

# ◀ China Insights

Vol. 1, Jan-Feb 2004

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## 2003 Report on China's World Trade Organization Compliance

In December of 2003, the United States Trade Representative ("USTR") presented its second annual report to Congress on China's World Trade Organization ("WTO") compliance (the "2003 Report"). The 2003 Report notes the progress made by China in implementing its WTO commitments. However, the 2003 Report, like the 2002 Report, highlights numerous failures in China's implementation efforts.

### China's WTO History

China was admitted to the WTO on December 11, 2001, after 15 years of negotiations with the U.S. and other WTO members. In connection with its admission to the WTO, China committed to implementing many trade-related legal and regulatory reforms (the "trade reforms") designed to open the Chinese trading market to the world. The trade reforms are far reaching, ranging from the elimination of market access barriers to strict enforcement of China's intellectual property laws and regulations. The U.S., along with other WTO members, expect that the implementation of the trade reforms will level the trade playing field, thereby making China a desirable place to do business.

**China committed to implementing many trade-related legal and regulatory reforms**

### Trading Rights & Distribution Services

Deputy USTR Assistant, Charles W. Freeman III noted that, "the top concern of many U.S. industries [doing business in China] involves trading rights and distribution services." Trading rights refers to the right of businesses with any non-Chinese ownership ("foreign businesses") to import goods into China and to export goods from

China. Distribution services relate to the right of foreign businesses to distribute products or provide services in China.

In connection with its admission to the

WTO, China committed to (i) providing trading rights to *all* foreign businesses by December 11, 2004, and (ii) eliminating market access restrictions on foreign businesses attempting to distribute their goods through a local Chinese distributor.

China has failed to make full trading rights available to foreign businesses. In fact, China has failed to even issue preliminary regulations providing full trading rights for foreign businesses. However, in an apparent attempt to silence public criticism over its failure to implement its trading rights commitments, the Chinese Ministry of Foreign Commerce reported that it is

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in the process of drafting amendments to the Chinese Foreign Trade Law to create an automatic trading rights system for all Chinese businesses, foreign businesses, and foreign individuals by December 11, 2004.

Currently, China permits foreign businesses to distribute their Chinese-made goods via wholesaling, retailing, and commissioned agents. When the goods are not manufactured in China, China permits only one foreign business—a foreign joint venture with minority foreign ownership—to distribute its goods. Before a foreign joint venture with minority foreign ownership is permitted to distribute goods, however, it must satisfy a number of stringent requirements.

### Import & Export Regulations

Foreign businesses have complained that Chinese laws, regulations, and practices hinder their efforts at importing goods into China and exporting goods out of China. In connection with its admission to the WTO, China agreed to revising those laws and regulations and eliminating those practices that have hindered the efforts of foreign businesses to import goods into China and export goods out of China. China has made progress in revising certain laws, regulations, and practices that have hindered foreign businesses in the past, however, many of those laws, regulations, and practices remain intact.

As promised, China implemented tariff rate reductions. These reductions aided foreign businesses in numerous sectors including construction equipment, medical and scientific equipment, paper and paper products, steel, and chemicals. Overall, the tariff rate reductions helped contribute to a 19% increase in U.S. exports to China last year as compared to 2002.

The benefits of tariff rate reductions will not be fully realized, however, if China fails to address trade inhibiting practices including import licensing requirements, customs valuation regulations, and its burdensome quota system. While China has issued draft regulations aimed at reforming these practices,

the U.S. and other WTO members fear that the draft regulations will not have the desired effect.

### Favoring The Domestic Product

Many Chinese laws, regulations, and practices favor goods that are either manufactured in China or distributed by Chinese businesses. To address this problem, China committed to implementing two of the WTO's core principles – the Most Favored Nation and National Treatment Rules.

The Most Favored Nation Rule provides that if a WTO member grants a benefit or advantage to the goods of one WTO member, it must immediately and unconditionally grant the same treatment to imported goods from all WTO members. The National Treatment Rule requires that WTO members accord no less favorable treatment to

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imported goods than it does for like domestic goods (*i.e.* once imported goods have passed across the national border and import duties have been paid, the WTO member may not subject those imported goods to internal taxes or charges in excess of those applied to domestic goods).

China does not observe the Most Favored Nation or National Treatment Rules in all areas of trade. For example, China continues to apply its value added tax system in a manner that discriminates against imports in favor of domestically produced products. Poor collection methods and fraud allow Chinese businesses to avoid the payment of value added taxes, while foreign businesses continue to pay such taxes.

## Intellectual Property Rights

Possibly the greatest concern of foreign businesses that do, or contemplate doing, business in China is the violation of intellectual property ("IP") rights. The violation of IP rights in China has led to:

- market value of counterfeit goods in China of between \$19 billion and \$24 billion; and
- copyright piracy levels of 90% or higher in 2003.

More telling is the fact that nearly 50% of infringing goods entering the U.S. originate in China.

In connection with its admission to the WTO, China committed to overhaul its IP laws, regulations, and enforcement mechanisms to combat the violation of IP rights. China has made progress in overhauling its framework of IP laws and regulations. However, China continues to lag behind in its commitments to overhaul its IP enforcement mechanisms.

## Regulation Of Service Providers

In connection with its admission to the WTO, China committed to substantially open the Chinese market to a broad range of services. Service providers continue to suffer, however, from market access barriers, regulatory issues, and a lack of transparency. For example, the People's Bank of China, the government entity responsible for regulating foreign-funded banks, imposes working capital requirements on foreign-funded banks that far exceed international norms. China Post, the Chinese postal authority and regulatory body, maintains a monopoly over the delivery of letters weighing less than 500g rams. Other service industries, such as insurance and motor vehicle financing, face problems similar to these.

## Commitment To The Rule Of Law

In an attempt to align its legal framework with that of other WTO members, China committed to making broad legal reforms in the areas of transparency, uniform application of law, and judicial review. Despite reviewing more than 2,500 trade related laws and implementing almost 100 more in 2003 alone, China's legal system remains a major concern of the U.S. and other WTO members. For instance, the U.S. and other WTO

members are troubled that China's ministries continuously fail to provide an opportunity for public comment before new or modified laws and regulations are implemented. Additionally, China has failed to make its new or revised laws and regulations immediately available in languages other than Chinese.

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Despite the challenges posed by China's as yet incomplete compliance with WTO requirements, an enormous and growing amount of manufacturing, importing and other commercial activity is going on between the U.S. and China. Increasingly this activity is being conducted by mid-market companies. We have assisted many such companies in reaching their U.S., China and world-wide objectives.

## Highlights

### October 30, 2003

Allan Goldner and Debra Yelsky were welcomed by the Deputy Governor of Bao Ying County, which is approximately 200 kilometers west of Shanghai, and met with him and several of his colleagues to discuss development and partnership opportunities.

### November 1, 2003

Steve Auil hosted a meeting in Beijing with a senior official in the Department of Cooperation, State Intellectual Property Office (SIPO) of the PRC, at which a number of current legislative and enforcement issues relating to the protection of intellectual property were discussed.

### November 3, 2003

Allan Goldner, Steve Auil and Debra Yelsky met in Hong Kong with a member of the Hong Kong/Japan Business Co-Operation Committee of the Hong Kong Development Council, who is also a member of the Trade and Industry Advisory Board of the Trade and Industry Department, Hong Kong, and a Committee Member of the Committee of Chinese People's Political Consultation Committee, Dalian City. Discussions covered a number of matters, including a comparison of establishing U.S. business operations in Hong Kong as compared to other locations in China.

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### November 17, 2003

Debra Yelsky participated in a discussion group with the Deputy Director of the Shanghai Municipal Government Financial Service Office, Policy Research Department, who held meetings in Cleveland with various members of the business community.

### February 2, 3, and 4, 2004

Several Benesch lawyers made presentations and moderated panel discussions at *Plastics News'* 2004 Executive Forum in Las Vegas, Nevada, including Jim Hill, Ira Kaplan, Megan Mehalko, as well as Allan Goldner who, together with Lou Longo of Plante & Moran, discussed the increasing effects of globalization on the plastics industry, with a special focus on China.

### February 5, 2004

*The China Challenge: How to Compete and Win* was co-sponsored in Columbus, Ohio by Benesch, PolymerOhio, Inc., Plante & Moran, 889 Global Solutions Ltd. and Bank One. Included in the presentations were:

- Steve Auvil, who gave a presentation concerning the protection of intellectual property rights;
- Debra Yelsky, who moderated and presented with a panel regarding sourcing from China;
- Diane Reynolds, who moderated and presented with a panel regarding exploiting Chinese markets; and
- Jim Farmer, who presented and lead a discussion regarding utilization of buying cooperatives to control costs.

## OUR MISSION

Our China Group's mission is to assist U.S. companies in a wide range of industries to develop successful strategies for competing in an increasingly global economy. Although competition from China-based manufacturing will continue to stress U.S. manufacturers, increased commerce with China can also afford significant opportunities for U.S. companies to become stronger, more competitive and more stable by increasing their profitability and expanding their markets.

We assist U.S. companies in transactions involving: (1) developing U.S.-based solutions to competition from China; (2) sourcing components or products from China; (3) establishing strategic alliances and joint ventures for manufacturing and/or distribution in China; and (4) establishing wholly owned manufacturing or other business operations in China. We also assist in accessing China's growing markets.

We have extensive experience in counseling clients and helping them to structure China-related transactions, as well as in the negotiation and documentation of all aspects of such transactions, including capitalization structure, and operating control and governance issues.

We also understand the critical importance of intellectual property issues in China-related transactions. Our intellectual property lawyers are experienced in working with their China-based colleagues and with governmental officials to maximize the protection of our clients' valuable patents, trademarks, know-how, trade secrets and other intellectual property.

We have an established network of experienced, competent and reliable U.S. and China-based service providers with whom we can orchestrate a complete China business solution for clients. These providers enable us to coordinate U.S., China and other international legal, tax, governmental relations, import/export, construction, operational and other matters for our clients -- all in a seamless, cost effective manner.

**For more information about the 2003 WTO Report or to discuss any aspect of your China strategy, contact any member of our China Group.**

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