China did not provide an appropriate period between publication and enforcement of the revision, either. All these might violate Article 2 of the TBT Agreement (Article 2.9, which stipulates the obligation of advance notification, and Article 2.12 which stipulates the necessity of securing a reasonable interval between the publication of technical regulations and their entry into force, *etc.*)

**<Recent developments>**

On December 28, 2005, the revised “List of the Restricted Toxic Chemicals” was announced and entered into force on January 1, 2006. As a result, the following situations were reported to the Ministry of Economy, Trade and Industry: as for dichloromethane and chloroform, newly added into the list, some of the cargos for which Japanese companies signed contracts before publication and shipment to China and that landed at ports such as Shanghai after January 1, 2006 had been denied entry into China by customs authorities, because a toxic chemicals registration certificate and an import certificate had not been prepared. There is a possibility that Japanese products cannot compete with China’s domestic products if high registration charges continue to be imposed only on foreign companies; and there is a concern that Japanese companies that had made shipments to China would suffer negative impacts on their operations.

In February, 2006, the Japanese embassy in Beijing pointed out to SEPA and the Ministry of Commerce that this problem, if administered badly by the Chinese regulatory authority, might cause serious damage to exports of chemicals from Japan to China and to Japanese user companies that had shipped to China and, and that this posed a question of inconsistency with international rules. Japan urged China to explain the reasons why chemicals for industrial use were added to the list, requested elimination of registration charges and immediate clearance permits for cargos for which the contracts were made before publication, and demanded early enforcement of the “Draft of Regulations for Registration Management on the Import and Export of Dangerous Chemicals”, which was said to be under domestic adjustment at present. However, there was no satisfactory reply from China.

Subsequently, when Japan raised the above concerns again at the Japan-China Economic Partnership Consultation, China responded that (i) the registration fee is not imposed for each contract, and once the registration certificate is obtained, it can be used for as many export shipments as desired during the period of validity (two years); and (ii) fees collected are being used for measures to control pollution and prevent risks. Japan repeatedly raised the matter in regular consultations with the Ministry of Commerce held in April 2006 and the WTO/TBT Committee held in March, June and November 2006, but China failed to provide satisfactory replies regarding consistency with the TBT Agreement, the early implementation of “Registration Management Rules for the Import and Export of Dangerous Chemicals (draft)” or future plans for additions to the list of toxic chemicals. On December 30, 2006, China announced a revised List of Toxic Chemicals Severely Restricted in the People’s Republic of China (it newly added 5 items to the list and deleted 48 items), which was enforced on January 1, 2007, but China failed to notify the TBT Committee this time around either. Japan, collaborating with Europe and the US, will take every opportunity to request China to correct this problem.

## TRADE IN SERVICES

Through bilateral negotiations and at the Working Party, China presented a schedule of Specific Commitments on services. The section below outlines the substance of such commitments, the status of their implementation, and points to be rectified for each main sector.

### **1) Distribution Services (wholesaling, retailing, and franchising)**

#### **Commitments upon Accession**

Prior to accession, there were strict restrictions on foreign investment in the Chinese distribution services sector. Some local governments have permitted foreign enterprises to enter this sector, but the central government has only permitted retailers to set up branches on an experimental basis in a few large cities and Special Economic Zones. Upon accession to the WTO, China made the following commitments to open the distribution services sector of its market:

In the wholesaling sector, joint ventures with foreign majority ownership would be allowed within two years after accession (by 11 December 2003). Within three years after accession (by 11 December 2004), regulations on foreign equity participation would be eliminated and the establishment of 100 percent foreign owned enterprises (exclusively foreign-owned companies) would be allowed. Geographical and quantitative restrictions would be removed within two years after accession (by 11 December 2003). The distribution of books, newspapers, magazines, pharmaceutical products, pesticides, and mulching films would be allowed within three years after accession (by 11 December 2004), chemical fertilizers, processed oil, and crude oil would be allowed within five years after accession (by 11 December 2006), and all other products (excluding salt and tobacco) would be allowed within one year after accession (by 11 December 2002).

In the retailing sector, joint ventures with foreign majority ownership would be allowed, in principle, within two years after accession (by 11 December 2003) and within three years (by 11 December 2004), restrictions on foreign capital would be eliminated. Foreign majority ownership and exclusively foreign-owned companies will not be allowed to operate chain stores with 30 stores or more handling books, newspapers, magazines, pharmaceutical products, pesticides, mulching films, processed oil, and chemical fertilizers, *etc.*, for the periods stipulated for each item. Elimination of the foreign equity limitation in automobile sales would be allowed for five years after accession (by 11 December 2006).

Geographic restrictions on the retailing sector would be eliminated within three years after accession (by 11 December 2004), while the 11 cities in the coastal region currently permitted would be increased upon accession to include Zhengzhou and Wuhan. Further liberalization would occur within two years after accession to include

all provincial capitals, Chongqing, and Ningbo. Upon accession, the retailing of all products (with the exception of tobacco) would be allowed, except books, newspapers, and magazines, which would be allowed within one year after accession (by 11 December 2002), pharmaceutical products, pesticides, mulching films, and processed oil within three years (by 11 December 2004), and chemical fertilizers would be allowed within five years (by 11 December 2006).

China committed to eliminate geographical and foreign equity restrictions on franchising within three years after accession (by 11 December 2004). With regard to restrictions in terms of the number of service suppliers (so-called supply-demand control), China did not have any particular reservations on its commitments. For this reason, China is obliged to take any restrictive measures concerning this sector in accordance with paragraph 2 of the Article XVI of GATS.

**Figure 1-5**  
**Schedule for deregulation of geographical and foreign equity restrictions**  
**in the distribution services sector**

	Wholesale		Retail			
	Geographical restriction	Equity participation ratio	Geographical restriction	Equity participation ratio (excluding chain stores on the right)	Equity participation ratio (automobile sales chains)	Equity participation ratio (chains handling some goods)
December 2001			13 cities	J/V permitted (foreign minority ownership permitted)		
Within one Year (by 11 December 2002)		J/V permitted (foreign minority ownership permitted)				
Within two Years (by 11 December 2003)	Restrictions eliminated	Foreign majority ownership permitted	All provincial capitals, with Chongqing and Ningbo Added	Foreign majority ownership permitted		
Within three years (by 11 December 2004)		Restrictions eliminated	Restrictions eliminated	Restrictions eliminated		
Within five Years (by 11 December 2006)					Restrictions eliminated	

**Status of Implementation and Points to be Rectified**

In June 2004, China's "Measures for the Administration of Foreign Investment in Commercial Fields" took effect. The measures gradually liberalize distribution services

and foreign investment and geographical restrictions in accordance with China's accession commitments. Under this law, for example, restrictions on the handling of pharmaceuticals, agrochemicals/pesticides, and mulching film by foreign-owned companies would be lifted after 11 December 2004; and, after 11 December 2006, the restriction on the handling of chemical fertilizers, would be rescinded in accordance with China's distribution services commitment schedule. However, the measures lacked guidelines and transparency with respect to implementation. On April 2, 2005, the "Notification on Expansion of Business Extent for Sales of Non-Commercial Foreign Investment Enterprises" was published and enacted, showing the way for conventional manufacturing enterprises and investment enterprises to increase sales from their current levels of business. Furthermore, on August 16, 2005, the "Related Regulations for Procedures to Establish Foreign Investment Commercial Enterprises" were published, defining details about examination procedures and application documents. The regulations define the examination period as one month in local sections and within three months in the Department of Commerce. Furthermore, on December 9, 2005, the "Notification on Commission of Authorization of Foreign Investment Commercial Enterprises to Local Sections" was published, and beginning March 1, 2006, when this Notification was put into effect, stores within a certain scale were authorized by local governments. As a result, the examination and approval process was simpler and more efficient, increasing the number of applications from foreign-owned enterprises. In April 2006, for example, business licenses for 20 foreign-owned commercial enterprises were issued by the Hangzhou City, Zhejiang Province Industry and Commerce Management Bureau. Prior to this, only three foreign-owned enterprises had been approved for establishment in Hangzhou City. Since implementation of the new regulations, foreign-owned companies are able to enter the Chinese market on a broader scale.

On December 4, 2006, the Department of Commerce promulgated the "Oil Products Market Control Law" and the "Crude Oil Market Control Law," and put these laws into effect on January 1, 2007. These two control laws established qualification requirements, application procedures, documents to be submitted, and supervision and management concerning companies that handle crude oil and oil products. The enforcement of these two laws abolished the existing uniform administration of crude oil resources by the government and shattered the wholesale monopoly over oil products previously held by China Petroleum and China Minerals. This allowed qualified foreign-owned companies to wholesale crude oil and oil products in China.

Japan requested the enactment of the guidelines to implement these measures at the meeting with MOFCOM in April 2006, then again at the Council for Trade in Services in November 2006. Japan will continue to closely monitor future trends in the development of regulations or guidelines.

## **(2) Construction, Architecture and Engineering**

### **Commitments upon Accession**

Before China's WTO accession, construction qualifications (*i.e.*, permits) were issued directly to Japanese construction companies, which received orders on a project-by-project basis (so-called direct order system).

Upon WTO accession, China committed to allow foreign majority ownership and, within 3 years of accession, wholly foreign-owned enterprises. China committed to this under the conditions set out in Figure 1-6, below.

**Figure 1-6**

#### **Construction projects which wholly foreign-owned enterprises can undertake**

1	Construction projects wholly financed by foreign investment and/or grants.
2	Construction projects financed by loans of international financial institutions and awarded through international tendering according to the terms of loans.
3	Chinese-foreign jointly constructed projects with foreign investments equal to or more than 50% and those jointly constructed projects with foreign investment less than 50%, but technically difficult to be implemented by Chinese construction enterprises alone.
4	Chinese invested construction projects which are difficult to be implemented by Chinese construction enterprises alone can be jointly undertaken by Chinese and foreign construction enterprises with the approval of the provincial government.

Regarding architecture and engineering services, China committed to permit foreign majority ownerships as for construction services, but allow wholly foreign-owned enterprises only after 5 years after accession.

### **Status of Implementation and Points to be Rectified**

In September 2002, China promulgated "Regulations on Administration of Foreign-Invested Construction Enterprises (Decree No.113 of the Ministry of Construction)" in compliance with its WTO construction services commitments to allow the establishment of wholly foreign-owned enterprises. In September 2003, the first wholly Japanese-owned construction enterprise in China was approved.

However, foreign-owned enterprises are assigned qualification grades based on a series of stringent requirements. The qualification grades include Extra, 1st, 2nd and 3rd. Each grade is subject to specific restrictions and limits, including restrictions on capital, the number of engineers and the scale of construction. Furthermore, in construction work, it is prohibited to use subcontractors for general frame building, and

wholly Japanese-owned construction enterprises have been assigned only the 2nd grade because of the stringent requirements. As a result of the grades assigned and their restrictions, companies are unable to undertake construction work that matches their abilities. The grades effectively act as a non-tariff barrier. In addition, direct orders, which were previously approved, now have not been approved since July 2005. It is more difficult than before China's WTO accession for foreign service providers to provide construction services.

China should improve its systems and deregulate or abolish the limitations and qualification grades for construction work by wholly foreign-owned enterprises to allow foreign service providers to receive treatment equal to or better than before.

**Figure 1-7**

**Examples of construction qualification grade requirements and limits on construction work approval**

	Extra	2 <sup>nd</sup>
Capital	About 4.5 billion yen	About 300 million yen
Number of employees (Engineers)	300 (200)	150 (100)
Limits of approval	None	Less than about 1.5 billion yen Lower than 120meters or 28 stories

For architecture and engineering services, on 10 October 2006, a public comment version of the "Rules for Implementation of Regulations on Administration of Foreign-Invested Construction and Design Enterprises" ("Detailed Rules"), which included interpretations and amendments to "Regulations on Administration of Foreign-Invested Construction Enterprises (Decree No. 114 of the Ministry of Construction) implemented on 1 September 2002 ("Design Regulations"), was prepared jointly by China's Ministry of Construction and Ministry of Commerce. An example of a requirement set out in, Article 15 of the Design Regulations is that the number of foreign service providers with the qualifications of Chinese certified public architects and certified public engineers must be at least one-fourth of the number of employees required by the various qualification requirements. However, the Detailed Rules state that Chinese certified public architects and certified public engineers can be employed if Article 15 is not satisfied and includes provisions relaxing other related requirements. The Detailed Rules were effective on 31 January 2006.

Furthermore, on January 26, 2006, the Ministry of Construction announced a public comment version of the "Construction Project Design Qualifications Standards," dividing the qualification standards into four grades: General Construction Project

Design Qualification Standards, Industry Construction Project Design Qualification Standards, Specialist Construction Project Design Qualification Standards, and Specified Construction Design Qualification Standards. Under the same proposal, a high standard would be imposed on General Construction Design Qualification Standards whereby, for example, the annual amount of construction project survey and design contracts for the most recent three-year period must be at least 100 million yuan. Under the above Detailed Rules, however, the qualifications of foreign-invested construction project design companies must conform to the Construction Project Design Qualification Standards, and consequently it is difficult for foreign-invested construction project design companies to obtain general construction project design qualifications.

Although the schedule for promulgation of the construction project design qualification standards has not yet been determined, the requirements for obtaining qualifications is too burdensome for foreign-owned companies and should be made more reasonable.

### **3) *Transportation Services***

#### **Commitments upon Accession**

Joint ventures with no more than 49 percent foreign capital were allowed in the freight forwarding agency service sectors at the time of accession, and by December 2002, foreign majorities were also allowed. China committed to allow wholly foreign-owned freight forwarding agency services to be established by December 2005. Freight forwarding agency services require a minimum of \$1 million in capital and an activity period of more than 20 years. Branch offices may be established one year after the joint venture is set up, and each branch office requires additional capital of \$120,000. China committed to providing national treatment for minimum capital restrictions by December 2005 and for additional branch office capital requirements by December 2003.

#### **Status of Implementation and Points to be Rectified**

The “Foreign Investment International Freight Transport Agency Business Control Rules” (“the rules”) took effect in January 2002. The rules define foreign investment for international freight transportation agency businesses as foreign enterprises that “operate under a commission from the receiver or shipper of export or import freight to provide international freight transportation and ancillary services on behalf of the customer in the name of the customer or in their own name and receive remuneration for these services.” The rules were eliminated in January 2003 and replaced by the “Foreign Investment International Freight Transport Agency Business Control Law” (“the Law”). The Law allows foreign investment ratios of up to 75 percent, but maintains the \$1

million minimum capital requirement and the \$120,000 additional capital per branch office requirement found in the rules.

On December 11, 2005, the “Measures for the Administration of Foreign Investment International Freight Transport Agency Business” were revised and promulgated, allowing wholly foreign-owned international freight transport agency enterprises to be established. Therefore, China has implemented its Accession commitment in this field.

The “Opinion on Implementation Concerning the Encouragement and Guidance of Participation in the Railway Construction Business by Privately-Owned Capital” announced by the China’s Ministry of Railways in July 2005 fully opens up the four railway sectors: railway construction; railway transportation; railway transport facilities manufacturing; and comprehensive railway management. It is clear that its intention is to authorize and encourage the participation of privately-owned capital. However, although a series of policy guidelines were announced, related detailed rules for application and implementation were omitted. At present, the National Development Reform Committee is establishing a bill to reform railway investment and financing institutions, and this bill is expected to provide guidelines and guarantees concerning participation by foreign capital and private capital in the railway market.

#### **4) Telecommunication Services**

##### **Commitments upon Accession**

Prior to accession to the WTO, China had stringent restrictions on the sale of telecommunication services and prohibited foreign entry to this sector. After accession, China committed to a phased-out opening of its markets.

Of the basic telecommunication services (public telecommunication infrastructure facilities, data communication, voice telecommunication services, *etc.*), foreign investment of 25 percent or less in joint ventures would be allowed in domestic and international telecommunication services in Beijing, Guangzhou, and Shanghai within three years after accession. Within five years after accession, the ceiling on foreign investment was raised to 35 percent and 14 provincial capitals were deregulated (Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qinghai, Shenyang, Shenzhen, Xiamen, Xian, Taiyuan, and Wuhan). Within six years, geographical restrictions were eliminated and the ceiling on foreign investment in joint ventures rose to 49 percent.

Upon accession, foreign investment of 25 percent or less was allowed in mobile telecommunication in Shanghai, Guangzhou, and Beijing. Within one year after accession, the above 14 cities were deregulated and the foreign investment ceiling was raised to 35 percent. Within three years, up to 49 percent foreign investment would be permitted and, within five years, geographic restrictions will be eliminated.

For value-added services, such as on-line information and database searches via the Internet, up to 30 percent foreign investment was permitted in Shanghai, Guangzhou, and Beijing upon accession. Within one year after accession, the above 14 cities were scheduled to be deregulated and the ceiling on foreign investment was raised to 49 percent. Within two years after accession, geographical restrictions would be eliminated and the ceiling on foreign investment rose to 50 percent.

**Figure 1-8**  
**Schedule of Deregulation of Geographical and Foreign Equity**  
**Share Restrictions in the Telecommunication Services Sector**

	Domestic and international calls		Mobile telecommunications		Value added services	
	Geographical restrictions	Equity participation restrictions	Geographical restrictions	Equity participation restrictions	Geographical restrictions	Equity participation restrictions
December 2001			Shanghai, Guangzhou, Beijing	25% or less	Shanghai, Guangzhou, Beijing	30% or less
Within one year (by 11 December 2002)			14 cities added	35% or less	14 cities added	49% or less
Within two Years (by 11 December 2003)					Restrictions eliminated	50% or less
Within three years (by 11 December 2004)	Shanghai, Guangzhou, Beijing	25% or less		49% or less		
Within five Years (by 11 December 2006)	14 cities added	35% or less	Restrictions eliminated			
Within six Years (by 11 December 2007)	Restrictions eliminated	49% or less				

### **Status of Implementation and Points to be Rectified**

Improvements to domestic laws on telecommunications include the Regulations on Telecommunications promulgated in September 2000. Article 80 of the Regulations provides for the State Council to stipulate specific regulations on the participation of foreign capital in telecommunication services. The Provisions on Administration of Foreign Investment in Telecommunications Operations took effect in January 2002.

Article 5 of the Provision on Administration stipulates minimum equity of 2 billion yuan for companies providing basic telecommunication services across multiple areas, 10 million yuan for companies providing value-added services, 200 million yuan for companies providing basic telecommunication services in one province, autonomous region or direct control city administered by the central government, and 1 million yuan for companies providing value-added services.

Article 6 of the Provisions on Administration, similar to Article 10 of the Regulations on Telecommunications, provides that, for companies providing basic telecommunication services, excluding paging services, foreign investment in joint ventures cannot exceed 49 percent. Paging and value added services are not administered by the Regulations. The Provisions on Administration, however, restricts foreign investment to 50 percent or less.

The “Classified Catalogue of Telecommunication Operations” under the “Telecommunication Regulations” was revised and took effect in April 2003. The revised Catalogue classified operations into categories, including: “basic telecommunication operations” and “value-added telecommunication operations.” In order to cope with rapidly developing telecommunication operations, the catalogue was revised in May 2004 to include subdivisions. Basic telecommunication operations were subdivided into nine sub-categories, including local phone, long-distance phone, mobile communications, satellite communications, Internet and other data transfer, provider operations and international communication infrastructure operations. There are nearly 30 sub-sub categories. Regarding mobile communications, the catalogue include a category for 3G next generation cell phones with a description of 3G mobile communications technology, showing significant progress by covering a wider range, compared to the regulations that took effect in April 2003. This catalogue, which clarifies the extent of communications service, is highly valued from the viewpoint of transparency. However, there is concern that new businesses created as a result of future technical innovation might not be approved until being listed in the catalogue.

The Regulations on Administration of Internet Information Services covering Internet business took effect in September 2000. These regulations stipulated that inspection and approval by the Information Industry Division of the State Council was necessary for establishing joint ventures with foreign capital, and provided that the equity ratio should adhere to the provisions of other laws, and that the Provisions on Administration of Foreign Investment in Telecommunications Operations should be applied.

China has gradually deregulated restrictions in the telecommunications market. However, the progress of foreign companies seeking entry into the Chinese telecommunications market has not been smooth. In 2006, foreign-owned companies entered China’s telecommunications market principally through capital participation and company alliances. In June of the same year, China Unicom made a designated issuance of \$1 billion in convertible bonds to Korea’s SK Telecom, and the companies concluded an agreement to form a strategic federation, creating a strategic alliance. Between September and November, Commonwealth Bank and J.P. Morgan made a major purchase of China Telecom stock on the Hong Kong stock exchange, reaching 8.2% and

7.2% stock ownership, respectively, and becoming the second- and third-largest shareholders of China Telecom respectively. However, this purchase was seen as a financially-motivated investment in which foreign capital looked favorably on the outlook for development of China's 3G, and most likely did not represent a genuine advance of foreign capital into the Chinese telecommunications market.

In keeping with its commitments at the time of accession, the Chinese government expedited the establishment of a "Telecommunications Law" and in September 2005, submitted the law to the National People's Congress. However, the law has not been reviewed according to schedule, and promulgation and implementation is expected to be rescheduled to 2007 at the earliest. The draft version of the Law includes provisions that: (i) relax requirements to access value-added services; (ii) establish a telecommunication supervision agency independent of the basic telecommunication supervision agency; and (iii) stipulate penalties for prohibited use of the Internet.

In addition, it is necessary to watch carefully whether communication regulations may not be unduly expanded to cover computer and other adjoining services. If they do, they will be a breach of China's WTO commitments.

## **5) Finance**

### **5-1) Insurance**

#### **Commitments on Accession**

Upon accession, joint ventures in life insurance with foreign equity shares up to 50 percent were permitted in Shanghai, Guangzhou, Shenzhen, Foshan, and Dalian. Joint venture partners could be selected freely and, within two years after accession, Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Tianjin and Wuhan would be liberalized. Within three years, geographical restrictions would be eliminated and the scope of business allowed would expand to include health insurance, group insurance, and annuities insurance for foreigners and Chinese.

For non-life insurance (accident insurance, *etc.*), the establishment of joint ventures and branches with foreign ownership up to 51 percent were allowed from the date of accession in Shanghai, Guangzhou, Shenzhen, Foshan, and Dalian. Within two years after accession, establishment of wholly foreign-owned subsidiary was permitted in Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang; Wuhan and Tianjin would be liberalized and both foreign and Chinese companies would be permitted to provide the full range of non-life insurance services. Within three years, geographical restrictions would be eliminated. However, obligatory insurance is treated as an exception to the principle of national treatment and China has not committed to allow foreign insurance companies to handle obligatory insurance.

Upon accession, the establishment of joint ventures with up to 50 percent foreign equity was permitted for insurance brokers, which earn commissions for providing insurance brokering services, in Shanghai, Guangzhou, Shenzhen, Foshan, and Dalian. Within two years after accession, Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, and Wuhan were liberalized. Within three years, geographical restrictions would be eliminated and the ceiling on foreign equity share rose up to 51 percent. Within five years the establishment of 100 percent foreign-owned subsidiaries became possible.

**Figure 1-9**

**Liberalization Schedule for Geographic and Equity Restrictions**

	Life insurance		Accident insurance		Insurance brokering services	
	Geographic restrictions	Equity restrictions	Geographic restrictions	Equity restrictions	Geographic restrictions	Equity restrictions
December 2001	Shanghai, Guangzhou, Dalian, Shenzhen, Foshan	50% or less	Shanghai, Guangzhou, Dalian, Shenzhen, Foshan	51% or less	Shanghai, Guangzhou, Dalian, Shenzhen, Foshan	50% or less
Within two Years (by 11 December 2002)	10 cities added		10 cities added	Restrictions eliminated	10 cities added	
Within three Years (by 11 December 2004)	Restrictions eliminated		Restrictions eliminated		Restrictions eliminated	51% or less
Within five Years (by 11 December 2006)						Restrictions eliminated

In the past, China has stringently restricted issuing licenses and many companies intending to enter the market, including Japanese companies, have declined to do so. From the date of accession, China committed not to impose economic needs test or quantitative limits on licenses other than the following qualifications:

- The investors shall be a foreign insurance company with thirty years or more of establishment experience in a WTO Member.
- It shall have a representative office in China for at least two consecutive years.

- The total assets of the company at the end of the year prior to application are, for companies other than brokers, \$5 billion or more, and for brokers, \$500 million or more upon accession (which would be lowered to \$400 million or more within one year after accession, \$300 million within two years, and \$200 million within four years).

The reinsurance obligation of 20 percent to Chinese reinsurance companies was lowered to 15 percent one year after accession. It was being further lowered to 10 percent two years after accession, 5 percent three years after accession, and eliminated four years after accession.

### **Status of Implementation and Points to be Rectified**

With respect to foreign equity shares in insurance companies, first, restrictions on foreign equity shares in life insurance companies continue. According to Article 3 of the “Implementation Rules for the Foreign Insurance Company Control Law” that took effect on June 15, 2004, foreign equity shares in Chinese and foreign joint insurance companies handling life insurance operations in China may not exceed 50%. This complies with China’s accession commitments. Second, the “Notification by the Chinese Insurance Association regarding the Implementation of the Commitments upon WTO Accession” of December 11, 2003, made it possible for foreign insurance companies to handle all non-life insurance operations except statutory insurance operations. This allows foreign insurance companies to proceed with related procedures including application for the change of “License for Insurance Operations”. In other words, foreign insurance companies are now able to operate independently in China, with restrictions on equity shares abolished. Third, China made a commitment to raise the limit on foreign equity shares of insurance broker companies from 50% to 51% within 3 years of accession (by December 11, 2004). According to the “Notification by the Chinese Insurance Association regarding the Implementation of the Commitments upon WTO Accession” published on December 11, 2003, the limit on foreign equity shares of insurance broker companies was raised to 51% or less as of the same date.

Furthermore, by abolishing the geographical restrictions on foreign insurance companies in December 2004 in accordance with its commitments, China has implemented the Accession commitment in this field.

Under the “Regulations on Administration of the Chinese Reinsurance Business” established in December 2005, insurance companies operating in China must make a priority offering of 50% or more of reinsurance premiums to at least two domestic companies exclusively in the business of reinsurance (Article 11). In addition, foreign insurance companies are prohibited from engaging in reinsurance transactions unless they have the approval of the Insurance Supervisory and Management Committee (Article 22).

Given that under the Node 3 commitment concerning reinsurance at the time of accession to WTO, China was expected to abolish the compulsory reservation system and eliminate all reserves concerning reinsurance by December 11, 2005—the fourth

year after accession—the above regulations may possibly be inconsistent with China's commitments upon WTO accession.

## **5-2) Banking**

### **Commitments upon Accession**

Upon accession, foreign currency businesses are free of any geographical or customer restrictions.

Local currency (Chinese currency Renminbi: RMB) business is currently permitted only in Shanghai and Shenzhen. Upon accession, Tianjin and Dalian were liberalized and within one year after accession Guangzhou, Zhuhai, Qingdao, Nanjing, and Wuhan were liberalized. Within two years, Jinan, Fuzhou, Chengdu and Chongqing were liberalized. Within three years, Kunming, Beijing, Xiamen; within four years, Shantou, Ningbo, Shenyang, and Xian were scheduled for liberalization. Within five years, all geographic restrictions were eliminated. Within two years after accession, provision of services to Chinese enterprises were permitted and within five years to Chinese clients. If local currency business is approved in one region of China, it is also permitted in any other region, where such business has been opened.

Licensing criteria for authorization to deal in China's financial services sector are solely prudential and there are not supposed to be any economic needs testing or quantitative limits on licenses. Within five years after accession, any existing non-prudential measures restricting ownership, operation and juridical form of foreign financial institutions was supposed to be eliminated. Qualification requirements for establishments are total assets at the end of the year prior to filing application of \$10 billion for establishing a subsidiary, \$20 billion or more for establishing a branch, and \$10 billion or more for establishing a Chinese-foreign joint bank. The requirements to conduct dealings in RMB business are three years business operation in China and being profitable for two consecutive years prior to the application.

### **Status of Implementation and Points to be Rectified**

On February 1, 2002, the Regulations on Administration of Financial Institutions with Foreign Capital were amended and took effect. This Regulation requires that foreign banks setting up in China have had a liaison office inside China for two years or more, and that total assets at the end of the year prior to application are \$10 billion or more in the case of establishing a subsidiary in China, and \$20 billion or more in the case of a branch. Requirements for dealing in RMB include having three years or more business operation in China and being profitable for two consecutive years prior to application.

In the past, merger partners on the Chinese side were limited to financial

institutions, but the amendments to this ordinance allow other companies to be merger partners as well. These requirements are all in line with China's schedule of the commitments on services.

With respect to dealing in RMB, Guangzhou, Zhuhai, Qingdao, Nanjing and Wuhan were added to the open dealing regions on December 1, 2002; Jinan, Fuzhou, Chengdu and Chongqing were added on December 1, 2003; Kunming, Beijing, Amoy, Xian and Shenyang were added on November 24, 2004. The "Notification on Matters Related to Further Opening of Banking Business" was issued on December 3, 2005, permitting dealing in RMB by foreign banks in Shangtou and Ningpo in accordance with China's commitments. Five other cities -- Heilongjiang, Jiling, Lanzhou, Yinchuan and Nanning -- were also opened ahead of the schedule.

The "Regulations on the Administration of Foreign-Owned Banks" were promulgated in November 2006, and implemented on December 11, 2006. At the same time, the "Detailed Rules for Implementation of the Foreign-owned Bank Control Regulations" established by the Bank of China Audit Board based on these regulations were also implemented. This was accompanied by the repeal of the "Regulations on Administration of Financial Institutions with Foreign Capital" (promulgated in 2001), and the local currency (Chinese currency Renminbi: RMB) business was fully opened to foreign-owned banks.

The conditions imposed on the business development of foreign-owned banks consist of the following.

(1) The minimum capital requirement of exclusively foreign-owned banks and Chinese-foreign joint banks is either 1 billion yuan or the equivalent value in hard currency. The controlling shareholder or largest shareholder must be a commercial bank. When exclusively foreign-owned banks and Chinese-foreign joint banks establish branches in China, the head office must contribute working capital of either 100 million yuan or the equivalent value in hard currency. However, the total amount of working capital contributed to branches must not exceed 60% of total capital. Branches of foreign banks must obtain working capital of 200 million yuan or an equivalent value in hard currency from the head office.

(2) Exclusively foreign-owned banks and Chinese-foreign joint banks may deal in RMB deposits for individuals in China, and handle credit card business. In addition, the scope of operations approved by the China Banking Regulatory Commission consists of government bonds, financial bonds, and non-stock foreign currency marketable securities. However, RMB business of foreign bank branches aimed at individuals in China are limited to time deposits of one million yuan or more per deposit, and thus establishing a local corporation is effectively a condition for foreign banks to comprehensively handle RMB aimed at individuals in China.

(3) The conversion of the branch of a foreign bank into a local corporation is treated from the same standpoint as a Chinese bank. Consequently, regulations such as "the ratio of loans to deposits cannot be more than 75%" and "loans to a single company

cannot exceed 10% of the balance of capital” are newly imposed.

		Exclusively foreign-owned banks and Chinese-foreign joint banks	Foreign bank branches
Capital restrictions	Registered capital or working funds	One billion yuan or the equivalent value of hard currency	200 million yuan or the equivalent value of hard currency
	Total assets at previous year-end up to application	\$10 billion	\$20 billion
Operations restrictions	Restrictions on foreign currency business	No restrictions	
	Restrictions on RMB business	No restrictions	RMB business aimed at individuals in China are limited time deposits of one million yuan or less per transaction.
Local restrictions		No restrictions	

Although it is viewed favorably that regulations for performance of accession commitments have been exercised, on schedule, China was committed to abolishing those existing measures, other than measures for maintaining orderly credit, that restrict the ratio of foreign equity participation, operations, and corporate structure. Although the WTO Financial Services Committee and China TRM of November 2006 confirmed the details of the system, for Japan, a satisfactory response has not been obtained. Attention should therefore continue to be focused on the state of China’s progress in opening up its banking industry to foreign participation, including the status of applications to participate.

## **6) Postal/Courier Services**

### **Commitments on Accession**

In the postal delivery services sector, China has (since accession) allowed the establishment of joint ventures with foreign capital ratios of 49 percent or less, except for services granted monopolies under the law. In December 2002, foreign capital majorities were also permitted, and in December 2005, wholly owned foreign subsidiaries will be permitted.

### **Status of Implementation and Points to Be Rectified**

In its Accession commitments, China promised to allow the establishment of wholly foreign-owned companies by December 2005, but at present (January 2007), it is not certain when this will be realized. It depends on future developments regarding the “Postal System Reform Bill” and the enactment of the “Postal Law”

The Postal Law enacted in 1986 is no longer able to prevent confusion in the courier market and increased friction between the courier industry and the postal service. Amendment of the Postal Law is inevitable. In 2006, there was no progress concerning the sixth draft of the amendment of the “Postal Law” (published in July 2004), and the focus was on discussions about the “Postal System Reform Bill”. This bill aims at clarifying the frame and scope of government control of the postal service by adjusting interests through reform, with an ultimate goal of removing obstacles to establishing the “Postal Law”. In September 2005, the “Postal System Reform Bill” was announced, and since September 2006, postal services control bureaus have been established at China’s provincial level (Tianjin City, Zhejiang Province, Shandong Province, Shisen Province and Shaanxi Province). The seventh draft of amendments to the “Postal Law” was announced in January 2006, but because this prompted much disagreement, an eighth draft was prepared in August. This eighth draft reduced the scope of the monopoly of China’s postal sector—which previously handled letters of less than 350g—to letters of less than 150g. However, this eighth draft, about which debate continues regarding such issues as the main authorization over the postal services exclusive business rights and supervision, administration and control, has not yet been placed on the agenda of the National People’s Congress Standing Committee. The eighth draft provides that “companies engaged in domestic letter express courier services must be companies other than foreign-invested companies,” and contains other stipulations that create difficulties for the expansion of operations in China by foreign-owned companies.

For securing implementation of the Accession commitments, future development of laws should be monitored continuously.

## **PROTECTION OF INTELLECTUAL PROPERTY**

### **Commitments on Accession**

One of the areas in which Members (especially developed country Members) strongly sought improvements from China in the Working Party on accession was its systems for protecting intellectual property. These concerns reflect the increasingly serious problem of counterfeit and pirated products and other infringing goods in China. Following Working Party negotiations, China committed to adhering to the TRIPS Agreement immediately upon accession.

China did not seek transitional measures as a developing country but committed to adhere to its obligations under the TRIPS Agreement upon the date of accession and to amend and improve its legal system to bring it into conformance with the TRIPS Agreement. In particular, China committed to reforming: the Patent Law (including patents for invention, patents for utility models, and patents for industrial designs), the Trademark Law, and the Copyright Law. In the area of enforcement, China further

committed to performing its obligations under the TRIPS Agreement by rationalizing compensation payments for losses, bolstering its system for suspending products, strengthening administrative measures and border measures, easing requirements for applying criminal penalties, as well as educating and enlightening the public.

### **Implementation Status**

In China, protection of intellectual property is regulated substantively through several laws including: the Patent Law; the Trademark Law; the Copyright Law; the Law against Unfair Competition (Anti-unfair Competition Law); regulations prohibiting acts infringing upon undisclosed information (trade secrets); the Implementation of the Protection Regulation of Layout Designs of Integrated Circuits; and the Regulations on Administration of Import and Export of Technique. Procedurally, intellectual property rights are protected through the general provisions of the Civil Law; the Criminal Law; the Customs Law; and the Regulations Governing Customs Protection of Intellectual Property Rights.

Numerous new laws have been established or amended and old laws and ordinances abolished to bring the legal system into conformance with the TRIPS Agreement. In addition, the protection of intellectual property rights has been recognized as an important strategy for converting China into a country with great capacity for innovation. China established the National Action Programme on the Protection of IPR (2006-2007) and China's Action Plan on IPR Protection (2006) to demonstrate China's commitment to active involvement in measures for the protection of intellectual property rights.

### **Points to be Rectified**

As to the actual legal system for protecting intellectual property rights, in general, China has brought it into conformance with the TRIPS Agreement, though improvements are still needed on a number of issues.

It has been noted that the abundance of counterfeit and pirated products and other infringing goods, long an issue in China, not only has seen little improvement but even worsening due to some companies in spite of the efforts of the Chinese authorities. A survey of Japanese companies showed that, among the companies that suffered damage caused by counterfeiting in fiscal year 2004, 62 percent cited China and Hong Kong as the country where counterfeit and pirated products were produced ("FY 2005 Survey Report on Losses caused by Counterfeiting," Japan Patent Office). Another survey shows 87 of 115 companies (76%) suffered from infringement of intellectual property in China from 2004 to 2005 ("Field Survey for Infringement of Intellectual Property Right in China," Ministry of Economy, Trade and Industry, May 2006.) These surveys confirm the seriousness of the situation. What is needed to rectify this situation is not only improvement of the actual legal system, but also drastic improvements in the

enforcement of the existing legal protections. Tighter control needs to be exerted in the administration of various judicial and administrative branches.

The following sections specifically identify points where further remedies or improvements are sought.

### **1) Issues related to Counterfeit, Pirated and other Infringing Products**

#### **<Outline of the measure>**

Protection of intellectual property first requires improvement of specific regulations. China's efforts to make improvements as it acceded to the WTO through a series of amendments to its laws should be recognized. Nevertheless, in ensuring the effective protection of intellectual property, in accordance with the provisions of the TRIPS Agreement, it is vital that enforcement systems using civil, administrative, criminal and other procedures be strengthened and, where necessary, implemented in an efficient and speedy manner. Moreover, enforcement systems must be administered in a fair and equitable manner.

The following section notes several issues on enforcement, which play a large role in protecting intellectual property in China.

#### **<Problems under international rules>**

##### **(a) Inadequate administrative, civil and criminal remedies**

For intellectual property rights infringements, Chinese laws and regulations recognize administrative penalties (suspension of infringements, levying of administrative fines, confiscation and disposal of goods infringing rights, *etc.* by the administrative authorities), and allow for civil recourse (embargo based on court judgment, compensation for losses, rehabilitation of reputation through advertisements expressing apologies, *etc.*), as well as criminal sanctions (imprisonment, fines, *etc.*).

##### **(Administrative Procedure)**

While the Chinese government has enforced administrative penalties, the penalties are insufficient. In the case of trademark infringements, for example, administrative penalties under the Regulations for the Implementation of Trademark Law (Article 52) provide for a maximum fine for an act of infringement of the exclusive right to use a registered trademark of three times the amount of the illegal business turnover, and (where it is impossible to calculate the amount of the illegal business turnover), 100,000 Yuan. It is doubtful, however, whether this is a sufficient deterrent compared to the illegal profits that can be earned by infringements. Also, in the case of the infringement

of copyrights, the procedures to enforce administrative penalties by the administrative agency in charge of copyrights (Copyright Agency) are not yet clearly defined. Moreover, it is doubtful that the procedures in place are sufficiently effective for copyright owners who wish to see the violators penalized, as they are required to submit the proof of infringement to identify the violators and/or pirate product manufacturers. It is desirable, therefore, to have clarification of the enforcement requirements and the mitigation of overly-demanding requirements.

Furthermore, the administrative penalty includes the seizure and destruction of goods that infringe rights, but rarely imposes confiscation of illegal income or destruction of the production implements, which are more effective to prevent repeat offenses. Japan, from the standpoint of a deterrent to further infringements, called for in Article 41 of the TRIPS Agreement, requests the strengthening of penalties.

Although simplified processing for Customs enforcement has been achieved through the implementation of the General Collateral Regulations, more improvements are required.

Japan looks forward to improvements in the procedures required under the current export regulation system (*e.g.*, improvement in the responding period for the rights holder, simplifying appraisal procedures, *etc.*), as well as abolition of the practice of having the rights holder pay warehousing fees and the forfeiture and destruction of infringing goods in the event of infringement. Regarding the forfeiture and destruction of infringing goods, regulations state that goods confiscated by customs shall be provided to a public organization to be utilized for social public works, or can be auctioned after removing the characteristic part of infringement if they cannot be utilized for public works and purchased by the rights holder except cases where the characteristic part of infringement can not be removed (Article 27 of Intellectual Property Right Customs Protection Ordinance and Article 30 of administrative instructions of same). There are reports that some infringing goods actually have been provided to public organizations. There are concerns that infringing goods could reenter the market through providing to the organization or auctioning. Japan needs to continue to monitor to ensure that there is: (1) effective prevention of infringing goods reentering the market; and (2) prevention of repetition of counterfeit crimes through the complete confiscation and destruction of infringing goods, in light of the relevant provisions in the TRIPS Agreement (*e.g.*, Articles 46 and 59).

There are also reports that counterfeit goods manufactured in China are exported to neighboring Asian countries and elsewhere, with potentially unfair and distortive effects on international trade. A survey of Japanese companies in China shows that 52 percent have responded that they suffer some damage from counterfeit and pirated products exported from China (including 19 percent expressing “doubts of damages caused by exportation”). (“The Forth Survey of Actual IPR Damages in China” JETRO Beijing Center/The Japanese Chamber of Commerce and Industry in China, March 2006). Furthermore, there are many reports of goods discovered with improper indications of origin. Article 51 of the TRIPS Agreement does not require the

introduction of export restrictions. However, this could still be considered an area requiring stronger measures in order to provide for effective exercise of rights under Article 41.1.

### **(Civil Recourse)**

With regard to civil remedies against infringements of intellectual property rights, compensation claims, including reasonable costs incurred by the rights holder in deterring infringements, are allowed (Patent Law Article 60, Trademark Law Article 56, Copyright Law Article 48, *etc.*). It has been pointed out, however, that adequate compensation is not necessarily being recognized, and compensation is rarely paid by infringers even if the rights holder wins a case. According to an investigation by the Chinese government, compensation averages only about 40,000 Yuan (“Investigation and Research on the Injury Caused by the Manufacture and Sale of Counterfeit Goods to the National Economy,” Project Group of External Economic Research Department, Development Research Center, State Council [May 2003]). In this regard, there have been some Interpretations of the Supreme People’s Court adopted on methods of calculating damages -- for example, “The Judicial Interpretation of the Supreme People’s Court on Questions Regarding Applicable Laws for Adjudication of Patent Dispute”, which went into effect in July 2001, “The Interpretation of the Supreme People’s Court of Several Issues Concerning the Application of the Law to the Trial of Civil Dispute Cases Involving Trademarks” and “The Interpretation of the Supreme People’s Court Concerning Several Issues on Application of Law in Hearing Correctly the Civil Copyright Cases”, which went into effect in October 2002. However, there are said to be many cases which approve compensation within the limits stipulated in those interpretations, yet do not adequately compensate the rights holder. Japan needs to continue monitoring how courts find damages and how these provisions are administered in light of the Article 45 of the TRIPS Agreement which requires adequate compensation for damages and the commitment made by China at the time of WTO accession to make adequate compensation for damages.

### **(Criminal Sanctions)**

As for criminal sanctions, Paragraph 7, Chapter 3 of the Criminal Code provides for imprisonment and fines for criminal cases of infringements of intellectual property rights (trademark infringement is covered in Articles 213 - 215, copyright in Articles 217 - 218).

In addition, the “Interpretation by the Supreme People’s Court and the Supreme People’s Procuratorate on Several Issues of Concrete Application of the Laws in Handling Criminal Cases of Infringing Intellectual Property” in effect since December 2004, partially lowered the monetary thresholds for criminal prosecution. The number of prosecution seems to be increasing and certain degree of effect has been achieved in terms of threshold reduction. Because existing thresholds are still high, coupled with a

lowered value for the amount of illegal business turnover due to calculations based on the price of infringing goods instead of the price of the genuine goods. It is impossible to meet the standards for criminal prosecution and to impose criminal penalties even if there is infringement on a commercial scale. Furthermore, the thresholds for units is three times the thresholds for individuals, making it difficult to impose criminal penalties against infringements by units. For example, for units selling a trademark counterfeited goods, an amount of sales (retail price multiplied by the number of sold goods) of 150,000 Yuan (approx. 2.25 million yen) or less would receive an administrative penalty but not be eligible for a criminal penalty. Since the aforementioned thresholds are constant, regardless of the type of goods, a problem emerges regarding low-price goods in particular. Even if a great quantity of counterfeited goods were confiscated, it would not exceed the thresholds and therefore a criminal penalty could not be imposed. Under the current conditions it is still difficult to levy criminal penalties, thus weakening the ability to deter infringement and not tying into the especially effective prevention of repeat offenses. As such, there are concerns regarding the effective enforcement of intellectual property rights. In addition, there are many cases of infringement where the distribution of small lots and inventory control is used to avoid meeting thresholds. At the small-scale retail level, criminal detection is quite difficult and it is not possible to respond to the reality of the increasingly organized and sophisticated counterfeit goods business.

There is a potential for current thresholds to be inconsistent with Article 41 of the TRIPS Agreement, which establishes expeditious/deterrent remedies, and Article 61, which stipulates criminal penalties for trademark counterfeiting and copyright piracy on a commercial scale. This issue has been brought up by the US on a number of different fronts; however, Japan also has a great deal of interest in the enforcement of effective intellectual property rights. Japan is requesting improvements during bilateral talks between Japan and China such as the Japan-China Economic Partnership Conference, as well as at multilateral forums such as the transitional review mechanism (TRM) of the WTO/TRIPS Council. Continued monitoring of developments remains necessary.

There remain concerns that China is not adequately fulfilling its WTO accession commitment to recommend judicial authorities to lower thresholds for criminal prosecution. These concerns stem from the fact that some provisions have not changed or have higher thresholds because the thresholds for units are three times higher than those for individuals. In addition, the range of infringement covered by criminal penalty is limited (*e.g.*, the “identical” requirement in trademark infringement (Article 213) and the “for profit” requirement in copyright piracy (Article 217)), which could be inconsistent with Article 61 of the TRIPS Agreement, requiring criminal penalties for willful trademark counterfeiting or copyright piracy on a commercial scale.

### **(b) Delay in Examination Procedures**

Since accession to the WTO, China has taken steps to remedy delays in examination procedures, *e.g.*, by increasing the number of examiners. In the past, there were delays in examining patent applications in the field of advanced technology. However, Japanese industry indicates that steady progress has been made by relevant Chinese authorities. Such progress is well appreciated.

Japan looks forward to a continued commitment by China to conduct timely examination and also urges enhancements of administrative rules and practices, such as the introduction of preferential examination or accelerated examination systems, which are effective means of ensuring timely examination. Additionally, it is thought that China will improve the transparency of the review process by publishing data on inspection time periodically. Since some companies have pointed out that the duration of opposition/invalidation process is getting longer due to recent increase of applications/examinations in China, it will be necessary for Japan to ask for improvement in the duration.

### **(c) Plagiarized Invention/Design from Foreign Country**

Some Japanese companies reported that, in China, there have been many cases where a patent application for an invention or design invented in a foreign country is submitted by a person other than the authentic inventor and a patent is granted by the intellectual property office.

When a misappropriated application is suspected, it is possible to request the Chinese authorities to investigate the true ownership of the intellectual property rights under the relevant laws, including Article 45 of the Patent Law and Articles 79 and 86 of the implementing regulation of the Patent Law. However, when the investigative process or court proceedings extend over a long period of time, damages to the authentic inventor, caused by the products copied by an applicant other than the authentic inventor, cannot be prevented while demand for the authorized product is high in the market.

Japan needs to ensure that China will introduce measures to effectively prevent such cases, in light of Article 41.1 of the TRIPS Agreement on expeditious remedies to prevent infringement.

### **(d) Local Protectionism**

One of the major problems cited concerning control of intellectual property rights infringements in China is “local protectionism.” In particular, the officers in charge of regional administrative agencies lack a basic understanding of intellectual property (incomplete understanding of systems and treaties or simply ignorance of their existence). There are some cases where local authorities use their discretion in controlling these goods, or, in extreme cases, unofficially provide manufacturers of counterfeit and pirated products with information of a crackdown, because of an understanding that the manufacturer of counterfeit and pirated products brings profits to the local area. These actions impede speedy and accurate enforcement of intellectual

property rights in China, and this is a problem in light of Article 41 paragraph 1 of the TRIPS Agreement (on ensuring the availability of enforcement procedures under a Member's law for effective action against any act of infringement). Cases where there are discriminatory effects in the recourse of foreigners and foreign companies could also cause problems regarding TRIPS Article 3.1 with respect to national treatment.

The Chinese Government has shown a positive stance toward remedying local protectionism through such actions as the defeat of local protectionism in the "National Action Programme on the Protection of IPR" and requiring all levels of local government to incorporate the protection of intellectual property rights into their agendas of important business. However, many are of the opinion that local protectionism still exists in China. Accordingly, Japan hopes that the Chinese Government will strengthen its education and control of local authorities.

## **2) Protection of Well-Known Trademarks**

### **<Outline of the measure & Problems under international rules>**

Japan, the US and the EU commented during the legislative review on the inadequacies of China's protection for well-known trademarks (an issue of great concern also to many other developed countries). In the past, the list of well-known trademarks only covered Chinese companies, which was counter to Article 3 of the TRIPS Agreement (national treatment). However, it is appreciated that foreign well-known trademarks have been recognized as well-known marks in China since the aforementioned Regulations on the Approval and Protection of Well-known Trademarks (enforced from June 1, 2003) went into effect and the practice of listing only Chinese companies was abolished. (Currently, the trademarks of six Japanese companies are recognized as "well-known trademarks" by the State Administration for Industry & Commerce.) Japan continues to monitor whether the enforcement of these Regulations and related local ordinances by China will improve the transparency of the approval procedures and guarantee the protection of well-known trademarks without discriminating between Chinese and foreign companies.

## **3) Licensing regulations on patents and know-how**

### **<Outline of the measure>**

China regulates contracts approving patent exploitation (so-called licensing agreements) between foreign and Chinese companies through the Technology Introduction Contract Administrative Ordinance, the Technology Introduction Contract Administrative Ordinance Application Rules, and the Technology Export and Import Contract Registration Administrative Statute.

**<Problems under international rules>**

Through the accession negotiations, the problematic provisions of China's licensing system were amended and now are closer to conforming to the TRIPS Agreement. While China's efforts to make improvements should be acknowledged, a number of restrictive clauses and mandatory warranties contained in the new regulations are subject to concern *vis-à-vis* Article 3 of TRIPS Agreement with respect to national treatment and Article 28(2) of the same Agreement with respect to the right of patent owners to conclude licensing contracts. In addition, some affected parties find the enforcement of the new regulations to be problematic, citing cases in which restrictions on counter values or contract periods have been imposed despite the abolition of related regulations.

The section below notes several issues in possible contravention of the TRIPS Agreement.

**- Restrictive Clauses – Technology Export and Import Administrative Ordinance Article 29 (5), (6) & (7)**

According to this Ordinance, technology import contracts shall not include a number of unreasonably restrictive clauses. It is not clear how the term “unreasonably” will be interpreted, or for that matter, how parties' choice of law will be allowed to interpret “reasonableness” in a TRIPS compliant manner.

**- Ownership of Improvements – Article 27 & 29(3)**

Article 27 states that improvements of the licensed technology belong to the improving party. This Article must be read in conjunction with Article 29(3), which prohibits the licensor from restricting the licensee to make improvements on the licensed technology or use the improved technology. Due to these mandatory provisions, the foreign licensor is faced with a dilemma: a foreign investor wishing to license his technology in China may be effectively prevented from doing so because he cannot control technology “improved” by the licensee.

In contrast, for domestic technology transfer/licensing contracts, Article 354 of the Contract Law stipulates that parties may contractually provide for the ownership of improvements resulting from technological achievements. Only in the absence of a contractual arrangement will the improvement belong to the improving party. Contract Law 355 provides that, if laws or administrative regulations stipulate other provisions for technology import and export contracts, patent contracts or patent application contracts, such provisions shall govern.

### **- Licensor Liability (Article 24 & 25)**

The responsibility found in the old ordinance that obligated a licensor to respond to any third-party suits claiming infringement arising out of the use of technology by a licensee has been deleted, but Article 24 still contains the wording: “If the recipient party in a technology import contract uses the technology provided by the supplier according to the agreement in the contract, and such use results in the infringement of others’ legal rights and interests, then the supplier assumes responsibility.” Foreign licensors are still at risk of legal liability from third parties and must, therefore, be extremely cautious in providing technology.

In addition, the licensor must ensure that the technology provided is complete, correct and effective and may fulfill the agreed technological goal (Article 25). This also raises the risk of liability.

Japan will request China to promote deregulation through the further revision of the Technology Exports and Imports Administrative Ordinance. Also, Japan needs to continue to monitor for discrepancies in the rules governing licensing contracts signed between domestic Chinese companies, as well as in the administration of permits for international licensing agreements.

### **<Recent developments>**

China is subject to TRIPS Council transitional reviews to verify its compliance with the TRIPS Agreement, both with respect to improving and operating its domestic legal system and enforcement system. The TRIPS Council conducted the fifth-year transitional review in October 2006. Japan set forth the aforementioned areas where further improvements were needed and especially pointed out the importance of enforcement with respect to counterfeits, piracy and other infringements of intellectual property rights. The United States and the EU made similar comments on the need to improve enforcement. In 2006, Japan requested China to make improvements regarding intellectual property-related issues during various bilateral discussions, including: (i) the regular consultation in April between the Japanese Vice-Minister and his counterpart from China’s Ministry of Commerce; (ii) the Japan-China Economic Partnership Conference in December; and (iii) the Commissioner’s Meeting between the JPO and SIPO in November, as well as in the WTO Trade Policy Review Mechanism in April, and the joint mission with the government and the International Intellectual Property Protection Forum (IIPPF), anti-counterfeit cross-industry organization in the private sector, in June. Transitional reviews and bilateral discussions will continue to be used to verify both improvements to the legal system protecting intellectual property rights in China and the administration of the system and seek redress when problems exist. If improvements are not apparent, WTO dispute settlement procedures will be considered where necessary.

In order for the Chinese Government to strengthen its enforcement, it is necessary to simultaneously improve the capacities of individual Chinese Government agencies. It is with this in mind that Japan provides support by accepting trainees and dispatching experts, as well as hosting various seminars. Assistance provided by Japan to China for

the improvement of its legal system has included: (a) opinion exchange with a patent law revision research group (September 2006); (b) a study panel for a law prohibiting unfair competition between Japan and China (September 2006); (c) hosting officials in charge of the legal system for intellectual property, including judges of the Supreme People's Court and procurators of the Supreme People's Procuratorate (November 2006); and (d) hosting officials from the State Council's Legislative Affairs Office and the State Administration for Industry & Commerce in charge of the legal system for intellectual property (December 2006). What is important from a medium- to long-term perspective is creating a wide-ranging program to work on the development of specialized human resources in the judicial branch and the administrative branch responsible for examination and enforcement, and to conduct educational activities to communicate the need for respect and protection of intellectual property to the general public.

The private sector conducted various activities, with the view of encouraging, and cooperating with, the Chinese authorities to further address the issues, including: requesting and providing information company by company; strengthening enforcement capacity by the IIPPF, a cross-industry organization; and working through the Quality Brand Protection Committee (QBPC) with participants including European and American companies. In order to support such activities, JETRO provides varied information to Japanese companies, while establishing consultation offices in Beijing, Shanghai, Hong Kong, Guangzhou, Dalian and Tsingtao as a mediator with the Chinese Government. It is important for the Government of Japan itself to encourage the vigorous activities of private companies, and to provide necessary support for the further promotion of efforts.

### **Note-1: Main Regulations**

#### **(1) Main regulations established in 2006**

##### *(a) Regulations on the Protection of Right of Communication through Information Networks (effective as of 1 July 2006)*

Enacted based on Article 58 of the Copyright Law, this provides effective methods to rights holders for the protection of copyright on the internet in China, including technical measures to protect communication through information networks and aid measures for rights such as requests for deletion of copyrighted works through an internet service provider (ISP).

##### *(b) General Collateral Regulations (effective as of 1 July 2006)*

This law, which simplifies customs procedures such as the paying of a designated amount to Customs as general security (money deposit), will negate the need to pay security (money deposit) for each instance where Customs discovers goods that are suspected of rights infringement.

**(2) The following are main regulations enforced before 2005:**

*(a) Patent Law*

In August 2000, the National People's Congress approved an amendment to the Patent Law, which covers protection of patents for invention, patents for utility models, and patents for Industrial design. The amended law took effect on July 1, 2001. Implementation Regulations for the Patent Law took effect on December 28, 2002.

Previously, the right to trial and judgment in a court had been permitted only for patents for invention. A major feature of the amended law is the fact that this right has been extended to patents for utility model and patents for industrial design. Further, the amended law provides rights to rights holders to prohibit acts by third parties to "apply for sale" or "import" without the rights holder's consent, and even in cases where the patent is applied by a third party in good faith, this can be certified as an infringement of patent rights unless it can be proved that the product relating to the patent has a legal basis. Provisions have also been incorporated which stipulate orders of suspending rights infringements and providing property preservation prior to litigation. The law also defines clearly the legal status of regional patent administrative agencies and establishes mechanisms for settling disputes. Japan will continue to monitor revisions to the Patent Law including provisions for inventions utilizing genetic resources and provisions for compulsory licensing for public health and non-working.

*(b) Trademark Law*

The National People's Congress decided on an amendment of the Trademark Law in October 2001 which took effect on December 1, 2001.

A major feature of the amended law is that it introduces provisions on "well-known trademarks," "collective Marks and certification Marks," "three-dimensional mark" and "the final decision of law." The amended law not only strives to conform to the TRIPS Agreement, but also clarifies the executive authority of administrative agencies. This step has been taken in order to deal with the problem of counterfeit goods and to respond to calls in recent years to strengthen controls against them. In order to raise the efficacy of controls against the selling of goods infringing rights, the "clear knowledge" (knowledge of unauthorized use of the registered trademark) requirement has been deleted and provisions strengthened on compensation for loss.

In conjunction with the amendment of the Trademark Law, China promulgated Regulations for Implementation of Trademark Law on September 15, 2002. The Regulation contains detailed administrative rules. Unlike the previous "Provisional Regulations on the Recognition and Administration of Well-Known Trademarks," the regulation allows for individual application for recognition of well-known trademarks in the event that there is a dispute regarding the ownership of trademarks at the time registration is filed for or adjudicated. The Trademark Office or the Trademark Review

and Adjudication Board are to make determinations in these cases. The regulation also includes a substantial increase in the fine for infringement from “not exceeding 50% of the volume of the illegal business turnover” to “not exceeding three times the amount of the illegal business turnover.”

The ‘Provisions on the Determination and Protection of Well-Known Marks’ were implemented on June 1, 2003, and the system for the advance approval of well-known trademarks was abolished. (Only Chinese companies had been protected through the listing of well-known trademarks.) The new regulation stipulates that determinations of whether a trademark is well-known will be made on a case-by-case basis. Currently, the Trademark Office of the State Administration for Industry & Commerce is examining a draft for the revision of trademark law.

(c) Copyright Law

The National People’s Congress amended the Copyright Law on October 27, 2001, and it took effect on the same day. Two objectives of the amendments of the Copyright Law were to bring it into conformance with the TRIPS Agreement and to expand protection of foreign copyrighted products in addition to explicitly stipulate lending rights.

The new implementing regulations for the Copyright Law, containing detailed administrative rules, were promulgated on September 15, 2002, in conjunction with the amendment of the Copyright Law. The regulation contains explicit wording regarding the “protection of foreign works,” and sets penalties at “not exceeding three times the amount of the illegal business gains.”

Further, the Computer Software Protection Ordinance based on the same law was promulgated in December 2001 and took effect on January 1, 2002. In order to comply with the TRIPS Agreement, this ordinance defines protection of computer software through copyright and amends provisions to enable copyright protection to continue for 50 years after the holders’ death as compared to previous provisions which allowed extensions from 25 years to 50 years.

(d) Technology Exports and Imports Administrative Ordinance

The Technology Exports and Imports Administrative Ordinance, which replaces the Technology Introduction Contract Administrative Ordinance and regulates contracts approving application of patents and know-how agreed upon between foreign and Chinese domestic companies (so-called international license contracts), was published in December 2001. The Import Ban and Import Restriction Technology Administrative Statute and the Technology Exports and Imports Contract Registration Administrative Statute, were promulgated in December 2001 and took effect on January 1, 2002. The formulation of these statutes is aimed at achieving conformance with the TRIPS Agreement, and provisions noted during the accession negotiations as not conforming to

TRIPS were deleted, such as the ten-year restriction on contracts approving application.

(e) Regulations on Customs Protection of Intellectual Property

These Regulations, which took into effect on March 1, 2004, include provisions based on the TRIPS Agreement. Under the Regulations, an importer can, for example, request customs procedures regarding patent rights by providing a security (money). The Regulations also include provisions that have been partially modified, but that do not effectively offer improvement. Among such provisions are those relating to the system for auctioning goods confiscated in relation to trademark infringement; and the responsibility of the rights holder to pay the fee for warehousing infringing goods.

(f) Interpretation by the Supreme People's Court and the Supreme People's Procuratorate on Several Issues of Concrete Application of the Laws in Handling Criminal Cases of Infringing Intellectual Property

The interpretation, which took effect on December 22, 2004, clarifies criminal penalties against infringement of intellectual property rights, including patent rights, trademark rights, copyrights and trade secrets:

- i) Lowered the thresholds for criminal prosecution, including the amount of illegal business turnover and illegal income, as stipulated in the 'Regulations on Prosecution Standards for Economic Crime Cases issued by the Supreme People's Procuratorate and the Ministry of Public Security of the People's Republic of China (the national prosecutor's office)', effective as of April 18, 2001;
- ii) Clearly defined terms used in the Criminal Law;
- iii) Introduced provisions concerning how to calculate values for items infringing on intellectual property rights;
- iv) Imposed punishment for crimes committed by a company that were three times more severe than crimes committed by an individual; and
- v) Prescribed distribution on the internet of music and films owned by others and regarded as illegal under the Criminal Law.

(g) Interpretation of the Supreme People's Court concerning Applicable Laws for the Trial of Technical Contract Disputes (effective as of 1 January 2005)

The Interpretation stipulates applications of laws when technical contract disputes occur under the Contract Law. It includes the same restrictive clauses as those in Articles 29.5 to 29.7 of the Technology Exports and Imports Administrative Ordinance, which Japan previously said were non-compliant with national treatment obligations in the TRIPS Agreement.

*(h) Measures for the Administrative Protection of Internet Copyright (effective as of 30 May 2005)*

The Measures stipulate the responsibilities of the copyright holder, Internet Service Provider (ISP) and contents provider in case of copyright infringement on the Internet. They provide that: (1) the ISP should promptly delete the contents in question when the copyright holder finds infringement of its rights and notifies the ISP; and (2) administrative penalties will be imposed if deletion is not performed by the ISP and this harms social public interests.

*(i) Provisions on the Protection of Products with Geographical Indications (effective as of 15 July 2005)*

Whereas Trademarks comprising geographical indications have been protected under the Trademark Law, these Provisions provide special protection for goods that include geographical indications. They stipulate the definition of goods, application, examination, publication, opposition procedure, utilization of special indications, protection, and other elements. They also stipulate registration and protection of goods comprising geographical indications originated in foreign countries.

*(j) Measures for the Implementation of Compulsory License to Patents Relating to Public Health (effective as of 1 January 2006)*

The Measures stipulate the implementation of the “Declaration on the TRIPS Agreement and Public Health” adopted at the fourth WTO Doha Ministerial Conference in November 2001, and the “Decision” adopted at the WTO General Council in August 2003. They stipulate that, for example, a compulsory license can be exercised in case of a public health crisis recognized as a national emergency, and the pharmaceutical products manufactured under compulsory license can be exported to a country which has insufficient manufacturing capacity for the product.

*(k) Measures for Protection of Intellectual Properties in Trade Fairs (effective as of March 30, 2005)*

The Measures stipulate protection of patent right, design right, trademark right and copyright at exhibitions in China. They clearly stipulate that actual sales are indispensable for the infringement-constituting element with regard to the display of design infringing goods.

## GOVERNMENT PROCUREMENT

### *Commitments on Accession*

WTO Members are not required to become signatories to the Government Procurement Agreement (GPA). This is a plurilateral agreement and only those countries that join are bound by its rules. Therefore, few countries, mainly developed countries, have joined the GPA. China has committed to participating in the GPA in the future and to working to ensure transparency in government procurement procedures as well as to provide MFN treatment when procuring from foreign countries. Although China has already been an observer of the Agreement, it has not taken any action for accession yet.

In 2004, China organized a task force in the Ministry of Finance to commence studying provisions and basic principles of GPA, the effect of participation on the current procurement system and internal social economy and proposed measures to prepare the accession negotiation. At the 16<sup>th</sup> China-US Joint Commission on Commerce and Trade held in July 2005, the Chinese Government promised that it would engage in technical consultations with GPA Members including the US. In September of the same year, the Chinese Ministry of Finance organized a research team regarding the WTO's Government Procurement Agreement (GPA), which commenced study of GPA membership. Moreover, in Beijing in November 2005, China's Ministry of Finance and the EC Commission signed the "China-Europe Government Procurement Cooperation Agreement" and agreed to create a government procurement dialogue mechanism. As a result, the First China-Europe Government Procurement Dialogue was held in Beijing in May 2006, where consultations were held concerning topics including their respective legal systems for government procurement, the status of implementation, the definition and scope of government procurement, the administration of supplier qualifications, the conclusion of contracts and the computerization of government procurement. Following the meeting, the concerned parties of the Ministry of Commerce declared that China would submit a detailed statement concerning the opening of the government procurement market by the end of December 2007 and planned to begin negotiations concerning membership in the WTO Government Procurement Agreement. This statement merits attention since it is the first time since the Chinese Government committed itself to GPA membership in 2001 that it has mentioned a specific timetable for public negotiations.

### **Status of Implementation and Problems under international rules**

To prepare for future participation in the Agreement on Government Procurement, China adopted the People's Republic of China Government Procurement Law in the 28th Session of the 9th NPC in June 2002; it took effect on January 1, 2003.

The law governs government procurement and has provisions that are similar to those of the GPA in terms of coverage (procurement organization, products, *etc.*), procurement methods (open and competitive bidding, *etc.*), procurement procedures and complaint filing procedures. However, there still remain some differences between the Law and the GPA, including:

#### **• National Treatment in Procurement**

The GPA basically bans discrimination in the procurement of goods and services above the relevant threshold by organizations covered by the Agreement. In contrast, China's Government Procurement Law stipulates that domestic goods and services can be given preference except in the following three cases: (i) goods and services cannot be domestically procured in China or cannot be produced under reasonable commercial conditions; (ii) procurement is for use in foreign countries; and (iii) other laws or regulations stipulate otherwise. These are not consistent with the principle of national treatment in the GPA, and are likely to pose problems in China's accession to the Agreement.

#### **• Procurement threshold**

In the GPA of the WTO, a procurement threshold for the central government, local governments, and other public agencies of each member country is stipulated respectively in the Appendixes, and is applied equally among agencies of the same level of government. However, in China, there are no unified regulations for procurement limits. The "Catalogue of Concentrated Procurement" and the "Government Procurement Limits" are set by the State Council for procurements by the central government. For provincial-level governments or authorized procurement organizations, they are set by local budgets. Therefore, procurement thresholds differ by region. Using the example of the Beijing government, where economic development has been significant, procurement limits for 2006 were raised from 300,000 RMB (equivalent to 37,000 dollars) in 2005 to 500,000 RMB for goods, 100,000 RMB (equivalent to 12,000 dollars) to 500,000 RMB for services, and 500,000 RMB to 600,000 RMB for construction. These standard procurement amounts, which are variable as indicated above, not only complicate bidding procedures, but by setting extremely low standard amounts in regional areas, they will probably work to the advantage of domestic suppliers.

#### **• Bidding methods**

The GPA provides that, in principle, open bidding, selective bidding (open to suppliers invited by the procurement organization), and competitive negotiation should be adopted; limited bidding is allowed only in special instances. In recent years, the

Chinese government has adopted a primarily public bidding system for government procurement, raising the percentage of public bidding in government procurement to 66% in 2005, up 6 percentage points from 2004. Under China's Government Procurement Law, however, in addition to these four bidding methods, there is a possibility to adopt methods other than bidding, such as multiple estimates.

#### • **Transparency**

The GPA puts emphasis on transparency in the government procurement process and has strict provisions detailing information disclosure related to procurement plans, closing bids and procurement procedures.

China's Law only stipulates in an abstract manner that government procurement information and background should be disclosed through designated media. The Chinese government and each local government has respectively promoted efforts to secure transparency, making regulations for disclosing procurement catalogues, procurement bidding information and procurement conditions. Specifically, "Measures for the Administration of Government Procurement Information Disclosure" published by the Ministry of Finance (enforced in September 2004) stipulates that various information related to government procurement in China should be disclosed through designated media except for state secrecy, commercial secrecy of suppliers, and confidential government procurement information defined by law and regulations. In addition, the "China Economic Bulletin" (a newspaper supervised by China's Ministry of Finance), "Chinese Government Procurement" (a magazine) and "The Chinese Government Procurement Network" are media for disclosure of government procurement information designated by China's Ministry of Finance and release information concerning government procurement free of charge. Seen from the perspective of information disclosure, the transparency of government procurement is high, and the amount of information released by the Chinese Government Procurement Network has increased substantially.

According to the "Chinese Government Procurement Network" published in December 2006, information relating to approximately 35,000 procurements were disclosed in 2005 (up from approximately 19,000 in 2004), while 33% (11,686) of closing bids were disclosed. Further efforts for information disclosure are required.

China's Law prescribes only general principles and lacks guidance for implementing rules. The Ministry of Finance promulgated regulations on the "Goods and Services Government Procurement Bid Participation Method", "Government Procurement Information Announcement Method" and "Government Procurement Supplier Complaint Handling Method," which took effect on September 11, 2004. The Ministry has also published draft rules on "Non-Bidding Government Procurement Control Methods", "Government Procurement Supplier Offence Punishment Control Methods", "Decentralized Procurement Methods", "Government Procurement Agreement Supply Control Methods", "Provisional Rules on Government Procurement Control and Administrative Operations" and "Government Procurement Action Rules", requested public comments from the related sectors and local governments.

## **Column: China's Recent Policy of Curbing Investment**

### **1) China's Recent Policy concerning Foreign Investment (a shift from "open door" to selection)**

In March 2006, China introduced its eleventh Five-Year Plan for 2006 to 2011. The plan sets forth China's policies for economic and social development for the next five years and seeks to build a stable society with reduced inequality (a moderately affluent and stable society) as a major goal. It cites as problems the imbalance between investment and consumption, excess production capacity, depletion of energy resources and growing environmental pollution. The plan represents a departure from the policy, which was set forth in the tenth Five-Year Plan for 2001 to 2006, of placing priority on growth and opening the economy widely to foreign investment.

At the opening of the fifth session of the 10<sup>th</sup> National People's Congress (NPC) on March 5, 2007, Chinese Premier Wen Jiabao delivered a report on the government's activities, the contents of which were in line with the policies set forth in the eleventh Five-Year Plan. Furthermore, the corporate tax law adopted at the NPC session abolished some of the preferential measures for foreign investment, indicating that China attaches importance to efforts to secure an equal footing in terms of competition for domestic and foreign companies.

China acceded to the WTO in December 2001 during the tenth Five-Year Plan and has, until now, supported foreign-invested enterprises by implementing and maintaining a variety of preferential measures for foreign investment. Following are major examples of the preferential measures.

#### **"2-Year Exemption, 3-Year Reduction" Tax System**

Foreign-invested manufacturing enterprises that have an operating life of 10 years or longer are exempt from paying corporate income tax for the first two years and are granted 50% tax reduction for the following three years.

#### **Tax Exemption for Imported and Domestic Manufacturing Equipment**

Exemption from tariffs and the value-added tax on imports is granted for imported manufacturing equipment necessary for projects that belong to the "incentive business type" as specified by the Catalogue for Guidance of Industries for Foreign Investment, and a value-added tax refund is granted for domestic manufacturing equipment necessary for such projects.

#### **Corporate Income Tax Refund for Reinvestment**

If a foreign investor reinvests profits distributed by a foreign-invested enterprise into another such enterprise or for the establishment of a new one, and the enterprise

receiving such reinvestment has an operating life of five years or longer, 40% of the corporate income tax paid on the reinvestment by the investor is refunded. If the enterprise is an exporter of products of a cutting-edge technology company, a 100% refund is granted.

Meanwhile, since 2004, concern has grown about phenomena such as an inequality in the tax burden borne by domestic and foreign enterprises, monopolization of some business sectors by foreign-invested enterprises, and transfers of profits from foreign-invested enterprises to foreign countries. In addition, China's vast trade surplus has begun to draw criticism from abroad. Accordingly, moves to abolish preferential measures for foreign investment, establish and enforce new regulations thereon and apply the policy of restriction and selection thereto as shown below have become conspicuous.

## **2) Abolition of Preferential Measures for Foreign Investment**

As stated above, the corporate income tax law that unifies the tax treatment of domestic and foreign companies by abolishing a preferential tax rate for foreign-invested enterprises was adopted at the last session of the NPC in March of this year. As a result, a tax rate of 25% is applied to both domestic and foreign-invested enterprises. Also abolished are some other preferential measures, such as a 50% tax reduction for export-oriented foreign-invested enterprises.

## **3) Introduction of Measures for Selective Acceptance of Foreign Investment**

In order to foster the high-tech industry while restricting investment in business sectors saddled with excess production capacity, the following policies and measures have begun to be implemented:

### **Selective Application of Preferential Tax Treatment**

Under the corporate income tax law mentioned above, (1) a concessionary tax rate of 15% is applied to high-tech companies, (2) preferential tax treatment is provided to companies that make investment in environmental protection and energy and water conservation, and (3) preferential tax treatment is provided to companies investing in agriculture, forestry and fisheries, as well as in infrastructure building, regardless of whether they are domestic or foreign.

### **Restrictions on Foreign Investment in Business Sectors with Excess Capacity**

As business sectors saddled with excess production capacity, the State Council cited steel, electrolytic furnaces, automobiles, steel alloys, coke, carbides and copper refining in the "notice concerning acceleration of implementation of structural adjustments in sectors with excess production capacity," dated March 12, 2006.

Furthermore, cement, electricity, coal and spinning were cited as sectors where excess production capacity may arise in the future. With regard to these business sectors, the notice stipulates that strict control and restrictions should be imposed on new projects and the standards for screening for approval should be upgraded.

*Protection and Promotion of Home-Grown Technologies and Brands*

Automobiles manufactured by a joint venture established by Chinese and foreign companies are required to be labeled with the name of the joint venture that includes the name of the Chinese partner and the trademark (in Chinese) in an easy-to-see manner. Although this requirement does not constitute a direct restriction on foreign investment, it effectively acts as protection for home-grown brands. Protection of home-grown technologies and brands is one of the specific goals included in the eleventh Five-Year Plan.

**4) Future Developments**

Although the abolition of preferential measures for foreign-invested enterprises has been expected by foreign investors for some time, its impact and future developments such as the establishment of detailed rules for the enforcement of the corporate income tax law must be carefully watched.

From the viewpoint of securing predictability for foreign companies making investment in China, it is desirable that the planned investment treaty between Japan, China and South Korea be concluded as soon as possible.

**Column: China's Accession to WTO**

**1) History of Accession Negotiations**

Fifteen years after China formally applied for accession to the GATT in the form of "resumption of its status as a contracting party" in July 1986 (and after China reapplied for accession to the WTO when the GATT lapsed in December 1995), its application was approved by the WTO Ministerial Council in Qatar in November 2001; its membership took effect on December 11, 2001.

Since that time (15 years after its initial application), China engaged intermittently in bilateral negotiations with 37 countries and regions including Japan, the United States, the European Union and other WTO members, in addition to multilateral negotiations in the WTO Working Party ("WP"). Japan moved ahead of other developed countries to stimulate China's accession negotiations and concluded bilateral negotiations with China on market access for goods in September 1997 and for the remaining services sector in July 1999. The bilateral negotiations between the United

States and China held the key to accession, but followed a rocky path, including suspensions following the Tian'anmen Square incident (June 1989) and the accidental bombing of the Chinese Embassy in Belgrade (May 1999). Afterwards, a US-China agreement was reached in Beijing in November 1999. The EU reached a substantive agreement with China in May 2000. The bilateral negotiations with all parties were completed in September 2001 when Mexico concluded its agreement with China.

Multilateral negotiations in the Working Party ("WP") were held 20 times from 1986 until 1995 under the GATT regime and 18 times from 1996 to September 2001 under the WTO regime. The WP Report (including the draft Protocol of accession) was adopted at the September 2001 WP meeting. Subsequently, China's accession was unanimously approved at the WTO Ministerial Meeting in Qatar on November 10, 2001.

**Notes: Main Bilateral Negotiations**

**a) Japan-China Negotiations**

From the very early stages, Japan consistently supported China's accession to the WTO and, therefore, moved ahead of other developed countries to hold bilateral negotiations with China on market access. When Prime Minister Hashimoto visited China in September 1997, the two countries reached an essential agreement on market access for goods (tariffs, import restrictions, standards, and certification). Subsequently intensive negotiations on market access for distribution, finance, telecommunications, construction and other services continued right up until Prime Minister Obuchi's visit to China in July 1999. China offered a package of concessions that were commercially significant for Japan which, consequently, led to substantial agreement and announcement of the successful conclusion of negotiations.

**b) US-China Negotiations**

US-China negotiations were held in Beijing in November 1999. The US delegation, led by United States Trade Representative Charlene Barshefsky and Presidential Economic Advisor Eugene Sperling met with the Chinese delegation, led by Trade Minister Shi Guangsheng and Vice Minister Long Yongtu, in intensive negotiations. Reports indicate that leaders of both countries exerted strong political leadership to bring the negotiations to a conclusion, with the active intervention of Premier Zhu Rongji. The China-US agreement that resulted includes: concessions on tariffs, improved market access for services (finance, telecommunications, distribution, audio-visual, and other areas), special safeguards for imports from China (to continue for 12 years after accession), anti-dumping (special transitional measures for China's non-market economy to continue for 15 years after accession), textiles (elimination of the Chinese quota for exports to the US by 2005 so as to bring measures into conformity with the WTO Agreement on Textiles, plus special safeguard measures for textiles until 2008).

### c) EU-China Negotiations

After the US-China agreement, Commissioner Pascal Lamy of the European Commission visited China to hold ministerial meetings with Trade Minister Shi Guangsheng and discussions with Premier Zhu Rongji in March 2000. No agreement was reached at the time because of differences in policy on the liberalization of financial and telecommunications services. Two months later, in May, Commissioner Lamy again visited China for ministerial meetings and obtained a substantial agreement from China committing to accelerated liberalization of service sectors, including financial and telecommunications services, in addition to the reduction in tariffs.

### 2) Accession-related Documents

Generally, at the time of accession to the WTO, the Protocol and the WP Report are prepared and these were the documents drafted in the case of China's accession. Annexes to the Protocol contain China's schedule of tariff concessions and its schedule of specific commitments in services.<sup>6</sup> "The Protocol (including the commitments referred to in Paragraph 342 of the WP Report) shall be an integral part of the WTO Agreement" (*see* Protocol Part I -General Provisions 1. General). Consequently, China has a legal obligation under the WTO Agreement to perform its commitments indicated in the Protocol and the WP Report.

#### **Note: China's non-market economy issue**

The issue of China's non-market economy status involves AD and CVD investigations of Chinese companies. Generally, non-market economy provisions are intended to help investigating authorities calculate prices and reach price comparisons for industries not governed by normal market conditions (*e.g.*, State-run enterprises in communist countries). GATT non-market economy provisions have existed since the 1950s and are part of the current AD Agreement. China's WTO accession Protocol (December 2001) stipulates that, in AD cases where Chinese manufactures are unable to show clearly that market economy conditions prevail in the industry manufacturing similar products, certain "surrogate country" methods can be used where comparisons of domestic prices or costs in China are based on data from economically comparable countries. In accordance with the provisions of the Protocol of Accession, China has maintained that Chinese manufacturers are being treated detrimentally in the AD investigations and have demanded in WTO meetings and bilateral negotiations that China be accorded market economy status.

After China's WTO accession, in March 2002, Japan revised its ordinance on anti-dumping and decided that in anti-dumping investigations of imports from China, Chinese prices can be used in investigations where Chinese manufacturers are able to

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<sup>6</sup> The texts of the accession-related documents can be obtained through the WTO web site ([http://www.wto.org/english/thewto\\_e/acc\\_e/protocols\\_accmembership\\_e.htm](http://www.wto.org/english/thewto_e/acc_e/protocols_accmembership_e.htm)). The outline of China's commitments, which is described below, is also available on the METI web site ([http://www.meti.go.jp/policy/trade\\_policy/wto/accession/index.htm](http://www.meti.go.jp/policy/trade_policy/wto/accession/index.htm)).

show clearly that market economy conditions have actually permeated in regard to the manufacture and sale of products similar to imported products.

### **3) Ensuring China's Implementation of WTO Obligations**

#### **a) Transitional Review Mechanism**

China has many issues to address to fulfill its obligations under the WTO treaty: the enhancement and amendment of an enormous number of domestic laws and regulations, the establishment of transparent, uniform administration and the training of human resources, to name just a few.

When China joined, the WTO created a special system to review its status in fulfilling WTO obligations (*see* Article 18 of the Accession Protocol, "Transitional Review Mechanism"; "TRM" hereinafter). The TRM was initiated for the first time at the WTO General Council on December 10, 2002, and, since then, the TRM has been held 5 times in 2003 to 2006. Prior to this, councils and committees working under the direction of the WTO General Council conducted their own TRMs and identified many issues.<sup>7</sup> The TRM occurs annually for eight years, with a final review within ten years after accession. The TRM is intended to obtain information and to exchange views on related Chinese policies and measures at each of the WTO councils and committees to encourage China to implement its commitments.

Japan actively used the TRM to point out issues and concerns and to question China how it intended to fulfill its WTO obligations at various Committee meetings.

**Below is a summary of the main points made by Japan.**

#### **Council for Trade in Goods**

Japan inquired and has concerns regarding China's: (1) certification system for finished vehicle characteristics; (2) export control on coke; (3) export control on fluorites; (4) failure to sign the Government Procurement Agreement; and (5) backtracking on commitments concerning distribution.

#### **Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS)**

In order to enhance enforcement, Japan asked China to actively pursue criminal

<sup>7</sup> These are the Council for Trade in Goods, the Council for TRIPS, the Council for Trade in Services, the Committee on Balance-of-Payments Restrictions, the Committee on Market Access, the Committee on Agriculture, the Committee on SPS, the Committee on TBT, the Committee on Subsidies and Countervailing Measures, the Committee on Anti-dumping, the Committee on Customs Valuation, the Committee on Rules of Origin, the Committee on Import Licensing, the Committee on TRIMs, the Committee on Safeguards, and the Committee on Finance.

prosecutions, strengthen penalties and sanctions, reduce the burden on rights holders with regard to customs procedures and rectify protectionism in regions, and requested the submission of data concerning the enforcement. Japan also requested non-discriminatory protection of well-established trademarks for domestic and foreign trademark holders and the streamlining of the trademark screening and approval process, and asked China to address Japan's concern over national treatment regarding restrictions on licensing.

#### **Committee on Market Access**

Japan inquired and has concerns regarding China's: (1) tariff rates for photographic film; (2) certification system for finished vehicle characteristics; (3) import restriction on second-hand clothes; and (4) export control on coke.

#### **Committee on Technical Barriers to Trade**

Japan inquired and has concerns regarding China's: (1) management of the CCC certification scheme for electrical products; (2) law for prevention and control of pollution concerning electronics information products; (3) registration system for initial imports of chemicals; (4) import and export control on toxic chemicals; and (5) standards for wireless LAN (local area network).

#### **Council for Trade in Services**

Japan inquired and has concerns regarding China's: (1) clarification and announcement of approval procedures under the law for the administration of foreign investment in commercial fields for distribution services; (2) requirements for the establishment of local subsidiaries for construction and related engineering services; and (3) the implementation status of the commitments made upon the WTO accession with regard to distribution services.

#### **Committee on Anti-Dumping Practices**

Japan pointed out matters inconsistent with the Anti-Dumping Agreement with regard to the Chinese investigative authorities' anti-dumping investigation procedures such as the use of facts available (FA) and the determination of injury.

### **b) The Chinese System for WTO Implementation**

#### **Relevant ministries and agencies**

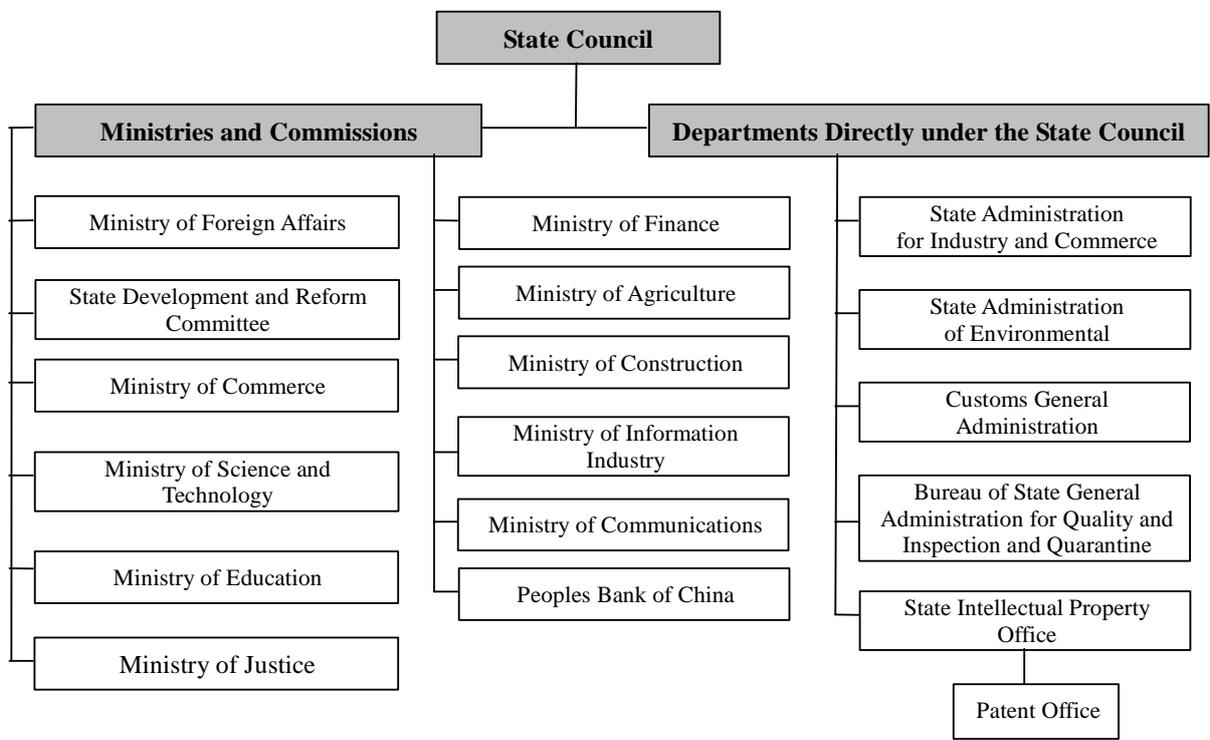
A number of different organizations within the Chinese State Council are responsible for WTO issues, led by the Ministry of Commerce (formerly the Ministry of

Foreign Trade and Economic Cooperation - (MOFTEC)). The figure lists the primary Chinese agencies and details their responsibilities with respect to the WTO Agreements.

The Ministry of Commerce plays the central role in WTO implementation and has jurisdiction over the formulation of policies and laws covering trade, economic cooperation and foreign investments in China. It is also responsible for formulating foreign economic policy, conducting bilateral and multilateral economic negotiations, and signing bilateral and multilateral treaties and agreements. The Ministry of Commerce has approximately 500 staff members. In addition to serving as the general liaison for WTO-related matters, the Ministry of Commerce has jurisdiction over the majority of the agreements.

In November 2001, the former MOFTEC replaced its Department of International Trade and Economic Affairs with a new Bureau of Fair Trade for Imports and Exports (responsible for anti-dumping, countervailing duties and dispute settlements, *etc.*) and a China WTO Notifications and Enquiry Center (responsible for notifications and enquiry). The WTO Department has a staff of 50. The government of China is in the process of revising domestic regulations and the WTO Department takes the lead in studying, formulating and implementing foreign trade policies and programs relevant to the WTO agreements. Though China established a Bureau of WTO Notifications to handle WTO-related inquiries, it is not necessarily able to adequately respond to the large numbers of questions posed by domestic and foreign governments and enterprises. Japan hopes that it functions more smoothly in the future.

Primary WTO-Related Organizations in China



### Ministries and Commissions with primary jurisdiction over WTO agreements

Responsibility	Jurisdiction
Management of WTO accession	Ministry of Commerce
General Agreement on Tariffs and Trade	Ministry of Commerce and Customs General Administration
Implementation of customs obligations and concession tables	Ministry of Finance, Ministry of Commerce and Customs General Administration
Notification based on WTO agreements	Ministry of Commerce and other authorities
Agreement on Agriculture	Ministry of Commerce, Ministry of Agriculture and Ministry of Finance
Agreement on Sanitary and Phytosanitary Measures (SPS)	Bureau of State General Administration for Quality Supervision and Inspection and Quarantine, Customs General Administration (AQSIQ) and Customs General Administration
Agreement on Textiles and Textile Products (Including Clothing)	Ministry of Commerce
Agreement on Technical Barriers to Trade (TBT)	AQSIQ and other authorities
Agreement on Trade-Related Investment Measures (TRIMs)	Ministry of Commerce, State Development and Reform Committee, and State Administration for Industry and Commerce
Anti-Dumping Agreement	State Tariff Commission and Ministry of Commerce
Agreement on Customs Valuation	Customs General Administration
Agreement on Pre-shipment Inspection	AQSIQ, Customs General Administration
Agreement on Rules of Origin	Customs General Administration and AQSIQ
Agreement on Import Licensing	Ministry of Commerce
Agreement on Subsidies and Countervailing Measures	Ministry of Commerce
Agreement on Safeguards	Ministry of Commerce and State Development and Reform Committee
General Agreement on Trade in Services (GATS)	Ministry of Commerce and other authorities
GATS Protocol on Trade in Financial Services	Ministry of Commerce and People's Bank of China
GATS Protocol on Basic Telecommunications	Ministry of Commerce and Ministry of Information Industry
Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)	Ministry of Commerce, State Intellectual Property Rights Office, State Administration for Industry and Commerce, State Administration for Industry & Commerce, Customs General Administration and other authorities
Understanding on Rules and Procedures Governing the Settlement of Dispute (DSU)	Ministry of Commerce and other authorities
Plurilateral Agreement on Government Procurement	Ministry of Finance and Ministry of Commerce
Other WTO issues	Ministry of Commerce