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UNICE STATUS REPORT

- EUROPEAN MARKET ACCESS PROBLEMS IN CHINA -

Introduction

The objective of this *status report* is threefold: (1) to give an up-to-date overview of market access problems encountered by European companies in their transactions with mainland China (public authorities and policy-makers; economic operators, manufacturers and distributors; and private consumers), (2) to report on and develop recommendations for required remedies and concrete market opening measures, and (3) to facilitate interaction and co-operation with the European and Chinese Governments and between business communities.

The report supplements as a *background document* the UNICE Statement on the occasion of the first EU-China High-Level Meeting in the margins of the London Asia-Europe Meeting/ASEM II, 2/4 April 1998. Frequent reference is made in this report to the process of China's accession to WTO.

This report should be regarded as a "living document". It is mainly based on business contributions (from UNICE member federations and companies), and other relevant sources of information (European Commission, World Bank, IMF, etc.).

General Information

China is the world's most populous country with around 1.2 billion inhabitants, and the third largest land area after Russia and Canada at 9,326,000 sq km. China is today the world's seventh largest economy at current exchange rates with a GDP of USD 817 billion in 1996, corresponding to a per capita GDP of USD 670[1]. In terms of purchasing power parity this figure exceeds USD 3,000 and is rapidly rising as GDP growth continues at 9-10% a year. Despite rapid growth, official inflation was only 8.3% in 1996. Some economists estimate that in real terms China is now the world's third largest economy, and perhaps the one with the most rapid sustained growth.

China is now in advanced transition from a planned to a market economy with continued state ownership of 41% of industry (in terms of production value) in 1996. Genuine progress has been made in the privatisation of agriculture, distribution and other services, and in introducing market economy conditions. Chinese growth is fuelled by rapid export-led industrialisation (exports corresponded to 18.4% of GDP in 1996) underpinned by large domestic savings (40% of GDP in 1996) and investment combined with a large influx of foreign direct investment, which reached USD 41.7 billion in 1996.

Chinese exports grew slightly less in 1996 than in previous years and reached USD 151 billion, while imports rose to USD 139 billion. Major exports consist of textiles, clothing, footwear, toys, machinery

[1] Statistics in this paper have been drawn from Eurostat, the World Bank and the IMF

and equipment. Imports are dominated by industrial machinery, motor vehicles, oil products, telecommunications equipment and aircraft. Major trading partners in 1996 according to IMF statistics were on the export side Hong Kong (21.8%), Japan (20.4%), the US (17.7%) and the EU (13.1%), on the import side Japan (21.0%), the US (1l.6%), the EU (14.3%) and Hong Kong (5.6%).

Trade with the European Union

China is the fourth largest supplier to EU markets with exports of ECU 26 billion (4.8% of total EU imports) in 1996. In the same year China was the largest market for European exports with imports of ECU 14.6 billion (2.6%). Trade with Hong Kong, which is to a large extent transit trade with China, is not included in these figures. If Hong Kong and China are counted together, they account for 6.1% of EU imports and 5.4% of EU exports. Given projected future economic growth in China of 9-10% a year over the coming years, China is destined to become an even more prominent trading partner as its weight in the world economy increases.

While the fundamental economic prospects for increased trade between Europe and China are extremely favourable, numerous legal and practical problems still exist which makes trade growth slower than it might be. Most of these originate in the incomplete transition of the Chinese economy from a centrally planned to a market economy.

The following problems in trade with China have been highlighted in one recent Swedish company survey, which gives an indicator of problems encountered by European companies doing business in China:

Lack of transparency in rules and laws (90%), violation of intellectual property rights (73%), discriminatory pricing (73%), breach of delivery agreements (70%), difficulties in settling claims (63%), restrictions on marketing and distribution (60%) and obligation to channel goods through foreign trade corporations (60%). Other areas had slightly lower response rates: joint venture requirements (52%), local content requirements (46%), divergent local rules (46%), import quotas and licences (45%), tariffs (41%), foreign exchange balance requirements (40%), restrictions on expatriate staff (31%), restrictions on recruiting local staff (21%) and restrictions on exports from China (18%).

China’s membership of the WTO

As coastal China, with a population of several hundred million people, develops to become the biggest newly industrialising region of the world, it is important to secure Chinese membership of the WTO at an early date. To join WTO, China will have to accept an economic framework compatible with WTO membership. China applied for membership of GATT as long ago as 1986, and participated in the Uruguay Round negotiations. Through the agreements made in the Uruguay Round and the establishment of WTO, China must now fulfill a much increased list of conditions for membership. Despite protracted negotiations it was not possible for China to accept all the new (and old) requirements of GATT/WTO, and it thus failed in its bid to join WTO as a founding member.

The WTO regulatory framework has been constructed to regulate trade between open market economies, and it cannot function to mutual satisfaction and produce fair results in a situation where one partner retains features of a centrally planned economy. It is therefore important to find an agreement in which China can accept all WTO disciplines according to a firm timetable tied to a simultaneous dismantling of remaining WTO incompatible restrictions on Chinese trade.

Remaining trade barriers.

Dealt with briefly below are some of the problems and barriers which European companies encounter in the Chinese market, and which are related to the rules of international trade within the framework of WTO and other international agreements. These mainly fall into the following categories:

- Trading rights
- Legal uncertainty
- Tariff levels
- Customs procedures
- Import and export restrictions
- Standards and certification
- Intellectual property rights
- Government procurement
- Trade in services
- Foreign direct investment

1. Trading rights

In principle, export and import transactions in China involving foreign buyers and sellers are only allowed for a small number of government-controlled trading companies. The capacity for end-users to import is still to a large extent regulated through allocations by government agencies, though more and more manufacturers are acquiring the right to trade directly. In fact, joint ventures now account for about 40% of foreign trade.

Import licensing is used as an additional control tool. This severely limits the freedom to export and constitutes a measure equivalent to a permanent impairment of benefits referred to in GATT Article XXIII. It also curtails the possibility for foreign subsidiaries to operate normally and successfully in the Chinese market.

2. Legal uncertainty

Uneven publication and implementation of laws and regulations remains a problem for foreign companies in China. Central regulations are often implemented differently at a local or provincial level, and local or provincial regulations in practice often supersede central regulations, or they remain in contradiction. Since regulations are sometimes not available directly to concerned companies, except through the implementing authorities, it is very difficult for companies to gain a complete understanding of the legal situation.

This makes discretionary treatment of companies by local authorities a common phenomenon in China. The uneven application of laws and regulations clearly has an economic impact also for the Chinese government and for Chinese economic operators since, according to the Chinese press, customs revenue amounts to less than 3% of the value of imports, while nominal tariff levels average around 35%. The difference is made up of tariff suspensions and local exemptions, as well as smuggling and fraud.

3. Tariff levels

Tariff levels in China are still high for many products. Even after the unilateral cuts announced at the APEC meeting in Osaka, Chinese tariff levels were still at an average of 24%, which is very high in a post-Uruguay environment. But according to Chinese declarations tariffs are expected to be further lowered to an average of 15 percent over the next few years.

Tariff levels remain high for products where China has a stated goal of building domestic industries in areas such as automobiles, chemicals or leather. As mentioned above, because of various special exemptions, average effective tariffs may have been lower, but that is of little significance for the individual foreign company. Generally tariff reductions are given for imports connected with major projects mentioned in state or sector plans.

The general duty exemption for imports of capital equipment by foreign investors was due to be phased out, but has been reinstated owing to recent sluggish inflows of new foreign direct investment. When this duty exemption is abolished, the long-term effect will be a simplification of the system even though the short-term result will in many cases be higher effective tariff levels. The deductibility of VAT (normally 17%) on imports remains subject to case-by-case decisions. This lack of transparency reinforces the climate of uncertainty for European operators.

4. Customs procedures

Customs clearance in China is often cumbersome and may under unfavourable circumstances take up to two or three weeks. There remains considerable uncertainty about the legal framework for customs procedures, both concerning the determination of appropriate tariff levels and whether a certain good is eligible for preferential treatment under various schemes. Duties may in fact vary from one customs office to another because of discretionary implementation or corruption. Sometimes clearly irrelevant documentation is requested by the customs authorities.

5. Import and export quotas and licences

Import licence requirements in 1996 covered around fifty percent of total Chinese imports by value. In order to support local production various import restrictions have been introduced over the years. However, China has now committed itself not to institute any new import restrictions to protect domestic production.

In the most recent market access agreement with the US, China pledged to eliminate three quarters of its licence requirements over two years, and 90% over five years. As a first instalment, the abolition of 170 licence categories out of a total of about 500 was announced at the APEC meeting in Osaka in 1996. However, much still needs to be done after the unilateral APEC liberalisation commitment of 1996.

China is using import quotas to achieve a planned trade balance. China’s exports are primarily according to central planning procedures, using aggregate estimates of ”demand” collected by local administrations. Ministries controlling state-owned production are involved in the approval process of ”their” imports. Import licensing connected to direct investment is partly determined by the category of investment in question.

By maintaining import licensing, China is today actively striving to achieve a positive trade balance, despite a huge need for imports. In the short run this may help to maintain a strong currency and keep inflation down. However, this state of affairs is incompatible with market economics and WTO principles.

There exist also examples of export restrictions applied by Chinese authorities limiting the access to Chinese raw material (e.g. raw hides and skin material). It is unclear if there is any legal basis for such restrictions.

6. Standards and certification

International standards are only applied in China to a limited extent, and numerous divergent national standards are applied. China requires a quality licence to be issued before a product can be imported into China. Certification from the country of production is usually not sufficient to obtain such a quality licence or import permit. Obtaining a Chinese licence can be time-consuming and expensive.

Products in 8l6 listed categories must undergo mandatory testing when they are imported. Sometimes the standards against which the products are to be tested are not published or even made available to the exporter. In this way standards may be used arbitrarily to exclude foreign products and to protect domestic products. In many cases testing of imported products is more rigorous than testing of domestic products. Sometimes different agencies as well as different procedures are used.

Testing fees are also typically higher for foreign than for local products. A new fee of USD 15,000 for safety certification of car parts, plus inspection at the producer's plant at his own expense, was announced to come into effect before the end of 1997. This measure will have a clear protectionist effect on imports of car parts. New certification of pressure vessels and pressure boilers according to the new China standard built on the US standard is substantially higher than in the US.

Each individual workshop within a company group has to obtain an individual certificate at a cost of around USD 15,000. This will make it impossible for small and medium-sized companies to export to the Chinese market. Chinese practices in the area of standards and certification should be brought into line with WTO rules and normal international practice before China's WTO membership comes into effect.

7. Intellectual property rights

Over the last ten years China has established an "OECD-style" patent system and passed legislation protecting intellectual property rights. Despite considerable progress, additional efforts are necessary to gain acceptance of the concept of intellectual property at the local administrative level and among economic operators. The present situation leads to considerable uncertainty about implementation of the 1985 patent legislation in case of litigation. Problems concerning counterfeit goods and copyright infringements also remain unsolved to a considerable degree. There is also uncertainty at a legal level about Chinese interpretation of the agreement between the EU and China on protection of intellectual property.This uncertainty also affects "pipeline protection", i.e. protection from the time a patent is applied for, until it is granted, which is very important for, among other things, the pharmaceuticals industry, and where the situation in China remains unclear in many respects.

8. Government procurement

Government procurement is not regulated through any specific, publicly available regulation. In some instances foreign-policy considerations may influence the evaluation of bids, but normally commercial considerations predominate. Allegations of corrupt practices occasionally occur in connection with public procurement. When domestic suppliers exist, procurement is often closed to foreign bidders. Even when foreign suppliers are admitted, domestic suppliers are normally given preferential treatment in all procurement not subject to rules on open international bidding imposed by international financing agencies.

Generally government approval is required for any imports associated with infrastructure and other investment projects with some government funding. Tendering procedures are usually non-transparent and different depending on the executing agency and the nature of the project. Often bidders are asked to comply with specific local-content requirements, to guarantee transfer of technology, to make production investments or to accept counter-trade. Additional post-bid negotiations are common to obtain further concessions on price, and/or additional commitments in the areas mentioned above or on other points of the contract. In joining the WTO, China should comply with WTO standards in this area. This means among other things that government procurement procedures will have to be regulated by law, and that procedures should be open and transparent.

9. Trade in services

China's service markets are in most cases heavily regulated, and trade in services is severely restricted. In most cases it is allowed only on a case-by-case basis. Joint ventures with Chinese service providers are often required in order to enter the Chinese market. Joint venture requirements are common in areas such as after-sales service, banking, insurance, transportation, as well as professional services such as legal counselling, accounting and consulting. Most foreign service companies are active in Beijing, Shanghai and Guangzhou, where they mainly work with foreign manufacturers, and in some cases with Chinese export companies. Many foreign subsidiaries as well as local Chinese exporters also buy various commercial services from local and foreign service companies in Hong Kong. The Chinese WTO service offer should be improved substantially and be based on the "eight guiding principles" for China's service offer as suggested by the European Commission in January 1998.

10.Foreign direct investment

Foreign direct investment in China is regulated according to sector in four categories: encouraged, permitted, restricted and prohibited. In most cases, except for ”encouraged” investments, a Chinese 50% local participation is required. Restrictions on the importation of components often hamper the prospects for successful local production. Most investors also face both legal and contractual requirements for technology transfers, and for local content, as well as requirements for export performance. Such requirements are contrary to the WTO TRIMs agreement and should be dismantled as a condition for Chinese entry into the WTO. Rules on foreign direct investment in service industries are even more restrictive than for investment in manufacturing.

Because of the unstable enforcement of laws and regulations, and the pervasive influence of government in all spheres of economic activity, many foreign subsidiaries are in practice hostage to local authorities when it comes to recruitment, utility prices, transport, etc. They may therefore find it difficult to develop a normal profitability. In practice it is often impossible to remit profits, because of foreign exchange regulations. If the present legal and administrative situation persists, it will have a negative long-term effect on foreign direct investment in China.

Conclusion

This "UNICE/China market access status report" is one of the European business initiatives to promote an environment conducive to trade and investment between the EU and China. UNICE is keen to pursue an active dialogue with the institutions concerned in order to contribute to the success of EU policy vis-à-vis China.