United States General Accounting Office

GAO

Report to the Honorable
Hank Brown, U.S. Senate

January 1995

U.S.-China Trade

Implementation of Agreements on Market Access and Intellectual Property

GAO/GGD-95-61

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-259747

January 25, 1995

The Honorable Hank Brown
United States Senate

Dear Senator Brown:

In recent years, market access barriers and inadequate protection of intellectual property rights have discouraged U.S. business activity in the rapidly growing economy of the People's Republic of China (PRC). To help address these barriers, in 1992 the United States and China signed two Memorandums of Understanding (MOUs) in which each country made certain commitments relating to improved market access and intellectual property rights protection. As you requested, we have examined China's implementation of the two MOUs. Specifically, this report focuses on (1) China's compliance with the provisions of the market access MOU and related progress needed for China to meet the eligibility requirements to join the General Agreement on Tariffs and Trade (GATT)[1] and (2) China's implementation of the MOU on the protection of intellectual property rights.[2] At your request, we are also providing information on the legal procedures involved in addressing U.S. concerns about foreign market access and intellectual property rights protection under Section 301 of the 1974 U.S. Trade Act, as amended.[3] (Apps. I and II provide more extensive details on the market access and intellectual property rights MOUs; app. III gives further information about U.S. trade law.)

Results in Brief

On the basis of our discussions with U.S. government officials, Chinese government officials, and U.S. company representatives, China appears to have taken steps to comply with most of the provisions of the MOUs on market access and the protection of intellectual property rights. However,

[1]GATT is an international organization created in 1947 pursuant to the GATT agreement that now has more than 100 nations as signatories. GATT is devoted to the promotion of freer trade through multilateral trade negotiations and was founded on the belief that more liberalized trade would help the economies of all nations grow. The Final Act resulting from the Uruguay Round of GATT negotiations was signed on April 15, 1994, and as of December 31, 1994, most of the participating countries had ratified it. The Final Act created a new World Trade Organization (WTO) as a successor to GATT, bringing all member countries under more of the multilateral trade disciplines. Throughout this report, the Uruguay Round Final Act will be referred to as "GATT 1994."

[2]An intellectual property right is the ownership of the right to possess or otherwise use or dispose of products created by human ingenuity. Patents, copyrights, and trademarks are examples of intellectual property rights.

[3]Under Section 301 of the U.S. Trade Act of 1974, as amended, 19 U.S.C. 2411, the President is authorized to take all appropriate action, including retaliation, to obtain the removal of any act, policy, or practice of a foreign government that violates an international agreement or is unjustifiable, unreasonable, or discriminatory and burdens or restricts U.S. commerce.

U.S. companies continue to experience problems in both areas. While ongoing efforts may produce positive results in the short term, U.S. government officials said that the full resolution of these problems will likely result only from gradual and long-term economic change in China.

- The United States Trade Representative (USTR) determined in January 1994 that China was substantially in compliance with the market access MOU. The U.S. government recognizes that the Chinese have made progress in the areas of transparency[4] and reduction of nontariff barriers. However, USTR and the U.S. Department of Agriculture (USDA) reported that China's compliance was lagging in terms of ensuring that Chinese sanitary and phytosanitary standards and testing requirements[5] are not used as import barriers. This finding contrasts with the position of Chinese officials we met with in March 1994, who told us that the government of China had faithfully implemented its MOU commitments. (See app. I for further information on China's compliance with the market access MOU.)
- The most frequent concern reported by the 33 U.S. companies who responded to our structured interview questions (see app. V.) on market access issues was transparency, followed by tariffs and nontariff barriers.[6] Fewer companies reported concerns or problems related to Chinese policies on import substitution[7] or product standards.[8]
- Since 1992, the U.S. and Chinese governments have met in both bilateral and multilateral contexts to discuss the conditions for China's accession to GATT or its anticipated successor, WTO. Before establishing a protocol of accession for China that is acceptable to all contracting parties, GATT/WTO members and Chinese negotiators must resolve a number of critical issues, such as increasing the transparency of China's trade laws and regulations, setting a timetable for China's tariff reductions, and improving Chinese enforcement of intellectual property rights protection.
- According to USTR, China has amended and issued intellectual property laws and regulations, fulfilling a number of its major obligations under the MOU on the protection of intellectual property. The Chinese government

[4]Transparency refers to the extent to which laws, regulations, agreements, and practices affecting international trade are open, clear, measurable, and verifiable.

[5]Sanitary and phytosanitary regulations are measures taken to protect human, animal, or plant life or health.

[6]We conducted structured interviews of 41 companies. However, only 33 companies responded to the specific questions relating to the provisions of the U.S.-China market access MOU.

[7]China's import substitution practices have typically involved denying approval for certain imports if an equivalent item is produced domestically, or conditioning import approvals on the transfer of foreign technologies into local manufacturing ventures.

[8]Only 1 of the 33 companies that responded to our questions was an exporter of agricultural products.

has amended its patent law, issued copyright regulations, and acceded to the Berne Copyright Convention and the Geneva Phonograms Convention.[9] However, according to officials at USTR and the Departments of Commerce and State, and some U.S. industry groups, China has not made significant progress in complying with the MOU's enforcement provision. Because of China's failure to enforce its intellectual property rights (IPR) laws and regulations, in June 1994 USTR designated China a "priority foreign country" under U.S. trade law, and immediately initiated a Special 301 investigation.[10] On December 31, 1994, USTR published a proposed list of Chinese products that could be subject to 100-percent tariffs if China does not address U.S. concerns about IPR enforcement.

Background

The dramatic growth and reform of the Chinese economy has created increased potential for U.S. companies interested in exporting to or investing in China. China's economy, measured by real gross domestic product (GDP), grew at a remarkable rate of almost 13 percent in 1992 and again in 1993. By comparison, real GDP growth averaged less than 2 percent annually for industrialized countries and about 6 percent for developing countries in 1992. Based on estimates by the International Monetary Fund (IMF), China is now the world's third largest economy.[11]

Despite the expanding needs and market potential of China's economy, Chinese market access barriers and inadequate protection of intellectual property rights have restricted U.S. business activity in many economic sectors, making it difficult for U.S. firms to export to China and contributing to the growing U.S. trade deficit with China. Between 1980 and 1993, the U.S. trade balance with China moved from a surplus of $4.5 billion (in 1993 constant dollars) to a deficit of $22.8 billion.

[9]The full titles of these conventions are the Berne Convention for the Protection of Literary and Artistic Works and the Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms.

[10]Under "Special 301" of the 1988 Omnibus Trade and Competitiveness Act (P.L. 100-418, 1988, 19 U.S.C. 2242), USTR performs an annual review to identify countries that do not provide adequate or effective protection for U.S. intellectual property rights. If a country is designated a "priority foreign country," USTR must decide within 30 days whether to initiate a Special 301 investigation into the country's IPR practices. Appendix III describes Section 301 and Special 301 laws and procedures more fully.

[11]The IMF's method for measuring China's gross domestic product is contained in an annex to the IMF's 1993 World Economic Outlook. Previous studies have compared each country's economic output by valuing its goods and services in a single currency, such as dollars, using market exchange rates. The method used in the IMF publication, known as "purchasing power parity," incorporates a valuation of nontraded output, such as housing and domestic transport.

Market Access

In October 1991, USTR self-initiated an investigation into Chinese market barriers under Section 301 of the U.S. Trade Act of 1974. These barriers included: failure to publish trade-related laws, regulations, judicial decisions, and administrative rulings; nontariff barriers such as import licensing requirements and quantitative restrictions; and restrictive product standards, testing, and certification requirements. After a year of negotiations, the United States and China resolved the Section 301 investigation by signing a bilateral MOU that commits China to eliminate certain market access barriers progressively over a 5-year period. The United States also made commitments to support China's achievement of contracting party status in GATT and to liberalize certain export controls.[12]

Intellectual Property Rights

In recent years, the need to strengthen protection for U.S. intellectual property rights worldwide gained greater prominence as an important international trade issue for the United States. The absence of strong intellectual property rights protection in foreign markets carries serious economic costs for U.S. industries. These costs include lost sales in third-country markets, diminished incentives and capital to fund new research and development, and distortions in trade flows. In the early 1980s, U.S businesses focused attention on the extent to which foreign infringement of U.S. intellectual property rights was weakening the competitiveness of their industries, which are recognized as world leaders in the development and export of intellectual property.[13]

In April 1991, USTR initiated a Special 301 investigation into China's intellectual property rights practices after it determined that China did not provide adequate or effective protection of U.S. intellectual property in China. The two countries resolved the investigation on January 17, 1992, when the United States and China signed an MOU that committed China to provide stronger protection for intellectual property rights.

Scope and Methodology

To review China's implementation of the provisions of the market access and intellectual property rights MOUs, we obtained information through interviews with U.S. government agencies, Chinese government ministries, and U.S. companies and business associations. Since USTR plays the lead

[12]In accordance with Section 306 of the 1974 Trade Act, USTR monitors the implementation of any measure or agreement that results from a Section 301 investigation. If a foreign government is not satisfactorily implementing an action or agreement, USTR may determine what further action should be taken.

[13]See Intellectual Property at a Crossroads: Global Piracy and International Competitiveness, Congressional Economic Leadership Institute (Washington, D.C.: 1990).

role in negotiating and monitoring the MOUs, USTR was our primary source of information from the U.S. government. We supplemented USTR's perspective with that of other agencies involved in U.S.-China trade activities, such as the Departments of Agriculture, Commerce, and State and the U.S. Customs Service. We obtained the Chinese government's perspective on implementation of the MOUs from Chinese government officials in Beijing during a March 1994 visit.

To obtain U.S. business views on China's implementation of the MOUs, we conducted structured interviews with representatives of 41 U.S. companies doing business in China. This enabled us to draw some general conclusions about these companies' perceptions of China's progress in eliminating market access barriers and strengthening protection for intellectual property protection. In addition, our structured interviews provided us with specific examples of how China's import regime and system for protecting intellectual property rights affect U.S. business activities. However, it should be noted that the comments of our 41 respondents are not necessarily representative of all U.S. companies doing business in China.

We performed our review from October 1993 to November 1994 in accordance with generally accepted government auditing standards. See appendix VI for more details on our objectives, scope, and methodology.

China Has Taken Steps to Implement Most Provisions of the Market Access Agreement, but Other Action Has Been Slow

USTR has determined that although China has not technically implemented all of the provisions of the MOU on market access, it has taken steps and made oral commitments that bring it substantially into compliance with the agreement. For example, in the area of transparency, China has begun to issue trade regulations and policies in a central document published monthly by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). Regarding nontariff barriers, China has liberalized some import quotas, licensing requirements, and controls according to the schedule set out in the agreement.

According to U.S. government officials, progress in implementing the agricultural standards provisions of the MOU has been slow. China continues to restrict imports of U.S. wheat and various fruits based on health and phytosanitary (animal and plant health) concerns. The U.S. government claims that Chinese phytosanitary standards are not scientifically justified and constitute an unfair trade barrier.

The U.S. government also made commitments in the market access MOU. USTR and Commerce Department officials said that the U.S. government has fully met its MOU commitments to (1) pursue the liberalization of export restrictions on products destined for China and (2) support China's efforts to join GATT/WTO.

Lack of transparency, high tariffs, and nontariff import barriers were the concerns most frequently mentioned by the U.S companies we interviewed about market access in China. A number of U.S. companies reported that while the government of China has taken steps to improve the transparency of its import regime, Chinese trade and investment laws are often unclear, inconsistent, or administered in an arbitrary manner. Some U.S. companies regarded Chinese tariff rates as prohibitively high for some products and complained that tariffs are not always administered uniformly from port to port. With respect to nontariff barriers, many of the companies we interviewed expressed particular concern about the import-licensing process, which they perceived as time-consuming and arbitrary.

U.S. government and business officials told us that several factors hinder China's full implementation of its commitments under the market access MOU. Declining central government control over provincial and local governments may limit implementation of the provisions of the agreement, according to these officials. In addition, the Chinese government's vested interests in state-owned enterprises can lead to arbitrary implementation of trade laws and regulations, putting U.S. companies at a disadvantage in some cases. For example, according to USTR, an industrial ministry overseeing a state-owned enterprise may apply trade rules in a way that benefits Chinese suppliers allied with that industry, rather than U.S. or other foreign companies. Further, China still lacks a convertible currency (one that is traded on international exchanges), still regulates prices, and still maintains state ownership in industry—factors that tend to work against the liberalization of China's import regime, according to a Commerce Department official.

The U.S. government is attempting to resolve the remaining concerns about Chinese market access barriers through ongoing trade promotion activities, bilateral negotiations, and through its participation in international negotiations on China's application to join GATT/WTO. In doing so, the U.S. government has the opportunity to encourage China to adopt policies that are compatible with free market economies and internationally accepted trading practices. The United States, China, and

other contracting parties must resolve a number of issues in order to agree upon a protocol for China's accession to GATT/WTO.

China Has Strengthened Intellectual Property Laws and Regulations, but Its Enforcement Structure Remains Weak

Overall, USTR has determined that China has met its obligations in implementing major provisions of the 1992 MOU, that is, adopting new and revising some existing Chinese IPR laws and regulations and joining international treaties. The Chinese government has amended its patent law, providing patent protection for pharmaceutical and agricultural chemical products and granting administrative protection for approved pharmaceutical and agrichemical products. China has acceded to the Berne Copyright Convention and the Geneva Phonograms Conventions and has issued regulations for implementing international copyright treaties.

While China has established most of the laws and regulations for obtaining intellectual property rights protection, an effective system for enforcing these rights is still in its early stages of development. Some U.S. industries, especially those dependent on copyrights, have reported serious and unabating infringement problems in China. In fact, in February 1994, the International Intellectual Property Alliance (IIPA), the trade association that represents the copyright industries, recommended that China be identified as a priority foreign country in USTR's annual Special 301 review. The U.S. government is urging the government of China to continue developing an effective administrative and judicial system for resolving cases of IPR infringement and deterring further infringement. It has recommended, for example, establishing criminal penalties for copyright infringement, providing for border enforcement, and committing greater resources for enforcement activities.

In the past, the U.S. government has pursued several options in its efforts to encourage improvement in China's protection of intellectual property rights, such as (1) maintaining bilateral discussions; (2) utilizing U.S. trade law, such as Special 301; and (3) enlisting multilateral organizations, including the World Intellectual Property Organization (WIPO) and GATT, to assist in education and training. For example, in pursuing bilateral engagement, U.S. government and industry representatives have suggested that the United States could play an important role in assisting China's implementation of enforcement through IPR training and education programs. Such active involvement could give U.S. industry a prominent role in influencing China's development of an enforcement regime.

Agency Comments

We discussed applicable sections of this report with responsible program officials from the Office of the U.S. Trade Representative and the Departments of Agriculture, Commerce, and State during August-October, 1994. These officials suggested some technical changes and/or factual updates, which we made where appropriate, but generally agreed with the information presented. We also gave the embassy of China in Washington, D.C., an opportunity to comment on a summary of our results, but we did not receive any response from Chinese government officials.

U.S. Trade Representative officials reviewing the report included the Director for Chinese and Mongolian Affairs, the Director for GATT Affairs, and the Assistant General Counsel. Reviewers in the Department of Agriculture included the Director, Multilateral Trade Policy; and the Director, Office of Asia, Africa and Eastern Europe. We discussed sections of the report with Commerce Department officials representing the Office of China and Hong Kong, International Trade Administration; the Office of the Assistant Secretary for Export Administration; and the Office of Multilateral Affairs. In addition, the State Department's Deputy Director for Chinese and Mongolian Affairs reviewed and commented on sections of the report.

As you requested, we plan no further distribution of this report until 10 days after its issue date. At that time, we will send copies to the Secretaries of State, Commerce, and Agriculture and to the U.S. Trade Representative. We will also make copies available to other interested parties upon request.

If you have any questions concerning this report, please call me at (202) 512-4812. The major contributors to this report are listed in appendix VII.

Sincerely yours,

Allan I. Mendelowitz, Managing Director
International Trade, Finance, and
Competitiveness

Contents

Abbreviations

AIC	Administration for Industry and Commerce
BSA	Business Software Alliance
CD	Compact disk
COCOM	Coordinating Committee on Multilateral Export Controls
EU	European Union
Eximbank	U.S. Export-Import Bank
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GLX	general licensing procedure
IPR	Intellectual property rights
IIPA	International Intellectual Property Alliance
IMF	International Monetary Fund
JCCT	Joint Commission on Commerce and Trade
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
MOU	Memorandum of understanding
MTOPS	million theoretical operations per second
NCAC	National Copyright Administration of China
NTE	National Trade Estimate
PRC	People's Republic of China
ROM	Record only memory
SAIC	State Administration for Industry and Commerce
SETC	State Economic and Trade Commission
TCK	Tellitia Controversia Kuhn
TRIPs	Trade-Related Aspects of Intellectual Property Rights
U.N.	United Nations
US&FCS	U.S. and Foreign Commercial Service
USDA	U.S. Department of Agriculture
U.S. PTO	U.S. Patent and Trademark Office
USTR	Office of the U.S. Trade Representative
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

Implementation of 1992 U.S.-China Memorandum of Understanding on Market Access

In January 1994, the U.S. Trade Representative (USTR) determined that China was "substantially in compliance" with the market access MOU. The U.S. government recognized that the Chinese have made progress in the areas of transparency and liberalization of nontariff barriers. However, USTR and USDA found that China's compliance with the MOU was lagging in terms of ensuring that sanitary and phytosanitary standards and testing requirements were not used as import barriers. This finding contrasts with the position of Chinese government officials we met with in March 1994, who told us that China had faithfully implemented all of its commitments under the market access MOU.

Although China was determined to be "substantially in compliance" with the specific provisions of the MOU, there seems to be some difference in perception among U.S. government and private sector observers about the extent to which market access in China is actually improving. State Department and Commerce Department officials commented that the lack of transparency of China's trade laws and regulations continues to be a major problem—a perception mirrored by our interviews with 33 U.S.-based companies doing business in China. Moreover, State and Commerce Department officials expressed concern about the possibility that the Chinese government may find other ways to restrict imports that are not addressed in the market access MOU. For example, they said the central government continues to restrict imports by (1) limiting access to the foreign exchange that is necessary for the purchase of foreign goods and services; and (2) devaluing its currency, which generally has the effect of discouraging imports by raising their prices to consumers.

U.S. government and business officials told us that several factors may inhibit the implementation of the market access MOU. These include the declining Chinese central government control over provincial and local governments, the interests of Chinese government ministries in protecting their respective industries from foreign competition, and the corruption and black market activities that exist in China.

Background

When President Clinton came into office in 1993, one of his five major trade policy priorities was to "resolutely enforce existing trade agreements and U.S. trade laws to open more export markets." He cited the Pacific Rim as a key region in which to encourage increased trading opportunities. According to USTR, China and Japan are the two major Pacific Rim countries presenting the greatest opportunities but also the greatest challenges for U.S. trade relations.

With real gross domestic product (GDP) growth of almost 13 percent in 1992 and in 1993, China has been the fastest-growing major economy in the world. Based on 1993 estimates by the International Monetary Fund (IMF), China is also the world's third largest economy, after the United States and Japan. Concurrently, the loosening of government controls over foreign trade, investment, credit, and prices has contributed to the significant expansion of China's international trade—from $165 billion in 1992 to $196 billion in 1993.

The dramatic growth and reform of the Chinese economy have created increased potential for U.S. companies interested in exporting to or investing in China. In some Chinese industry sectors, estimated market growth far surpasses real GDP growth. For example, the Department of Commerce's U.S. and Foreign Commercial Service (US&FCS) predicted that there would be 20-percent growth in China's market for aircraft and aircraft parts and 42-percent market growth for computers and computer peripherals between 1993 and 1995. US&FCS also expects significant expansion of the Chinese market for U.S. telecommunications equipment, electric power systems, and industrial chemicals, among other things. Table I.1 summarizes selected market indicators for 10 sectors identified by US&FCS as the best prospects for U.S. exports to China.

Table I.1: US&FCS Assessment of 10 Best Prospects for U.S. Exports to China

Industry Sector	Estimated total market size 1995 (millions)	Estimated annual market growth rate 1993-95 (percent)	Estimated annual growth of imports from U.S. 1993-95 (percent)	China's estimated receptivity to U.S. products in this sector[a]
Aircraft & parts	$ 5,993	20	20	5
Electric power systems	73,136[b]	10	29	4
Computers & peripherals	1,763	42	50	5
Telecommunications equipment	7,500	20	20	4
Automotive parts & service equipment	11,080	15	5	4
Agricultural chemicals	8,670	5	–15[c]	3
Industrial chemicals	16,117	10	12	4
Plastic materials & resins	5,700	10	–12	4
Chemical production machinery	3,783	10	10	4
Building products	12,541	8	6	5

[a]US&FCS rated China's receptivity to U.S. products in these sectors on a scale of 1 to 5, with 5 as the highest rating.

[b]This number is deceptively large. Imports are possible only for that portion of the market that is denominated in foreign exchange—about $6 to 8 billion per year.

[c]US&FCS attributed decreasing U.S. sales in this sector to sales of pirated versions of U.S. agricultural chemicals in China.

Sources: U.S. Department of Commerce, 1994 Country Marketing Plan and China Commercial Guide: 1994-95.

Despite the expanding needs and market potential of China's economy, Chinese market access barriers have restricted U.S. sales in many sectors, contributing to the growing U.S. trade deficit with China, according to USTR reports. (The U.S. trade deficit with China reached an historical high of $22.8 billion in 1993.) In 1991, USTR initiated an investigation under Section 301 of the U.S. Trade Act to determine whether specific market access barriers in China are unreasonable or discriminatory and restrict U.S. commerce. The investigation included Chinese government practices, such as inaccessible or unpublished Chinese trade laws and regulations; nontariff barriers such as quantitative restrictions on imports; and restrictive standards, testing, and certification requirements. In October 1992, the United States concluded the investigation into these Chinese practices by negotiating a bilateral MOU on market access with the government of China.

Both Chinese and U.S. government officials have acknowledged that the evolution of China's economy to a truly open market will be long-term and gradual. One US&FCS official noted that until China has a convertible currency, a high degree of enterprise autonomy, and has removed price controls, it will be impossible to fully eliminate state control of imports. This official explained that with tight control over currency exchange and prices of goods, as well as procurement by state enterprises, the Chinese government can continue to regulate imports of foreign goods and services, even if it liberalizes most other aspects of its trade regime.

U.S. and Chinese Commitments Under the MOU

Under the provisions of the October 1992 U.S.-China MOU on market access, the government of China agreed to (1) increase the transparency of its trade regime by openly publishing all trade-related laws, regulations, and decrees and ending the use of restricted internal trade directives, among other things; (2) remove a significant number of nontariff barriers, including quantitative restrictions, import-licensing requirements, and import controls;[1] (3) eliminate standards and testing requirements as barriers to trade, especially for agricultural products; (4) eliminate import substitution policies and measures; and (5) significantly reduce selected tariffs.

For its part, the U.S. government agreed to (1) pursue liberalization of Coordinating Committee on Multilateral Export Controls (COCOM)[2] export control lists and procedures, including restrictions on exports of computers and telecommunications equipment, providing these measures are consistent with the national security interests of the United States; and (2) staunchly support China's achievement of contracting party status to the General Agreement on Tariffs and Trade (GATT) and work with the Chinese government and other GATT contracting parties to reach an acceptable protocol of accession.

[1]According to USTR, quantitative restrictions, also referred to as quotas, are numerical limits on imports for specified products; import-licensing requirements are rules or regulations requiring the buyer in China, whether a domestic or foreign entity, to obtain an official license or approval from the appropriate Chinese trade and/or industry sector ministry in order to import certain products; and import controls are quantitative restrictions on products designated in China's State Plan, affecting various sectors. An annex to the MOU provides a listing of specific products, by Harmonized Tariff System number, and the year-end dates by which the Chinese government has agreed to liberalize associated quantitative restrictions, import licenses, and/or controls. (The Harmonized Tariff System was established in 1985 to provide a uniform system of product classification accepted by all major trading countries.)

[2]COCOM was established in 1949 to protect the strategic technology advantage of its 17 members. The organization was officially terminated in 1994 and has not yet been replaced by a new organization to coordinate the export of strategic goods.

The Chinese Government Has Complied Overall With the Transparency Provisions of the MOU, but Implementation at the Provincial and Local Levels Is Lagging

USTR believes that China's commitments on transparency are acceptable and do meet the requirements of the MOU, but implementation needs to be monitored closely. The government of China did not meet all the MOU requirements by the original October 10, 1993, deadline, but by December 31, 1993, Chinese officials had made enough progress to satisfy USTR's concerns. However, the American Chamber of Commerce in Beijing[3] told us in February 1994 that a lack of transparency remained a widespread concern among U.S. companies doing business in China.

Positive Steps Taken to Improve Transparency

In the area of transparency, China has begun to publish trade regulations and policies, as agreed in the MOU. Of primary importance was the issuance of Chinese State Council Circular 63 on September 23, 1993, providing that only those Chinese trade-related laws, rules, and regulations that have been published may be enforced. This action was taken to ensure that one uniform trade policy, conforming to international standards, would be enforced across China.

In October 1993, China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC) established a daily publication to serve as a central repository for trade-related laws, regulations, and other announcements. As of January 1994, MOFTEC had published 93 previously confidential trade documents in this journal and rescinded 391 other confidential trade documents. MOFTEC also published a number of trade-related documents in other publications in Beijing and in the provinces, including two volumes of trade and investment regulations.

In complying with the MOU, the government of China has taken additional steps, such as (1) publishing lists of products subject to import licenses, quotas, and import controls by Harmonized System tariff category for 1993;[4] (2) publishing in the journal China Tendering a list of major central government projects and selected projects at the provincial level planned through the year 2000; and (3) ordering Chinese provinces to bring their trade rules and regulations in line with those of the central government.

[3]The American Chamber of Commerce in Beijing has a membership of approximately 350 U.S. companies with operations in China.

[4]According to USTR, these lists do not include adequate information on the quantity or value of specific products affected by these controls.

Although a number of the MOU provisions remain to be addressed, Chinese officials made commitments in December 1993 negotiations with USTR to, among other things, (1) provide to the United States all "internal" trade-related documents that continue to be in effect and that have been issued by central government ministries other than MOFTEC; (2) undertake investigations in 1994 to determine whether local governments have implemented trade regulations that have not been published or issued trade-related investment measures that are not in compliance with central government policies; and (3) make public all trade documents and provide to the United States a list of all previously published trade-related documents.

Areas Where Progress on Transparency Has Been Slow

Although China has recently taken steps to improve transparency, China's trade regime is still far from transparent, according to 1994 statements from the Commerce Department and the American Chamber of Commerce in Beijing. U.S. government and private sector observers we spoke to seemed to agree that the biggest challenge will be getting implementation and enforcement at the provincial and local levels. In response to these concerns, China's central government has committed to completing investigations to ascertain the level of transparency in key commercial provinces. Any internal and unpublished trade documents are to be made public and available to foreign governments and traders.

In addition, we were told the government of China has not yet ensured that its trade rules are applied in a uniform manner. Arbitrary application of trade rules, particularly by the Chinese Customs Service, is widespread and a serious impediment to market access in China, according to USTR. Further, USTR officials said that MOFTEC and other ministries responsible for trade in specific industries do not adequately coordinate their policies and decisions, which adds to the confusion U.S. companies face when doing business in China. In our March 1994 interview, State Economic and Trade Commission (SETC) officials told us that the government of China is committed to implementing import policies consistently across all levels of government (central, provincial, and local).

Insufficient commercial information on major projects remains a major concern for the U.S. Commerce Department. With the exception of World Bank and Asian Development Bank-financed projects, Commerce officials said that Chinese bid solicitation and contract award processes are generally not made public. Although the government of China gave the U.S. government a listing of projects to be completed between now and

the year 2000, detailed information regarding planning status, project funding, projected tender date, and key government contacts was not included. According to the Commerce Department, such information is often revealed to countries offering more extensive tied aid options than the United States provides.[5] Such discriminatory treatment may put U.S. companies at a disadvantage when competing with other foreign companies for project contracts.

China Has Complied With Most of Its Commitments to Liberalize Nontariff Barriers, but Several Key Issues Are Unresolved

In the MOU, China pledged to reform its import regime by reducing nontariff barriers to imports. These nontariff barriers include quantitative restrictions, import-licensing requirements, and import controls for the product categories listed in the annex to the MOU. In the MOU, China pledged to dismantle almost 90 percent of its nontariff barriers between 1992 and 1997. Officials of China's State Economic and Trade Commission (SETC) told us that the government's goal to abandon the centrally planned economy and move to a socialist market economy was the motivating force behind its commitment to reduce nontariff barriers.[6] According to USTR, China has complied with its MOU commitments to reduce import-licensing requirements, quantitative restrictions, and controls.

Positive Steps Taken to Eliminate Nontariff Barriers

China has made good progress in reducing nontariff barriers to trade since signing the market access MOU, according to USTR. For example, USTR data show that the Chinese government reduced the total number of quantitative restrictions from about 3,000 in 1992 to about 400 in 1994.

In late 1992, the government of China took some important initial steps toward eliminating nontariff barriers. By December 31, 1992, China had eliminated import restrictions, quantitative restrictions, licensing requirements, and controls on goods such as instant print film, instant cameras, and certain telecommunications equipment, according to the schedule in the annex to the agreement. In addition, China's elimination of

[5]"Tied aid" refers to foreign assistance that is linked to the purchase of exports from the country extending the assistance. Until recently, the U.S. government generally discouraged the use of tied aid for major capital projects, due to concerns about the possible distortion of funds allocation in developing countries. However, in February 1994, the U.S. Export-Import Bank (Eximbank) released a draft of its new tied aid policies and procedures, signaling a more proactive approach to tied aid. As part of this effort, the Eximbank is administering a new tied aid capital projects fund.

[6]SETC was formed in 1993 by the State Council. SETC's mandate includes management of the day-to-day operation of the economy, reform of state enterprises, and coordination of foreign trade policies.

restrictions on its digital-switching systems market[7] allowed two U.S. suppliers to sign agreements for major telecommunications projects. Since that time, one U.S. telecommunications company reported that it had sold about $500 million in digital-switching systems equipment to China. Further, China removed import-licensing and quota restrictions on certain chemical products in 1992, according to officials of China's Ministry of Chemical Industry and USTR.

In 1993, China took additional steps to implement the MOU. For example, China eliminated import restrictions for 16 high-priority U.S. export categories, including 258 items, such as food products, metals, construction materials, and aircraft. China also eliminated most restrictions on 171 machinery and electronics products (subject to new procurement rules) and lifted ahead of schedule restrictions on integrated circuits and some chemical products. Later in the year, China significantly liberalized quantitative restrictions on products listed in an annex to the MOU, including heavy machinery, some auto parts, computers, and medical equipment. For example, China reduced quantitative restrictions on electronics and heavy machinery products by over 40 percent, according to a USTR official. In addition, China eliminated internal quotas on imports of distilled spirits.

Regarding China's import-licensing and approval system, China has both reduced licensing requirements[8] and increased the transparency of the system. In the MOU, China agreed to eliminate 75 percent of its import-licensing requirements over a 2-year period, according to a USTR report. In keeping with this agreement, China lifted the first set of import-licensing requirements in December 1993. USTR expects this liberalization to greatly benefit U.S. exporters of agricultural products, iron and steel products, commercial aircraft, and electrical machinery.

Further, the Chinese government published a document outlining a simplified import-licensing and approval process. According to USTR reports, obtaining permission to import products now subject to quotas or quantitative restrictions appears to be considerably simpler and more transparent than in the past.

[7]China's State Council Document 56, issued in 1989, restricted the digital-switching systems market in China to three foreign suppliers.

[8]Before implementation of the MOU, China's import-licensing system affected approximately 50 percent of the value of China's imports, including 53 major product categories of consumer goods, raw materials, and production equipment.

Areas Where Progress on Liberalizing Nontariff Barriers Has Been Slow

The U.S. and Chinese governments are still working to resolve some issues relating to nontariff barriers, such as investigating U.S. industry complaints about quotas and other import restrictions that are either new or have been recently discovered. Although China has pledged to remove import controls from numerous items, some of these items have been placed on newly created lists as part of China's efforts to restructure its system for controlling imports of electronic and machinery products, according to a Commerce Department report. Under this new system, certain items previously subject to import controls would now be subject to quantitative restrictions or new procurement regulations and approvals. For example, SETC officials told us that 18 categories of goods, such as autos, computers, and audiovisual equipment, would be subject to new controls.

In addition, China maintains a significant number of hidden quotas and nontransparent regulations that effectively keep U.S. intellectual property products out of the market, according to USTR. These include quotas on the import of foreign films and sound recordings. The International Intellectual Property Alliance (IIPA) reported in July 1994 that China maintains an informal, nontransparent quota on foreign recordings of approximately 120 foreign record releases per year, which would limit the number of U.S. musical compositions that could enter China. The effect of these quotas is compounded by an apparent ban on foreign ownership in a joint venture or enterprise designed to produce and distribute recorded music. IIPA has requested that the U.S. government negotiate with the government of China to reduce Chinese quotas and investment restrictions in the sound recording industry as well as in other industries, such as motion pictures, book publishing, and computer software.

China Continues to Restrict Imports of U.S. Products on the Basis of Standards and Certification Requirements the U.S. Government Deems Unjustifiable

Under the standards provisions of the market access MOU, China agreed that (1) all sanitary and phytosanitary (animal and plant health) standards and testing requirements must be based on sound science and administered in a manner that does not impede or create barriers to imported products; and (2) the U.S. and Chinese governments will apply uniformly across their respective countries the same testing and certification standards to imported and domestic nonagricultural products.

Despite these commitments, U.S. government officials reported in August 1994 that China has continued to use standards and certification requirements as barriers to trade. According to U.S. Department of

Agriculture (USDA) and USTR officials, China has yet to comply with many of the agricultural standards provisions of the market access MOU. Despite high-level efforts, China has continued to refuse to use internationally recognized pest risk analysis techniques in the application of its sanitary and phytosanitary regulations, according to USDA. For example, China continues to apply sanitary and phytosanitary standards to U.S. wheat, apples, tobacco, grapes, and other fruits, as well as some livestock genetics, based on health and phytosanitary concerns that the U.S. government claims are not scientifically justified.

Positive Steps Taken to Implement Standards Provisions

According to USDA officials, China has taken some steps toward basing its agricultural standards assessments on sound science. To date, the government of China has (1) signed protocols to eliminate scientifically unjustifiable sanitary standards for imports of pigs, dogs, and bovine semen; (2) allowed a trial shipment of wheat from the Pacific Northwest to Hainan Island, China's southernmost province, in December 1993; and (3) decided to allow imports of two varieties of Washington State apples from selected orchards and packing houses to the Chinese mainland in June 1994.

Areas Where Progress on Standards Has Been Slow

Despite some positive actions, Chinese progress in complying with the agricultural standards provisions of the MOU has lagged behind its efforts in other areas, and significant standards-related barriers to U.S. imports remain, according to U.S. government officials. For example, the Chinese government continues to ban U.S. exports of Pacific Northwest wheat to mainland China, claiming that it has concerns about Tellitia Controversa Kuhn (TCK) smut—a type of fungus—infestation. USDA officials told us that these concerns are not scientifically supported. They also pointed out that although China is now accepting Pacific Northwest wheat shipments into Hainan Island, the lack of milling facilities and the inadequate transportation infrastructure between Hainan Island and the mainland will preclude any near-term significant increase in U.S. wheat exports to China.

In addition, the government of China still bans U.S. exports of grapes, apples, and other fruit from the state of California due to concerns about medfly infestation. USDA officials told us that China is the only country in the world that (1) restricts importation of U.S. fruit based on medfly concerns and (2) cites TCK smut as a reason to restrict wheat imports. Further, the United States has not yet obtained commitments from China on liberalizing restrictions on imports of stone fruit (plums, peaches, and

nectarines), grapes, leaf tobacco, and some animal genetic products. According to USDA, the U.S. government will continue to pursue progress in China's compliance with the agricultural standards provisions of the market access MOU in the context of negotiations on China's accession to GATT/WTO.

Regarding nonagricultural standards, USTR reported that Chinese testing and certification requirements add significant cost and uncertainty to the transactions of U.S. exporters. Since China generally does not accept U.S. certification of product quality, U.S. companies must go through a time-consuming and expensive process to obtain a Chinese quality license. For example, U.S. companies exporting automobiles to China must provide two free samples of their product, pay $40,000 in testing fees, and finance the inspection of their factories in the United States by Chinese officials. The standards and specifications against which foreign products are evaluated are often unavailable to the exporter. Further, the government of China often imposes higher standards and testing requirements for foreign products than for domestically produced goods. According to USTR, these factors combine to protect Chinese manufacturers and exclude foreign products considered unnecessary for China's development.

The Government of China Claims That It Has Eliminated Its Import Substitution Policy

Before the market access MOU, China had a longstanding import substitution policy, allowing Chinese government agencies to deny permission to import a foreign product if a domestic alternative existed. The government of China claims that it has rescinded its import substitution policy, as promised in the MOU. USTR officials told us in a September 1994 interview that they believe China no longer practices import substitution. In March 1994 interviews with Chinese SETC officials, we were told that the Chinese government has eliminated its import substitution list of 1,700 products.

A related issue involves China's local content requirements[9] and technology transfer policies, which are similarly designed to protect and promote the development of Chinese domestic industries. According to State Department and USTR officials, the Chinese government is putting pressure on U.S companies in joint ventures to increase local content in their products within specific time periods. U.S. companies have reported to USTR that local content requirements are commonplace and

[9]Local content requirements oblige an investor to purchase or use a specific amount of inputs from local suppliers.

nontransparent, despite China's MOU commitment not to condition issuance of import licenses upon such things as transfer of technology, investment in China, or provincial and municipal local content requirements. For example, U.S. automobile and electronics manufacturers operating in China have had to increase their use of Chinese parts and supplies in order to meet local content requirements. In some cases, they have had difficulty locating Chinese components up to their quality standards, thus lowering the quality of the final product.

China Has Reduced Tariffs as Required by the MOU, but Overall Tariff Rates Remain High

Positive Steps Taken

According to USTR and Chinese government officials, China has met its MOU commitment to significantly reduce tariffs that were raised in 1988 for product categories, such as edible fruits and nuts, selected chemical products, machinery and mechanical appliances, and photographic or cinematographic goods. To this end, the government of China reduced tariffs on over 200 items by an overall average of 50 percent.

In addition to fulfilling its commitments under the market access MOU, China has indicated an interest in gradually bringing its tariff system into conformity with international standards. In early 1992, the government of China reduced import tariffs on 225 products from an average rate of 45 percent to 30 percent and abolished its import regulatory tax, which applied a 20- to 80-percent surcharge on 18 categories of goods. At the end of 1992, China lowered tariffs by an average of 7 percent on 3,371 items, according to Chinese government officials and USTR reports. For example, China lowered tariffs on instant print film and instant cameras from the rate of 80 percent ad valorem to 5 percent, on chocolate and sugar confectioneries from 70 percent ad valorem to 15 percent, and on apples from 40 percent ad valorem to 15 percent. At the end of 1993, China reduced tariffs on an additional 2,818 items by an overall average of 9 percent.

The U.S. Government Is Encouraging Further Tariff Reductions

Although China has fully complied with the tariff reduction commitments in the market access MOU, overall Chinese tariff rates are still prohibitively high, according to USTR statements. A 1994 World Bank study[10] found that in 1992, before China had fully implemented its MOU commitments, China's unweighted average tariff rate was 43 percent, while its trade-weighted average tariff rate was 32 percent.[11] At that time, China's average trade-weighted tariff rate was equal to Brazil's and was the third highest among large developing countries after India and Pakistan, according to the World Bank study.[12] The World Bank found that China's average unweighted tariff rates were typical of most large developing countries in that they were relatively higher for manufactured consumer goods than for agriculture, mining, or capital goods.

U.S. government officials reported other concerns associated with Chinese tariffs that may adversely affect U.S. companies doing business in China. For example, Chinese tariff rates may vary for the same product, depending on whether the product is eligible for an exemption. If an item is incorporated into China's state or sectoral plans, such as certain advanced technologies, the Chinese government may apply a tariff that is significantly lower than published rates. U.S. companies have also complained to USTR about the lack of uniformity in duty rates at different Chinese ports, where local officials may negotiate special rates with Chinese customs officers. Moreover, Commerce Department officials in China pointed out that although tariffs have been lowered on many products, the combined effect of China's recently devalued currency and the new value-added tax has increased the tariffs and prices for these products overall.[13] As a result, U.S. exporters may still have to charge prices that are prohibitively high for Chinese consumers.

[10]China: Foreign Trade Reform, The World Bank (Washington, D.C.: Feb. 1994).

[11]A "weighted" average tariff rate factors in the value of trade at world prices in each product category, so that product categories in which imports are minimal receive relatively less weight than those with a higher level of imports.

[12]These developing countries included Argentina, Brazil, China, Colombia, Egypt, Hungary, India, Kenya, Pakistan, and the Philippines.

[13]As of January 1994, U.S. exports to China are subject to China's new value-added tax, which together with a new consumption tax, replaces the 1958 consolidated industrial and commercial tax. According to a Commerce Department report, the value-added tax rate for various products is higher, on average, than the former consolidated industrial and commercial tax, except for products referred to as luxury items.

U.S. Implementation of Its Commitments Under the Market Access MOU

USTR and Commerce Department officials said that the U.S. government has fully met its MOU commitments to (1) pursue the liberalization of export restrictions on products destined for China and (2) support China's efforts to join GATT/WTO.

Export Controls

The United States made three specific MOU commitments to liberalize export restrictions on products destined for China. These included (1) pursuing the liberalization of COCOM export controls, (2) considering liberalized treatment of computer exports for civilian end-use, and (3) significantly liberalizing controls on exports of telecommunications products.

Regarding the first commitment, the United States and other COCOM members agreed in November 1993 to terminate COCOM and to establish a new organization to coordinate the export of strategic goods. COCOM went out of existence on March 31, 1994. Since then, the United States and its COCOM allies agreed to work toward completing negotiations on establishing a new multilateral export control regime to succeed COCOM by late 1994.[14] However, as of December 1994, a new organization to replace COCOM had not yet been formed. In the interim period between the end of COCOM and the beginning of the new regime, former COCOM and COCOM-cooperating countries have committed to maintain the existing control lists of controlled goods and technologies until agreement is reached on lists for the new regime, and the new regime begins its operations. All licensing decisions are currently subject to national discretion.

Regarding the second and third MOU commitments on liberalizing export controls, the U.S. administration announced on April 4, 1994, a new general licensing procedure referred to as the "GLX." This procedure allows liberalized treatment for a broad range of controlled goods and technologies destined for civilian end-users in formerly proscribed destinations, including the former Soviet Republics, Eastern Europe, and China. For example, the GLX procedure allows U.S. companies and individuals to export computers with the capability of up to 1,000 million theoretical operations per second (MTOPS) and virtually all civilian

[14]Founding members of the new regime are expected to include the former COCOM members and those countries designated by COCOM as cooperating countries (Ireland, Austria, Sweden, Finland, Switzerland, and New Zealand). Russia has been invited to be a founding member of the new regime, provided it adopts the appropriate national policies required of members. Additional members will be admitted by consensus.

telecommunications products to these destinations. According to the Department of Commerce, the removal of certain individual validated license requests by the GLX procedure will eliminate 35 percent of the individual validated licenses previously required for proscribed destinations. Certain countries—such as Cuba, Libya, Iran, and Iraq—will continue to be subject to controls on exports of U.S. telecommunications and computer equipment. In addition, the United States will retain strict controls on items that could assist in the development of weapons of mass destruction or ballistic missiles.

China's Application to Join GATT/WTO

Since 1992, the U.S. and Chinese governments have met in both bilateral and multilateral contexts to discuss the conditions for China's accession to GATT or its successor, WTO, as a result of a completed Uruguay Round. Negotiators must resolve a number of critical issues before formulating a protocol of accession for China. Among these concerns are (1) the lack of transparency in China's trade laws and regulations, (2) the timetable for China's tariff reductions, and (3) the ability of China's central government to apply GATT 1994 obligations uniformly across regions and provinces. (These negotiations are discussed in greater detail in the final section of this appendix.)

U.S. Companies' Views on China's Progress in Implementing the Provisions of the Market Access MOU

The most frequent concern reported by the 33 U.S.-based companies who responded to our structured interview questions on market access issues was transparency, followed by tariffs and nontariff barriers. Fewer companies reported concerns or problems related to Chinese import substitution or product standards and testing policies.[15]

Transparency

Fifty-two percent of the 33 companies that responded to our structured interview questions about China's implementation of the provisions of the market access MOU told us that they have experienced problems related to the transparency of China's trade regulations, laws, and policies. However, six of our respondents said that transparency has been improving as China has increased its efforts to move to a market economy. Twenty-seven percent of the respondents said that transparency has not been a major

[15]The relative lack of concern about Chinese product standards among the 33 companies we interviewed may be attributed, in part, to the fact that only 1 of the companies we interviewed was an exporter of agricultural products.

problem for their companies. Among the latter, two companies said that their local staffs have been instrumental in obtaining and understanding Chinese trade policies.

A majority of the structured interview respondents who identified transparency as a problem reported that China's trade and investment laws are unclear and administered in a seemingly arbitrary manner. For example, a pharmaceutical company told us that Chinese enforcement of its requirements for product testing and registration seemed to vary from one case to the next, depending on the company involved. A computer company reported considerable difficulty in understanding and applying Chinese regulations regarding imports, foreign exchange, and employment of domestic labor. Other companies noted that many Chinese trade and investment regulations are still unpublished or difficult to interpret. Two companies commented that business transactions are based more on personal contacts or negotiation than on written policies. Companies we interviewed also pointed out variations in trade and investment policies among the Chinese government ministries.

Six companies reported that problems with transparency were accentuated at the provincial and local levels. For example, some companies perceived inconsistency in the application of Chinese trade policies between the central government and the provincial/local government levels. One company official noted that the national laws and regulations are generally published but that provincial and local ones are not. He added that increasingly powerful local bureaucrats who want to maximize their economic flexibility may be less apt to publish local trade regulations. Another company official observed that the farther away from Beijing one is, the greater the variability in the interpretation and implementation of laws and regulations.

Nontariff Barriers

Respondents to our market access questions reported mixed experiences with Chinese nontariff barriers. One-third of the 33 companies that responded to our questions on Chinese market access reported that they had experienced problems related to nontariff barriers on imports. At the same time, 10 companies said Chinese nontariff barriers posed no major problems for their business in China, while 2 said the situation seemed to be improving. The remainder said that the issue of nontariff barriers was either not applicable to their businesses or that their companies had too little experience in this area to comment.

Among the companies that reported problems related to nontariff barriers, import-licensing requirements were the most frequently mentioned concern. Since the buyers of products are often Chinese state-owned enterprises, the central government is able to exert a significant amount of control over the issuance of import licenses, according to some U.S. companies. License issuance can be based on factors ranging from foreign currency availability to protection of state or local industries to personal relationships between plant owners and government officials. In addition, the Chinese government may use the import-licensing process to promote other interests, such as technology transfer or increased local content. For example, one company believed that China was attempting to pressure U.S. joint venture companies into increasing technology transfer by requiring a certain minimum percentage of local content in order to obtain import licenses.

Standards

Only 12 percent of the companies we contacted told us that they had experienced problems related to Chinese product standards. For example, one company expressed concern that Chinese vehicle design standards are based on European, rather than U.S., standards. Another company noted that Chinese product standards sometimes differ from global standards. However, a larger number of companies pointed out that since U.S. technologies were still more advanced than Chinese technologies in their industries, Chinese product standards have not been an impediment.

Import Substitution

Twenty-seven percent of the U.S. companies we interviewed reported problems related to Chinese import substitution practices. One company official told us that he perceived an increase in the instances of import substitution for high-technology products, such as computer equipment.

Tariffs

After transparency, the high level of Chinese tariffs was the second most frequently mentioned concern among the respondents to our market access questions. In some cases, Chinese tariffs and, consequently, prices, are so high that U.S. products are affordable only to the wealthiest consumers in China. Several other companies reported that in addition to the imposition of unusually high tariffs, Chinese tariffs are not uniformly applied throughout China. For example, the tariff rate for one product may vary depending on (1) the supplier's personal contacts in Chinese ministries, (2) the port to which the product is shipped, or (3) the location of company operations in China. Other companies noted that the

establishment of the new Chinese value-added tax has reduced the benefits of China's recent tariff liberalization in certain product categories. One U.S. company official noted that her company feels pressure to establish operations in China because of high tariff rates.

Among those companies that told us that Chinese tariffs were not a major problem were companies that (1) have operations in China and/or (2) produce items that are not competing with the local Chinese industries.

Factors That May Impede China's Implementation of the Market Access MOU

U.S. government officials told us that declining central government control over provincial and local governments has inhibited the implementation of China's MOU commitments. Although provincial leaders have identified legal reform as a priority, progress in drafting new standardized regulations has been slow, according to one State Department official. Municipal and county bureaucracies interested in maintaining local autonomy may be resistant to implementing central government regulations. To help address this problem, China's MOFTEC is running seminars to educate and train the provincial and local governments on how to implement the MOU, according to a U.S. embassy official. In addition, the central government is attempting to reassert control over the provinces by developing new taxation policies to be applied throughout China.

Another obstacle to implementing the MOU arises from the fact that in many cases, the ministry that oversees the manufacturing of a particular product is also involved in the import approval process. Since these ministries have an interest in protecting state-owned domestic industries, they may administer import policies in such a way as to restrict imports. A Commerce Department official added that as certain ministries see their power eroding, they are more inclined to "drag their feet" on implementing market-opening initiatives.

Finally, corruption and black market activities, including smuggling and piracy, may impede the implementation of the MOU, according to State and Commerce Department officials. However, it is difficult to determine the extent to which these activities affect China's market-opening initiatives and level of imports.

U.S. Government Efforts to Promote Increased Market Access in China

The U.S. government has a variety of bilateral and multilateral tools with which to encourage China to increase access to its growing market. On the bilateral level, government/industry exchanges and training could help China to develop the legal and financial institutions necessary for participation in international markets, according to U.S. government officials. For example, the governments of the United States and China signed a framework arrangement in August 1994 under the U.S.-China Joint Commission on Commerce and Trade[16] (JCCT) to enhance bilateral cooperation in certain industry sectors.[17]

Proposed cooperative activities would generally take place within the JCCT Business Development Working Group and would initially include seven industry sectors, such as information technologies, energy, and transportation. (Other sectors may be included as mutually agreed). In addition, the JCCT arrangement proposes activities, such as (1) establishing technical exchange programs; (2) establishing information centers or other means to exchange industrial, commercial, scientific, and technological information; and (3) facilitating the organization of bilateral trade symposia, seminars, and expositions. For instance, under the Joint Statement on Cooperation in Commercial Law (one component of the broader arrangement) the United States and China agreed to explore ways to expand cooperation in the area of commercial law, such as organizing joint legal seminars, exchanging legal experts, and disseminating the laws of each country. In addition, the Commerce Department and China's MOFTEC signed a memorandum of understanding to develop proposals for a joint Commercial Strategy Center. The purpose of this center would be to facilitate mutual understanding of each country's commercial policies, business environment, and factors affecting economic growth and stability.

USDA also has technical assistance and export promotion programs that could help to increase China's receptivity to U.S. agricultural products. USDA officials told us that the U.S. government has tremendous technical expertise in food and drug safety testing that could be of assistance to China and at the same time improve market access for U.S. products. In

[16]JCCT, co-chaired by Commerce and China's MOFTEC, was established in 1983 to provide a forum for consideration of bilateral trade and investment issues and to serve as a vehicle for promoting commercial relations. The U.S. government suspended annual high-level JCCT meetings from June 1989 to December 1992 in response to the Chinese military crackdown in Tiananmen Square. Since late 1992, the U.S. and China have been formulating new JCCT initiatives.

[17]The majority of the activities proposed under the framework arrangement are in the early planning stages, and implementation is contingent upon obtaining funding from government or private sector sources.

addition, USDA's Office of International Cooperation and Development has a scholarly exchange program with China's Ministry of Science and Technology.

U.S. trade laws authorize USTR to negotiate with our trading partners, including China, to promote more open international markets. If the Chinese government failed to follow through on its market access MOU commitments, USTR would have authority under U.S. trade law to reinstate Section 301 investigation procedures, possibly resulting in the imposition of higher tariffs on selected Chinese imports.

To promote Chinese market access in the multilateral context, the U.S. government could continue to work with China and other GATT/WTO contracting parties to develop an acceptable protocol for China's accession. China's desire to join WTO as a founding member gives the Unites States the opportunity to encourage China to broaden its economic reform program and build a free market trading system based on GATT principles.

Status of Recent Negotiations on China's Application for GATT/WTO Membership

The commitments that the Chinese government accepted in the market access MOU were designed to bring China's trade regime closer to the international trade standards required by GATT. Thus, from the U.S. government's perspective, China's progress in implementing the market access MOU provisions serves as an important indicator of China's readiness to undertake GATT 1994 obligations. As of October 1994, the U.S. government, the Chinese government, and other GATT contracting parties were engaged in negotiations to develop a mutually acceptable protocol of accession to enable China to join GATT/WTO.

Background

The former Republic of China was an original member of GATT in 1948, but the nationalist government of Taiwan withdrew from GATT in 1950 after the Communist revolution in China. The People's Republic of China (PRC) secured GATT observer status in 1982 and applied for full GATT membership in 1986. The GATT Working Group on China met for the first time in 1987 to begin negotiating the terms under which China might eventually join GATT.

Negotiations stalled in the spring of 1989 as China curbed its economic and trade reforms but regained momentum in 1992 when the government resumed its reform efforts. In addition, the successful negotiation of the U.S.-China MOU on market access in October 1992 gave GATT contracting

parties renewed confidence in China's ability to meet GATT eligibility requirements.

Since 1992, the U.S. and Chinese governments have met in both bilateral and multilateral contexts to discuss the conditions for China's accession to GATT or its successor, WTO. The China GATT Working Party (including GATT members and Chinese negotiators) met in Geneva, Switzerland, in June and July 1994 to begin consideration of specific issues for China's terms of accession. U.S. and Chinese GATT delegations met bilaterally in September 1994 to discuss all aspects of the protocol package, including Chinese market access commitments for goods and services, commitments on internal supports and export subsidies for agriculture, and the terms of adherence to the GATT 1994 agreement. These technical-level bilateral meetings should contribute to progress in the negotiations.

GATT Working Group Negotiating Document

In June and July 1994, the Chairman of the GATT Working Party circulated a negotiating document based on contracting party contributions containing possible commitment terms for China's accession to GATT/WTO. This document was intended to create a negotiating framework for further discussion with China on commitments to be contained in the accession documents, including the protocol. At the end of July, China tabled a response negotiating document in the same format that, according to USTR, falls significantly short of the breadth and level of commitment anticipated by the contracting parties.[18] Further refinements are likely as a result of China's ongoing bilateral discussion with the United States and other WTO members, and the final shape of China's protocol will be greatly influenced by the government of China's willingness to adopt and enforce basic GATT 1994 provisions in its trade regime from the date of accession.

Issues to Be Resolved

According to USTR, as of October 1994, GATT/WTO members and Chinese negotiators must resolve a number of critical issues before formulating a protocol of accession for China. Among these concerns are

- the lack of transparency in China's trade laws and regulations;
- the timetable and level of China's tariff reductions;
- the elimination of nontariff measures not permitted under GATT 1994;

[18]USTR officials stressed that neither document constitutes a draft protocol, nor is it certain that the document finally negotiated with China as a protocol will contain all of the current elements.

- the phased elimination of industrial subsidies prohibited by the Uruguay Round Subsidies Agreement;
- the expansion of trading rights and elimination of designated trade in certain products by certain firms;
- the ability of China's central government to apply GATT 1994 obligations uniformly across regions and provinces;
- the extension of national treatment to imported goods and to foreign companies operating in China, particularly in the services industry;
- phasing out of state-fixed prices;
- China's ability to provide protection for intellectual property rights;
- the provisions of a "safeguards" clause to protect WTO members against sudden surges of Chinese exports;[19]
- nontariff measures on agricultural products; and
- foreign exchange issues.

U.S. Position Compared to Other Countries' Views

The U.S. government and other GATT 1994 contracting parties participating in the negotiation share many of the same concerns about China's willingness to undertake basic GATT 1994 obligations and its ability to apply them to its trade regime from the date of accession, according to USTR. To a greater or lesser extent, and depending on the issue, most current contracting parties are willing to discuss appropriate transition periods for implementation of specific aspects of GATT 1994 for China. None, however, are willing to automatically grant China all the exemptions from GATT 1994 provisions allowed for developing countries.

The U.S. government has held firm in its view that China's request for transition periods in some areas must be matched with appropriate commitments from China on the basic issues, e.g., specific schedules of elimination for Chinese trade policies that are inconsistent with GATT 1994 standards; establishment of a unified foreign exchange market; additional Chinese offers for increased market access for goods and services, including financial services; and commitments recognizing from the date of accession central GATT 1994 obligations in trading rights, market access, nondiscrimination, and national treatment.

Earlier in 1994, the Commission of the European Union (EU) appeared to support China's accession to GATT by the end of 1994 on the basis of less stringent commitments. More recent EU efforts have focussed on the need for greater market access commitments by China. Canada and Japan have

[19]A safeguard is a temporary import control or other trade restriction that a country imposes to prevent injury to domestic industry from increased imports. It is designed to facilitate the adjustment of domestic industries to the influx of fairly traded imports.

also tabled significant market access requests and have agreed that progress on completion of the protocol terms should not outstrip bilateral progress on market access commitments. Members of the Cairns Group of agricultural exporting countries have pressed for greater market access and transparency in the area of state-traded agricultural products. Finally, the EU places great emphasis on the inclusion of a special safeguard mechanism in the accession provisions to address excessive imports from China during the transitional period.

The U.S. government has also expressed concerns about the extent to which China's economy remains under state ownership,[20] which, in effect, confers control and direction; China's refusal to agree to publish quotas on state-traded agricultural products; and China's demand that it automatically be entitled to take advantage of the exemptions from standards GATT 1994 confers on developing countries. Further, U.S. negotiators have raised questions about the consistency between GATT 1994 policies and (1) the provisions of China's new Foreign Trade Law and (2) the measures employed in the State Industrial Programs to develop certain industries. To date, China has declined to make any commitment to GATT 1994 consistency in these areas that would address U.S. concerns.

China's Position

In response to concerns raised by the United States and other GATT/WTO members, the government of China said that it is taking steps to improve the transparency of its trade regime and liberalize nontariff barriers as agreed in the 1992 U.S.-China market access MOU. However, Chinese government officials maintain that as a developing country, China should be allowed to take a gradual approach toward trade reform in order to protect its economy. In addition, Chinese government officials contend that many state-owned enterprises are now operating according to market principles.

[20]According to a Congressional Research Service official, 90 percent of Chinese industry is owned by either central, provincial, or local government entities.

Implementation of 1992 U.S.-China MOU on the Protection of Intellectual Property

In recent years, numerous U.S. industries have been drawn to the rapid growth and development of the Chinese economy and the huge potential market it represents. However, without the presence of an effective system for the protection of intellectual property rights (IPR) in China, major U.S. industries also face the threat of significant trade losses, according to USTR. U.S. copyright industries, those involved in the production and sales of sound recordings, motion pictures, computer software, and books, have estimated losses of $827 million in 1993 due to the infringement of their copyrights in China. Other U.S. industries, especially those in high-technology areas that depend on patent protection, have been concerned about exporting or expanding business operations in China without strong assurance that their intellectual property will be protected and their rights enforced. In addition, U.S. companies have become increasingly concerned that their products, manufactured illegally in China, are being exported and sold in third-country markets.

The evolution of China's legal framework to protect intellectual property is a fairly recent development. In 1980, China joined the United Nations' (U.N.) World Intellectual Property Organization (WIPO); and in the following decade, China adopted and enacted several laws protecting the major forms of intellectual property (patents, copyrights, and trademarks). The Chinese laws and regulations protecting intellectual property and their effective dates are as follows:

- the Chinese Trademark Law, effective on March 1, 1983;
- the Chinese Patent Law, effective on April 1, 1985; and
- the Chinese Copyright Law, effective on June 1, 1991, and Regulations for the Protection of Computer Software effective in the same month.

For several years, the United States and China discussed ways to improve China's regime for intellectual property protection and strengthen protection for U.S. intellectual property in China; however, USTR determined in 1991 that China did not provide adequate or effective protection of U.S. intellectual property rights. On April 26, 1991, pursuant to the Special 301 provision[1] of the Trade Act of 1974, USTR identified

[1]Pursuant to section 182 of the Trade Act of 1974, 19 U.S.C. 2242, USTR must annually identify those countries that deny adequate and effective protection for intellectual property rights or deny fair and equitable market access for persons that rely on intellectual property protection.

China as a "priority foreign country";[2] on May 26, 1991, USTR initiated an investigation into China's intellectual property rights practices. Under Special 301, the U.S. government could impose trade sanctions on China if the investigation resulted in negative findings and the two governments were not able to reach an agreement successfully resolving their issues.

U.S. and Chinese Commitments Under the MOU

On January 17, 1992, the governments of the United States and China signed an MOU that resolved USTR's 1991 investigation into China's protection of intellectual property rights. Under the major provisions of this agreement, the government of China agreed to

- revise its patent law, including providing protection for chemical products and processes and extending patent protection from 15 years to 20 years from the filing date;
- provide administrative protection[3] for U.S. pharmaceutical and agricultural chemical product inventions that meet specific conditions;
- accede to the Berne Convention and the Geneva Phonograms Convention and revise its copyright law and regulations in accordance with these conventions and the MOU;
- enact a law providing protection for trade secrets[4] before January 1, 1994;
- provide effective procedures and remedies to prevent or stop, internally and at the borders, infringement of intellectual property rights and to deter further infringement; and
- consult promptly at the request of the U.S. government on matters relating to the protection and enforcement of intellectual property rights.

The U.S. government agreed to

- provide effective procedures and remedies to prevent or stop, internally and at the borders, infringement of intellectual property rights and to deter further infringement;

[2]Countries that are identified as priority foreign countries are potentially subject to an investigation under Section 301 of the Trade Act of 1974 conducted on an accelerated time frame. In addition, USTR may identify a trading partner as a priority foreign country or remove such identification whenever warranted.

[3]Administrative protection, which is also referred to as "pipeline" protection, requires a country that provides product patent protection for pharmaceuticals and agrichemicals for the first time to grant patent or administrative patent-like protection for those inventions not previously considered to be patentable subject matter, provided that the inventions were not yet marketed in the country and the inventions are currently under patent in the United States. The term of such protection is usually the term remaining on the U.S. patent.

[4]Trade secrets are technical and/or business information, such as formulas, methods, or processes, that derive value from not being generally known to the public.

- consult promptly at the request of the Chinese government on matters relating to the protection and enforcement of intellectual property rights; and
- terminate its Special 301 investigation of China and revoke China's designation as a priority foreign country.

China Has Taken Steps to Strengthen Its IPR Laws, but Enforcement of Laws Is Considered Poor

According to officials at USTR and the Departments of Commerce and State, overall China has fulfilled its obligations in amending the laws and regulations and acceding to the international treaties agreed to in order to implement the 1992 MOU. Specifically, China has amended its patent law, issued copyright regulations, joined international copyright conventions, and enacted protection for trade secrets. In the area of enforcement, however, U.S. government officials report that China has made minimal progress in establishing the legal and administrative framework that would provide effective procedures and remedies to address IPR infringement and to deter further infringement.

U.S. business representatives, especially the copyright industries, also reported that widespread infringement of their works occurs, with inadequate channels for recourse. An official of the National Copyright Administration of China also told us that while China has been successful in strengthening its copyright and patent laws, the government still has work to do in terms of enforcing the laws for both Chinese and foreign copyright owners.

Revision of Chinese Patent Law

China amended its patent law and enacted implementing regulations, effective on January 1, 1993. Officials at USTR and the U.S. Patent and Trademark Office (U.S. PTO) officials told us that these revisions satisfied its obligations in the MOU, with the possible exception of the amended provision for compulsory licenses.[5] The revised Chinese law expanded a patent holder's rights to include the right to prevent others from using or selling a product from a patented process and from importing a product obtained from a patented process. The amendment made product patent protection available for all chemical inventions, including pharmaceuticals and agricultural chemicals, for which only process patents had previously been granted. A process patent protects an invention involving a process or method of making or using a product or for a new use of a known

[5]A compulsory license is an authorization by a government that permits someone, without the consent of the patent owner, to make, use, or sell a patented product or to use a patented process.

process or method. In addition, China extended the term of patent protection to 20 years from 15 years.

As provided for in the MOU, China also issued regulations for administrative protection for U.S. pharmaceuticals and agricultural chemicals. The MOU stipulated that pharmaceutical and agrichemical products must meet three requirements to be considered for administrative protection. Inventions that meet the requirements (1) must not have received exclusive protection in China before the 1993 amendment to the Chinese law; (2) must have obtained a U.S. patent between January 1, 1986, and January 1, 1993; and (3) must not have been marketed in China. The term of administrative protection agreed to was the remainder of the term of patent protection in the United States, not to exceed 7-1/2 years.

According to officials at USTR and U.S. PTO, the compulsory-licensing provisions may not fully comply with the MOU. For example, both USTR and U.S. PTO noted that uncertainty exists about how the Chinese government would interpret a provision for granting compulsory licenses where "the public interest" is at stake, or where "any extraordinary state of affairs" exists. An official of the Chinese Patent Office emphasized that a compulsory license has never been granted since the enactment of the Chinese Patent Law. A USTR official noted that the Chinese government attempted to follow the model for compulsory licensing used in the GATT 1994 negotiations on Trade-Related Aspects of Intellectual Property Rights, commonly referred to as "TRIPs"; however, he said that the Chinese may not have understood how to achieve compliance.

China's Implementation of the Copyright Provisions

In accordance with the MOU provisions related to copyrights, China acceded to the Berne Convention on October 15, 1992, and to the Geneva Phonograms Convention on April 30, 1993. China also issued regulations for the implementation of international copyright treaties, effective September 30, 1992. The implementing regulations govern protection for foreign works as provided for in the Berne Convention and the 1992 MOU and stipulate that international treaties and the MOU superseded these and other existing Chinese regulations.

Although it agreed to do so in the MOU, China has not completely amended its copyright law to make it fully consistent with the Berne Convention. China also has not agreed to a specific timetable by which it would comply with the convention. In addition, under the provisions of the MOU, China

agreed to provide retroactive protection for U.S. existing works by March 17, 1992, the date when bilateral copyright relations were established. However, on April 20, 1993, China's National Copyright Administration issued "Document Number 28," which stated that continued sale of foreign existing works was permissible until October 15, 1993. As it stands, the burden of proof lies with the copyright owner to prove when an illegal reproduction of the work was made, which is very difficult to do, according to USTR. It remains unclear how the United States and China would clarify and resolve this issue of retroactive protection for copyrights.

Protection of Trade Secrets

China passed an Unfair Competition Law, which became effective on December 1, 1993, that contained provisions for protection of trade secrets, as agreed to in the MOU. The provision stipulated that trade secrets should not be acquired from the rightful owner by improper means or used by or disclosed to others in violation of an agreement or nondisclosure requirement. However, according to an official at USTR, while China has fulfilled its commitment to enact legislation protecting trade secrets, some concerns about the law remain. For example, the law requires prior knowledge of an illegal act, stating that "acquisition, use or disclosure of trade secrets by a third party who clearly knew or should have known the illegal acts . . . shall be deemed as an infringement of trade secrets." The USTR official said he believed that these concerns could be addressed in the implementing regulations.

Enforcement Provision

The enforcement provision of the MOU is limited to one sentence. Both countries agreed to "provide effective procedures and remedies to prevent or stop, internally and at their borders, infringement of intellectual property rights and to deter further infringement." China did not specifically commit itself in the MOU to enact new legislation on enforcement, such as authorizing the Chinese customs service to inspect and seize infringed goods at the borders. However, on September 15, 1994, the Chinese government issued an interim directive providing such authority. The authority given the Chinese customs service under the directive is inadequate, according to USTR, because (1) the IPR holder must prove infringement before the customs service can intervene and (2) the customs officials will not destroy goods determined to be infringing; rather, the seized goods will be returned to the importer or exporter. As a result, the procedure does not remove infringing goods from the market; it only blocks their import into or export from China. USTR noted, however,

that permanent regulations were expected to be issued at the end of 1994 to become effective by April 1995. The provisions in these regulations are not yet known.

According to officials at USTR and the Departments of Commerce and State, China has implemented few measures that work toward satisfying the MOU's provision for enforcement of IPR. While the Chinese government has established judicial and administrative channels for seeking recourse for IPR infringement, U.S. government and business representatives said the enforcement system currently available is generally not adequate. Similarly, representatives of a major Chinese nongovernmental trade promotion agency said that China does not yet have a strong legal structure in place to enforce IPR. For example, they believed that China must enact additional laws and regulations that would grant broader enforcement powers to government bodies, including the Chinese customs service. Additionally, they said that the administrative fines available for IPR infringement need to be raised in order to have a deterrent effect. Finally, they noted that China needs more qualified lawyers and judges to handle IPR cases.

Due to the widespread nature of IPR infringement in China and after failing to see progress from the Chinese government on enforcement of IPR laws and regulations, USTR elevated China to the priority watch list from the watch list[6] on November 30, 1993. In 1994, the U.S. government began discussions with the Chinese on building an effective enforcement system, focusing on the following three areas: (1) making China's body of intellectual property law complete, including adopting provisions for criminal penalties for copyright infringement; (2) establishing an effective enforcement regime by creating an administrative enforcement system that is transparent, responsive, nondiscriminatory, and free from conflicts of interest and includes border controls; (3) providing broad education programs for the public and governmental bodies about the nature of intellectual property rights, the laws that protect against infringement of those rights, and the government's resolve to enforce those rights.

USTR Cites Inadequate Enforcement Efforts and Designates China a Priority Foreign Country in 1994

According to USTR, negotiations with the Chinese government to provide a stronger enforcement structure failed to produce adequate progress. On June 30, 1994, USTR designated China as a priority foreign country under the Special 301 provisions of the Trade Act of 1974, describing the Chinese

[6]USTR prepares a list of countries that it determines lack adequate and effective protection for intellectual property rights. The list is ranked, beginning with those countries that have the most egregious IPR problems and ending with those that still warrant monitoring: (1) priority foreign country, (2) priority watch list, and (3) watch list.

government's enforcement of its laws and regulations as "sporadic at best and virtually nonexistent for copyrighted works." In addition, USTR cited that China maintains numerous hidden quotas and nontransparent regulations, effectively barring U.S. persons who rely on intellectual property protection from the Chinese market.

Following this designation, USTR sought negotiations with China to resolve these enforcement and market access issues. However, after a 6-month investigation, on December 31, 1994, USTR announced that it would take retaliatory action if China did not agree to address U.S. concerns regarding IPR enforcement. On this date, USTR also published a proposed list of Chinese products being considered for retaliation. USTR announced that it will make a final determination on February 4, 1995, on whether "China's IPR practices are unreasonable or burden U.S. commerce."

China's Current Judicial and Administrative System for Enforcing Intellectual Property Rights

Currently, an intellectual property owner may seek to enforce his or her rights in China through administrative and/or judicial channels. To seek recourse through the judicial system, a suit must be filed in civil or criminal court. Criminal penalties are available for "serious" cases of trademark, patent, and, since July 1994, copyright infringement. The Chinese government recently established a number of specialized legal chambers to handle intellectual property cases. These IPR chambers have been established within the People's Courts in Beijing, Shanghai, Shenzhen, Guangzhou, Hainan, and Fujian.

In seeking administrative remedies, an intellectual property owner must petition the Chinese administrative body responsible for the particular type of intellectual property right to investigate the alleged infringement. The National Copyright Administration administers copyrights; the State Administration for Industry and Commerce is responsible for trademarks; and the Chinese Patent Office oversees patent cases. Enforcement procedures differ for each type of intellectual property right. For example, a trademark owner who seeks administrative redress may petition the Trademark Office in Beijing and the local/provincial offices of the State Administration for Industry and Commerce, where the infringement takes place. A foreign copyright owner, however, must first file his case with the National Copyright Administration of China (NCAC), regardless of where the infringing act occurred. NCAC can take further action on a claim in Beijing if it considers the alleged infringement to be "serious and damages the public interest." NCAC can handle the case on its own or request that a local government authority in charge of copyright protection handle it. (See further discussion of copyright difficulties below.) USTR officials told

us that both the judicial and administrative processes are still relatively opaque, and to their knowledge, the acceptance of cases is not based on published criteria.

Absence of a Clear Chinese Government Structure for IPR Enforcement Contributes to Difficulties for U.S. Firms

U.S. government officials and representatives of U.S. companies and their industry associations discussed various difficulties in protecting U.S. intellectual property rights in China. The types of difficulties they described related mainly to the absence of a viable enforcement structure, stemming from an inconsistent application of laws and regulations in China, fragmented and unclear responsibilities among Chinese ministries, a lack of resources dedicated to IPR enforcement, and a pervasive lack of transparency.

Chinese Laws and Regulations Appear to Be Applied Inconsistently

A number of U.S. company representatives reported that IPR laws and regulations are not uniformly applied among the central government and the provincial and local governments. They attributed this inconsistency to several factors, including government decentralization; differing attitudes toward IPR; and varying levels of training about intellectual property rights among the central, provincial, and local governments. Another contributing factor is that the laws, regulations, and procedures at the provincial and local government levels are particularly unclear, according to U.S. industry and U.S. government representatives. A Chinese official from MOFTEC also commented about the potential for confusion at the different levels of government. He explained that provincial Administrations for Industry and Commerce (AIC), the governmental bodies that review and decide trademark infringement issues, fall under the jurisdiction of the national State Administration for Industry and Commerce (SAIC). However, provincial AICs have the authority to enforce local trademark regulations, which may be different from those of the central government or another province's regulations. Nonetheless, a company that is dissatisfied with the findings of a provincial AIC may seek a rehearing by a superior AIC agency.

Enforcement Responsibilities Among Chinese Agencies Are Not Clearly Defined, and Potential Conflict of Interest Exists

U.S. government and industry representatives also said that some Chinese ministries and agencies have unclear lines of authority, fragmented responsibilities, and potential conflicts of interest in enforcing IPR. For example, according to USTR officials, although Chinese copyright law designates NCAC as the agency responsible for copyright enforcement, they said in practice it is not clear which government agency would investigate and decide cases for motion pictures, sound recordings, and computer software. For copyright enforcement, the Press and Publications Administration, the Ministry of Radio and Television, and the Ministry of Culture have various responsibilities, depending on the industry involved. Moreover, a MOFTEC official acknowledged that there is no published guidance that explains the steps that a foreign company should take to seek remedy for infringement. He also added that the process can be confusing since it may involve many different ministries.

Finally, USTR officials expressed concern that a potential conflict of interest exists because these ministries, along with the Press and Publication Administration, have the sole authority to decide which foreign sound recordings will be imported into China. The Ministry of Radio and Television, for example, has 67 audiovisual companies, and the Ministry of Culture has 20 companies under its purview, and these companies may be subject to allegations of piracy, according to USTR.

China Has Committed Limited Resources for Enforcement

The Chinese government has committed very limited resources for the enforcement of IPR. According to U.S. and Chinese government officials, the agency with primary responsibility for copyright enforcement, NCAC, has a staff of three assigned to nationwide monitoring. Some US&FCS officers posted in China said that in addition to having inadequate resources for copyright enforcement activities, Chinese agencies, such as NCAC, are reluctant to take a lead role in enforcing rights. Rather, NCAC has encouraged U.S. companies to file civil suits against infringers to delay actions required of NCAC and to include the participation of other organizations, such as the Ministry of Justice and the Public Security Bureaus, which will assume the burden of making a ruling.

U.S. Industries Report Difficulty With IPR Enforcement and China's Application of Administrative Protection Regulations

We administered structured interviews to representatives of 33 U.S.-based companies to obtain information about their experiences in protecting and/or enforcing intellectual property rights in China. Our survey covered companies' experiences with patents, trademarks, copyrights, and trade secrets. Since the process to obtain and enforce IPR protection for these different types of protection varies significantly, it was difficult to aggregate and provide conclusive results from the survey.

Twenty-seven of the 33 companies had sought IPR protection in China. The majority of these companies reported that they did not have serious problems in obtaining IPR protection, that is, in receiving a patent or registering their trademarks. More than half of the companies reported that they did not yet have experience in enforcing their intellectual property rights in China. However, of the 12 companies that had had experience in enforcing their rights, only 1 company reported a positive experience, while the remainder reported various negative experiences. Of the companies that had taken action to enforce their IPR, several companies said that they believed that the Chinese government authorities administering their cases had conflicts of interest, including one case in which the infringing party's parent entity was a state ministry.

In addition to the structured interviews, we obtained information about companies' experiences with IPR protection in China from representatives of several industry associations. In some cases, the U.S. companies that we contacted referred us to their industry association for discussion of industrywide views and concerns.

U.S. Copyright Owners Report Unabating Infringement and Market Access Barriers

In the area of copyright protection, enforcement has been described as "poor to nonexistent" by U.S. industry and government representatives. The copyright industry's trade association, the International Intellectual Property Alliance (IIPA), made China its top priority for 1994 under Special 301, recommending to USTR in February 1994 that China be identified a priority foreign country. According to IIPA, the copyright industry faces nearly 100-percent levels of infringement in China. Over the years, USTR and the U.S. copyright industries have been urging China to establish criminal penalties for copyright infringement. On July 5, 1994, China amended its criminal code to provide sanctions for criminal copyright infringement, allowing a maximum sentence of 7 years in prison plus a fine.

In addition to the adverse effects that copyright infringement poses, the U.S. copyright industries have also encountered various market access barriers that impede their ability to conduct business in China. According to IIPA, these barriers include a lack of transparency in the rules and regulations for establishment of operations and investment requirements and for rules that govern the production and distribution of copyrighted materials by foreign citizens and companies in China. IIPA has also noted that foreign ownership in a joint venture or enterprise appears to be effectively banned for the sound recording, motion picture, and book-publishing industries.

Available Remedies for Copyright Infringement

As previously discussed, copyright owners have two channels to seek redress for infringement of their works: (1) NCAC, through which administrative fines are possible; and (2) the courts, either through a criminal suit or a civil suit. According to IIPA, however, the administrative channel is inadequate. NCAC does not have the authority or the staff to catch offenders, for example, by running raids of manufacturing facilities, and cannot force infringers to pay their fines without a separate court order.

Because criminal penalties have been available for copyright infringement only since July 1994, it is too early to predict their effectiveness. According to USTR, an infringement case can be introduced in the criminal court system in three ways: (1) the copyright holder can bring his case to a special prosecutor assigned to handle these cases; (2) NCAC can refer the case to the special prosecutor; or (3) the rightholder can bring a civil case, and if the presiding judge considers it serious enough, he or she can refer it to the special prosecutor.

Compact Disk Factories in South China Reportedly Produce Millions of Illegal Copies of U.S. Copyrighted Works

In late 1993, the U.S. copyright industry and U.S. government reported that 26 compact disk (CD) factories were either currently operating in southern China, illegally reproducing U.S. copyrighted works, or were awaiting licensing by the Chinese government. The estimated total capacity of these factories by the end of 1993 was about 75 million CDs, while the demand for legitimate CDs in the Chinese domestic market is estimated to be about 5 million. Counterfeit CDs are being exported to Southeast Asia and other foreign markets in volumes, according to USTR. The sound recording industry estimates that if all these plants were to operate at full capacity, the value of these infringed CDs would be about $500 million on the world market.

The recording industry has been active in pursuing innovative ways to monitor enforcement of copyrights in China. In August 1993, the record industry signed a memorandum of understanding with the Guangdong Province government. Under the agreement, the provincial government agreed to set up a special agency, "The Social Culture Task Force." This task force, with the cooperation of five cities, is expected to enforce copyright laws by monitoring the activities of the growing number of CD plants and conducting raids on the infringing plants. The record industry would contribute funding to the task force and would also provide training for its personnel. According to a U.S. representative of the industry, the task force has not yet come into force because the local Chinese government has failed to promulgate the law that was to serve as the basis of task force actions.

U.S. Software Industry Filed First Cases in Beijing IPR Tribunal

The Business Software Alliance (BSA), which represents U.S. software companies, reported that in 1993 the U.S. software industry had total losses of $322 million in China. The association also estimated that 94 percent of all packaged software used in China was illegally obtained, according to BSA research that compared the total number of hardware units sold with the total number of software packages sold.

In response to the widespread infringement of its software, in March 1994 BSA filed its first complaints with the Intellectual Property Tribunal of the Beijing Intermediate People's Court. BSA named five Chinese retail outlets suspected of selling unauthorized software, including one of China's largest distributors of computer software. On June 29, 1994, accompanied by BSA representatives, officials of the tribunal raided the five retail outlets named in the complaint. The officials seized more than 300 software programs, CD-record only memory (ROM) disks, and 6 computers suspected of containing illegal software. BSA said that the tribunal officials also ordered the retailers to produce their financial accounts and other records. According to BSA, the tribunal officials accepted the cases of five U.S. software companies based on the evidence collected in the raids.

Although BSA said it considered the raids a "step forward in the industry fight against software piracy," the alliance supported USTR's decision to designate China as a priority foreign country, "because of the unreasonably long, expensive, and muddled legal process leading up to the raids." According to BSA, its foremost concern is that the Chinese government has yet to demonstrate a long-term interest in reducing software piracy in China.

U.S. Trademark Owners Also Said Enforcing Rights in China Is Challenging

Although trademark issues were not addressed by specific provisions of the 1992 MOU, trademark owners' interests were represented in the enforcement provision of the agreement, according to a representative of U.S. PTO. The International Trademark Association, the industry association representing trademark interests, wrote in its 1994 Special 301 submission to USTR that revisions to the Chinese trademark law and implementing rules, effective in July 1993, failed to address a number of issues. The major problems the association cited included the absence of judicial appeals of administrative decisions, the inability to meet with Trademark Office examiners, and the retention of the "official agent" system that requires foreign trademark owners to hire agencies designated by the Chinese government to process trademark applications. In addition, the International Trademark Association said that "most procedures remain uncodified in published rules and are inconsistent with international practice."

While China has had an enforcement system for trademarks, including criminal penalties, since 1983, many U.S. companies we surveyed reported infringement of their trademarks. One U.S. manufacturer of athletic footwear told us that counterfeiting of its product is rampant in China. A representative from the company told us that it has received good support from the local Public Security Bureaus[7] and the local AICs, which are responsible for reviewing and investigating trademark infringement cases. In cases where the company had enlisted the assistance of the Public Security Bureau and AIC, these agencies have searched manufacturing facilities and also confiscated counterfeit goods. The problem, according to the company official, is that the Public Security Bureau and AIC do not have the authority to destroy the manufacturing equipment used to produce the counterfeit goods. Therefore, the Chinese agencies could not guarantee that the infringing activity would cease after the search and confiscation of goods.

U.S. Companies Experience Difficulties in Obtaining Administrative Protection for Patented Products

U.S. pharmaceutical and chemical companies we interviewed reported a number of problems in obtaining administrative protection for their inventions. These problems included issues related to the transparency of requirements and the Chinese government's interpretation of the regulations and the MOU.

[7]According to the Department of State, the Ministry of Public Security supervises local Public Security Bureaus throughout China. These offices frequently have wider responsibilities than any single law enforcement agency in the United States. Public Security Bureau functions at the local level, for example, include law enforcement, criminal investigation, narcotics, some domestic intelligence functions, and embassy security.

The Case of the First U.S. Application for Pipeline Protection

In 1993, the American Cyanamid Company applied for administrative protection in China for an herbicide—the first known case of a U.S. patent holder to seek this protection. The application was submitted to China's Ministry of Chemical Industry, which is responsible for reviewing and approving administrative protection applications for agricultural chemicals. According to a company representative, American Cyanamid's herbicide comes in two forms: (1) a 5-percent formulated, ready-to-use solution; and (2) an active "technical product" (the pure form). The company representative said that American Cyanamid had previously marketed the 5-percent solution in China but not the technical product, which it would not have attempted to sell since the product had no protection in China. American Cyanamid applied for administrative protection only for the technical product. The company believed the technical product met all the requirements, including the stipulations that the product had not been marketed in China before the filing date of the application and had been granted a separate U.S. patent. Ultimately, however, the Ministry of Chemical Industry denied the application on the grounds that in its view the product had previously been marketed in China.

According to Ministry of Chemical Industry officials, the Ministry is responsible for overseeing development of the domestic chemicals industry in addition to its purview over applications for administrative protection for agrichemicals. This dual responsibility is problematic, according to American Cyanamid. The company believes that two Chinese chemical institutes, with affiliation to the Ministry of Chemical Industry, were engaged in copying the company's technical and, thus, the 5-percent solution.

U.S. Companies Report Other Difficulties in Obtaining Administrative Protection

Of the six chemical and/or pharmaceutical companies that we interviewed, two other companies said that they had experienced difficulty in obtaining administrative protection related to the Chinese government's interpretation of the regulations and some nontransparent requirements. One U.S. pharmaceutical company reported difficulty in obtaining administrative protection as an "exclusive licensee"[8] of an invention. The company applied for administrative protection for a vaccine product with China's State Pharmaceutical Administration, which is responsible for reviewing applications for patents and administrative protection for pharmaceuticals. China's implementing regulations for administrative protection state that "[t]he right of applying for administrative protection

[8]A patentee can use the patent himself or herself or allow others to do so, for example, by licensing its use. An exclusive licensee is someone who has been promised by the patentee that no other person will be granted use of the patented good.

of pharmaceuticals belongs to the owner of the exclusive right of the pharmaceutical." The U.S. company had received an exclusive license from the American research institution that originally had developed the vaccine.[9] The State Pharmaceutical Administration, however, denied the vaccine administrative protection on the grounds that the U.S. company was not the original U.S. patent holder. The U.S. company representative felt that the State Pharmaceutical Administration's decision was based on an overly narrow interpretation of both the regulations and China's commitment to the provisions of the MOU.

According to another U.S. pharmaceutical company, some requirements for administrative protection currently imposed by the State Pharmaceutical Administration do not adhere to either the MOU or the administrative protection regulations. For example, the company reported that Chinese officials are now taking the position that an applicant for administrative protection must both manufacture and sell the product for which the protection is sought in its home country. The company representative said that the "manufacture" requirement is not consistent with either the MOU or the implementing regulations, both of which require an applicant to submit only the "approval for manufacturing or sales of the product" from its home country. According to the company representative, the State Pharmaceutical Administration has rejected at least one application on the grounds that it did not meet the "manufacture" requirement.

In the company's view, this requirement is a major concern since it is a multinational company. Only a limited number of patents that were issued in the narrowly proscribed time period stipulated by the MOU and the implementing regulations can be considered for administrative protection. In the majority of cases, the manufacture requirement would force an applicant to transfer manufacture from its original manufacturing site to the country where the eligible patent exists. As a result, this requirement would seriously affect the chances of foreign pharmaceutical companies to obtain administrative protection for their eligible products in China.

The United States Has Options for Achieving Progress in China

The U.S. government can continue to encourage and press for strengthened protection of U.S. intellectual property in China in several ways. In pursuing bilateral engagement with China, U.S. government and industry representatives suggested that the United States has a role in

[9]Research laboratories or universities commonly negotiate exclusive licensing arrangements with companies, which invest in further development and marketing of such products.

providing technical assistance and training. In addition, the U.S. government and business community could utilize U.S. trade law, such as Special 301, in addressing problems with Chinese protection of IPR. Finally, the United States could pursue a multilateral approach to effect change in China's IPR regime through organizations, such as WIPO and WTO.

Offering China U.S. Technical Assistance and Training

The U.S. government and business community have an opportunity to establish long-term communication and cooperation with the Chinese government as it continues to develop its intellectual property regime. Officials from the Department of State and the US&FCS pointed out that the United States could play a key role in developing China's enforcement system by offering assistance through technical training and education programs. Similarly, officials from MOFTEC said that the United States could provide more training in IPR administration and development, noting that other countries, such as Germany, have offered more extensive training. The MOFTEC officials characterized the United States as adept in "knowing how to use the big stick" but not as willing to offer positive measures for improvement.

U.S. government officials have identified areas where the United States, in cooperation with U.S. industry, could assist China in further developing its intellectual property regime, particularly its enforcement structure. These areas include (1) judicial training—although China has established several IPR courts, the Chinese judges need training to develop an expertise in intellectual property law; (2) law enforcement training—to provide active and competent enforcement of IPR laws, the local AICs, prosecutors, and customs and patent agents need to develop an understanding of IPR as well as specific enforcement skills; (3) administrative practices and development of laws—in assisting in this area, the United States could offer its input into issues that have arisen about China's adjudication of IPR cases and its further development of implementing regulations and new legislation; and (4) educational programs—U.S. industry and the federal government have sponsored a number of successful IPR seminars in China; however, continued efforts could help reinforce the message and reach a wider audience.

Using Special 301 to Address Inadequacies in IPR Protection

As discussed earlier, USTR has used the Special 301 provision of U.S. trade law to investigate and promote change in China's IPR practices. U.S. companies and industry associations could also petition USTR to investigate China's IPR system. As previously mentioned, on June 30, 1994, USTR

identified China as a priority foreign country for its failure to enforce its IPR laws and regulations effectively. This identification required USTR to decide within 30 days whether to initiate an investigation, which began immediately in this case. If negotiations are not successfully resolved, sanctions could be imposed on selected Chinese exports to the United States.

Engaging Multilateral Cooperation to Influence China's IPR Regime

The United States has the opportunity to influence further change in China's system for protecting and enforcing IPR through multilateral organizations, such as WIPO. In the past, China has been receptive to WIPO delegations and invitations to participate in WIPO-sponsored IPR seminars. In addition, some representatives of the U.S. government and business commented that they have observed positive changes in China as it aims to align its system more closely to the GATT 1994 TRIPs model and eventually accede to WTO.

U.S. Trade Law and Procedures to Combat Foreign Trade Barriers

The U.S. government has established trade laws to promote the opening of foreign markets and the protection of U.S. intellectual property rights abroad. Section 301 of the U.S. Trade Act of 1974, as amended, and Special 301, 19 U.S.C. 2242, which was added in the Omnibus Trade and Competitiveness Act of 1988, provide the legal basis for the U.S. government to enforce U.S. rights under bilateral and multilateral agreements and to seek to eliminate acts, policies, or practices of foreign governments that burden or restrict U.S. commerce.

Section 301

Legislative Background

Section 301 of the U.S. Trade Act of 1974, as amended, gives the President broad discretion to enforce U.S. trade rights granted by trade agreements and to attempt to eliminate acts, policies, or practices of a foreign government that violate a trade agreement or are unjustifiable, discriminatory, or unreasonable and burden or restrict U.S. commerce.[1] Section 301 provides a domestic procedure under which affected enterprises or individuals may petition USTR to initiate actions to enforce U.S. rights under bilateral and multilateral trade agreements. USTR also may initiate Section 301 investigations at its own discretion.

Procedures

The Section 301 action process usually begins with the submission of a petition by a domestic industry alleging a violation of a trade agreement or an "unjustifiable," "unreasonable," or "discriminatory" action that burdens or restricts U.S. commerce. Once the petition is filed, USTR is required to review it and determine within 45 days whether to initiate an investigation of the alleged trade complaint. Once USTR elects to accept a petition, the subsequent investigation is to be based on overall U.S. policy and national concerns rather than just the petitioner's interests.[2] USTR is to publish a notice in the Federal Register as soon as the investigation is formally initiated. The notice is to request public comment and may contain an announcement for a public hearing. If requested by the petitioner, the hearing must be held within 30 days of a case's initiation.

[1]According to USTR, it has initiated 92 investigations pursuant to Section 301 since 1974.

[2]If USTR declines to initiate an investigation, the petitioner must be informed of the specific reasons behind the decision, which is published in the Federal Register.

If the case involves a violation of an international agreement that has a dispute settlement mechanism, such as the GATT 1994 code, USTR must invoke such dispute settlement provisions. Under GATT 1994, the overall dispute settlement process has five main stages: (1) consultation and conciliation, (2) establishment of panels, (3) deliberation of panels, (4) consideration of panel findings and recommendations, and (5) follow-up and implementation.

With certain exceptions,[3] if the case does not involve a violation of an international agreement that has a dispute settlement mechanism, such as the GATT code, the dispute must be resolved through bilateral consultations. Depending on the type of practices alleged, USTR must submit its recommendations to the President within 6 to 18 months. Each aspect of the investigation is subject to an interagency review process overseen by the Section 301 Committee, whose responsibility includes defining issues, marshaling evidence, pursuing international consultations and dispute settlement, and making formal recommendations to the President.

If the determination at the end of the investigation is affirmative and involves a trade agreement or an alleged unjustifiable practice that burdens or restricts U.S. commerce, USTR must take action. If the determination is affirmative but involves an unreasonable or discriminatory practice that burdens or restricts U.S. commerce, USTR may decide which actions, if any, are appropriate. USTR may delay implementation of any action for up to 30 days after making a decision and for an additional 180 days in certain circumstances.

Possible actions USTR may take against the country under investigation include (1) suspension of trade agreement concessions, (2) imposition of duties or other import restrictions, (3) imposition of fees or restrictions concerning services, (4) entry into agreements with the subject country to eliminate the offending practice or to provide compensatory benefits for the United States, and (5) restriction of service sector access authorizations. The action taken should be commensurate with the damage caused to the United States by the practices investigated. Action may be taken against any goods or economic sectors, without regard to whether the goods or economic sectors were the subject of the

[3]Exceptions include cases in which the foreign country is taking satisfactory measures to grant the rights of the United States under the trade agreement or cases in which sanctions would have an adverse economic impact on the United States substantially out of proportion to the benefits of the sanctions, and cases in which sanctions would cause serious harm to the national security of the United States.

investigation. However, USTR must give preference to the imposition of duties over taking other types of action.

In accordance with Section 306 of the 1974 Trade Act, USTR is to monitor the implementation of any measure or agreement that results from a Section 301 investigation. If a foreign government is not satisfactorily implementing an action or agreement, USTR may determine what further action should be taken. One option could be the reopening of a Section 301 investigation.

Special 301

Legislative History

As an outgrowth of the Section 301 process, certain legal procedures were created to combat the lack of intellectual property rights protection in foreign countries. For example, the Trade and Tariff Act of 1984 (P.L. 98-573, 1984) contained amendments to the Trade Act of 1974 that emphasized congressional intent for Section 301 to be used in dealing with a variety of "new" trade issues, such as investment barriers and inadequate protection of IPR. Subsequently, the Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418, 1988) amended the Trade Act of 1974 to include what has been commonly called the "Special 301" process.[4] Under this process, USTR must identify on an annual basis foreign countries that lack adequate and effective protection of IPR or that deny fair and equitable market access to U.S. persons and firms relying on IPR protection. From this group, USTR must also identify as "priority foreign countries" those countries that "have the most onerous or egregious acts, policies, or practices" and whose acts, policies, or practices have the "greatest adverse impact (actual or potential) on the relevant U.S. products." Countries named priority foreign countries must not be negotiating in good faith or making progress in negotiations to provide adequate and effective protection. Under the Special 301 provisions, USTR has discretion in deciding whether to retaliate against countries identified as having inadequate protection of intellectual property rights.

[4]19 U.S.C. 2242.

Procedures

USTR decides whether to identify countries each year within 30 days after issuance of the National Trade Estimate report.[5] USTR, however, may identify a trading partner as a priority foreign country or remove such identification whenever warranted. Section 302(b) of the amended Trade Act of 1974 directs USTR to initiate a Section 301 investigation within 30 days after identification of a priority foreign country "with respect to any act, policy, or practice of that country that was the basis of an identification." However, USTR is not required to initiate an investigation if it determines that such an investigation would be detrimental to U.S. economic interests or if the country is already the subject of another Section 301 investigation. After a priority foreign country investigation is initiated, the procedural and other requirements of Section 301 authority generally apply, except that the investigation and resulting determinations must be concluded on an accelerated time frame. USTR is required to determine within 6 months if there are unfair trade practices and if any retaliatory measures will be taken. Investigations may be extended for up to an additional 3 months if complex or complicated issues are involved, if substantial progress is being made, or if effective measures are being undertaken.

As a means of increasing the effectiveness of the Special 301 provision, USTR has divided into two categories—the "priority watch list" and the "watch list"—those countries perceived to deny adequate and effective intellectual property protection or market access, but whose problems are not as severe as priority foreign countries. Countries placed on the priority watch list are those that USTR considers to have made less progress in strengthening protection of intellectual property than those on the watch list, or whose practices cause the greater economic harm to U.S. interests.

[5]The National Trade Estimate Report on Foreign Trade Barriers (NTE) is an inventory of the most important foreign barriers affecting U.S. exports of goods and services, foreign direct investment by U.S. persons, and protection of intellectual property rights. USTR is required by statute to submit this report annually to the President, the Senate Finance Committee, and appropriate committees in the House of Representatives.

U.S. Companies Interviewed

American Cyanamid Company
AT&T
Campbell Soup Company
Cambrex/Nepera Hong Kong Ltd.
Caterpillar China Limited
Chrysler Corporation
Continental Grain Company
Cooper Energy Services International
Digital Equipment Corporation
Dow Chemical Pacific Limited
Hewlett-Packard Company
Honeywell China Inc.
Hughes Aircraft Company
International Business Machines Corp.
Johnson & Johnson
Joseph E. Seagram & Sons, Inc.
KFC International, Asia/Pacific Region
Lotus Development Corporation
Med-Tech International
Merck & Co., Inc.
Monsanto Company
Motorola, Inc.
Sun Microsystems, Inc.
Syntex Corporation
Texas Instruments Incorporated
The Procter & Gamble Company
The Walt Disney Company
Unisys (China) Company, Ltd.
U.S. China Investment Corp.

Note: This appendix includes only those companies that agreed to be listed.

Structured Interviews of U.S. Companies Doing Business in China

U.S. General Accounting Office

Structured Interviews of U.S. Companies Doing Business in China

Introduction

The U.S. General Accounting Office (GAO) is conducting a study to assess China's progress in implementing the 1992 U.S.-China trade agreements on (1) market access and (2) the protection of intellectual property. In the following interview, we are interested in obtaining information about your company's experiences in gaining market access in China and discussing whether the implementation of the agreement on market access has had any effect on your company's business activities in China.

We will call you in advance to schedule an appointment. The interview should take about 45 minutes. In the meantime, if you have any questions, please call Ms. Sara Denman at (202) 512-3037 or Ms. Mary Park at (202) 512-4843.

* * * * *

U.S.-China Agreement on Market Access

On October 10, 1992, the United States and China signed an agreement, resolving a Section 301 investigation into barriers to the entry of U.S. exports into China. Under the agreement, the Chinese government committed itself to implementing the following key provisions:

- -- eliminate import barriers, including licensing requirements, quotas, controls, and restrictions in many key U.S. export sectors, between 1992 and 1997;
- -- increase the transparency of its trade regime, by openly publishing all laws, regulations, and decrees that govern trade;
- -- eliminate the use of import substitution policies and measures;
- -- remove standards and testing requirements that are barriers to trade, especially in the area of agricultural standards; and
- -- significantly reduce tariffs on a variety of U.S. goods by December 31, 1993.

I. Company Experience in China

1. What are the primary lines of business in which your company is involved?

2. What products does your company currently export to China?

3. What percent (to the nearest 10%) of annual sales do exports to China represent?

4. What kinds of business activities does your company conduct in China?

5. Does your company operate facilities in China?

6. In your opinion, how would you rate your company's overall experience in China? *(Check one.)*

   1. ☐ Very successful
   2. ☐ Somewhat successful
   3. ☐ Neither successful nor unsuccessful
   4. ☐ Somewhat unsuccessful
   5. ☐ Very unsuccessful

7. To what do you attribute your company's success or lack of success in China?

II. Market Access in China

8. Are you familiar with the 1992 U.S.-China agreement on market access?

9. What has been your company's experience with each of the following potential market barriers in China?

   1. Transparency (e.g., disclosure of trade laws, regulations, and policies)
   2. Quantitative restrictions (e.g., quotas and import licensing requirements)
   3. Product standards
   4. Import substitution
   5. Tariffs

10. Since October 1992, has there been any change in your company's experience with these barriers?

11. If yes, please describe the specific ways that your company's experience has changed.

12. Can your company measure any change in the degree of success it has had in exporting to China since October 1992?

13. If yes, please describe this change.

14. To what extent would you attribute this change to the elimination of trade barriers provided for in the agreement on market access? *(Check one.)*

1. ☐ Very great extent
2. ☐ Great extent
3. ☐ Moderate extent
4. ☐ Some extent
5. ☐ Little or no extent

III. Other Factors that Affect Company's Experience in China

15. Have other factors affected your company's experience in gaining market access in China?

16. If yes, please describe.

17. If your company experienced any specific difficulty related to market access, did you approach any Chinese government ministries or authorities for assistance or guidance?

18. If yes, how was this difficulty resolved?

IV. U.S. Government Efforts

19. Has your company participated in any U.S. government-sponsored seminars or conferences related to market access in China?

20. Does the U.S. government provide services or other types of assistance that your company has used in entering the Chinese market?

21. If yes, please describe.

22. Has your company approached the U.S. government for assistance with any of the specific concerns discussed above?

23. If yes, what was the U.S. government response?

U.S. General Accounting Office

Structured Interviews of U.S. Companies Doing Business in China

Introduction

The U.S. General Accounting Office (GAO) is conducting a study to assess China's progress in implementing the 1992 U.S.-China trade agreements on (1) the protection of intellectual property and (2) market access. In the following interview, we are interested in obtaining information about your company's experiences obtaining and enforcing intellectual property rights (IPR) in China and discussing whether the implementation of the agreement on IPR has had any effect on your company's business activities in China.

We will call you in advance to schedule an appointment. The interview should take about 45 minutes. In the meantime, if you have any questions, please call Ms. Sara Denman at (202) 512-3037 or Ms. Mary Park at (202) 512-4843.

* * * * *

U.S.-China Agreement on Intellectual Property Rights Protection

On January 16, 1992, the United States and China signed an agreement that committed China to providing improved protection for intellectual property rights in China. This agreement resolved a Special 301 investigation into inadequate IPR protection in China. Among the most important terms of the agreement, China pledged to:

-- join the Berne Copyright Convention and Geneva Phonograms Convention;
-- protect computer programs as literary works under the Berne Convention;
-- provide full product patent protection for pharmaceutical and agricultural chemical products; and
-- adopt legislation to protect trade secrets from unauthorized disclosure or use.

I. Intellectual Property Rights in China

1. Are you familiar with the 1992 U.S.-China agreement on IPR?

2. Which forms of IPR are relevant for your company?
   1. Patents
   2. Copyrights
   3. Trademarks
   4. Trade secrets

3. Has your company sought IPR protection in China?

4. If yes, for what forms of IPR?

5. What has been your company's experience in obtaining protection for its intellectual property?

6. What has been your company's experience in enforcing its intellectual property rights?

7. Since January 1992, has there been any change in your company's experience protecting its intellectual property?

8. If yes, please describe specific ways that your company's experience has changed.

9. To what extent would you attribute this change to stronger protection of intellectual property rights provided for in the agreement? *(Check one.)*
   1. ☐ Very great extent
   2. ☐ Great extent
   3. ☐ Moderate extent
   4. ☐ Some extent
   5. ☐ Little or no extent

II. Other Factors that Affect Company's Experience in China

10. Have other factors affected your company's experience in obtaining adequate and effective IPR protection in China?

11. If yes, please describe.

12. If your company experienced any specific difficulty related to IPR, did you approach any Chinese government ministries or authorities for assistance or guidance?

13. If yes, how was this difficulty resolved?

III. U.S. Government Efforts

14. Has your company participated in any U.S. government-sponsored seminars or conferences related to IPR protection in China?

15. Has your company approached the U.S. government for assistance with any of the specific concerns discussed above?

16. If yes, what was the U.S. government response?

Objectives, Scope, and Methodology

In light of China's efforts to liberalize its economy and join the international trading system, Senator Hank Brown asked us to provide information on (1) China's compliance with the provisions of the market access MOU and related progress on meeting the eligibility requirements to join GATT and (2) China's implementation of the MOU on the protection of intellectual property rights. In addition, as requested, we provided information on the legal procedures involved in addressing U.S. concerns about foreign market access and intellectual property rights protection under Section 301 of the 1974 U.S. Trade Act, as amended.

To assess China's compliance with the specific provisions of the market access and intellectual property rights MOUs, we obtained information primarily from three broad sources: (1) U.S. government agencies involved in negotiating and monitoring the implementation of the MOUs, (2) Chinese government officials responsible for trade and protection of intellectual property rights, and (3) U.S. companies or business associations with interest in China's import regime or intellectual property protection system.

As the U.S. government leader in negotiating and monitoring the market access and intellectual property rights agreements, USTR was our primary source of information on the MOUs, as well as on negotiations on China's accession to the General Agreement on Tariffs and Trade. USTR provided us with materials documenting China's progress in implementing the provisions of the MOUs and with updates on USTR actions to promote U.S. interests. We supplemented this information with perspectives from other U.S. government agencies, including the Departments of Agriculture, Commerce, and State and the U.S. Customs Service.

We visited China and Hong Kong in March 1994, where we met with U.S. and Chinese government officials, as well as private sector representatives. In Beijing, Guangzhou, and Hong Kong, we met with U.S. embassy and consulate officials to obtain their perspectives on the business and trade environment in China and to discuss their views on China's implementation of the specific provisions of the MOUs. These discussions included meetings with officials in the U.S. economics, commercial, and political sections, as well as with agricultural attachés and U.S. Customs Service officers.

In Beijing, we met with Chinese government officials in positions of responsibility for foreign trade and intellectual property rights protection to obtain their views on China's implementation of the MOUs. Our meetings

included Chinese officials from MOFTEC; the SETC; the Customs Administration; the State Administration for Industry and Commerce; the National Copyright Administration; and the ministries overseeing key importing industries, such as chemicals, electronics, and radio and film.

To obtain information on U.S. companies' experiences in gaining access to the Chinese market and in protecting and enforcing their intellectual property rights in China, we conducted structured interviews with representatives of 41 U.S.-based companies, including 17 companies we met with in China and/or Hong Kong. This group of companies was selected judgmentally to reflect a variety of industry sectors, including the pharmaceutical, computer, automotive, and consumer product industries. However, it was not necessarily representative of all U.S. companies doing business in China.

Not all of the company representatives we interviewed were able to fully answer our questions on both market access and intellectual property rights issues. Thus, although we interviewed a total of 41 companies, we tabulated responses from 33 companies on market access issues and 33 companies on intellectual property rights issues (these groups were not identical). It should also be noted that only 29 of the companies we contacted agreed to have their company names listed in appendix IV.

In addition to our structured interviews with U.S. companies, we obtained information from business associations with interest in market access and intellectual property protection issues. These associations included the American Association of Exporters and Importers, the American Chamber of Commerce in Beijing and Hong Kong, the American Soybean Association, BSA, the Electronics Industry Association, IIPA, the International Trademark Association, the National Association of Manufacturers, the Pharmaceutical Manufacturers Association, the U.S.-China Business Council, the U.S. Feed Grains Council, and the U.S. Wheat Associates.

To outline the Section 301 and Special 301 processes, we reviewed U.S. trade laws as well as USTR documents and previous GAO reports. We also consulted with USTR's Office of General Counsel, who verified the information. The information presented in this report on Chinese law does not reflect GAO's independent analysis but is based on secondary sources and interviews.

We performed our review from October 1993 to November 1994 in accordance with generally accepted government auditing standards.

Major Contributors to This Report

General Government Division, Washington, D.C.	Virginia C. Hughes, Assistant Director Elizabeth J. Sirois, Assistant Director Sara B. Denman, Evaluator-in-Charge Mary M. Park, Evaluator Susan S. Westin, Senior Economist Rona H. Mendelsohn, Evaluator (Communications Analyst)
Office of the General Counsel, Washington, D.C.	Richard R. Perruso, Attorney-Adviser
Far East Office	Kathleen M. Monahan, Site Senior Joyce L. Akins, Evaluator Karen L. Seymour, Evaluator

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (301) 258-4097 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Mail
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested