

Information Technology Industry Council –
Semiconductor Industry Association – Software & Information Industry Association – TechAmerica –
Telecommunications Industry Association

**Written Comments to the U.S. Government
Interagency Trade Policy Staff Committee
In Response to *Federal Register* Notice
Regarding China's Compliance with its
Accession Commitments to the World
Trade Organization (WTO)**

September 27, 2010

TABLE OF CONTENTS

I. Introduction	3
A. Executive Summary	3
II. China’s “Indigenous Innovation” Policy Drive	5
A. Summary	5
III. Intellectual Property Rights	6
A. Enforcement	6
B. Semiconductor Layout Designs	9
C. Policy Issues	10
D. Misappropriation of Financial Information	10
IV. Market Access and Technical Barriers to Trade	11
A. Technology Licensing	11
B. Technical Standards	12
C. Customs Valuation	15
D. Conformity Assessment and Type Approval	15
E. Cyber Security/Information Security Policies	17
V. National Treatment	21
A. Public Procurement	21
B. Government Procurement	22
1. China’s Commitments to Join the GPA	22
2. Government Procurement Law	23
C. Transparency	25
D. Environmental Standards in the Manufacture of Electronics	26
VI. Communications Services	29
A. Impediments to Market Access	29

I. Introduction

We are pleased to have this opportunity to provide input to the Interagency Trade Policy Staff Committee's annual assessment of China's World Trade Organization (WTO) compliance. The review provides USITO and its members an effective means to raise issues of concern and suggest approaches to resolve areas of disagreement with China's government over implementation of its WTO agreements.

EXECUTIVE SUMMARY:

- ***China's Indigenous Innovation Policy Drive:*** This continues to be a primary concern of USITO members. China's campaign to promote "indigenous innovation" is being applied to industrial policies and measures that systematically favor products and services of Chinese companies over those of foreign invested companies. While Chinese authorities have reiterated China's commitment to foreign investment and suspended publication of a national Indigenous Innovation Product Catalog, other policies and provincial-level catalogs continue to use government procurement as a tool to favor domestic products.
- ***Increase in Burdensome Industrial Policy Making (MIIT):*** USITO is concerned that the Ministry of Industry and Information Technology (MIIT) and other agencies of the Chinese government are increasingly taking a heavy-handed government approach to regulation and interventionist methods to encourage industry development. This will only create a more burdensome regulatory environment, and lead to new and unwarranted barriers to trade.
- ***Intellectual Property Rights:*** Despite expanded efforts in the past years to deal with Intellectual Property Rights (IPR) problems, and a clear recognition by senior Chinese leadership that IPR problems continue to create trade disputes and stunt economic growth, piracy and counterfeiting at the wholesale and retail level, and over the Internet, remain at significant levels due to inadequate penalties, uncoordinated enforcement among local, provincial, and national authorities, and the lack of transparency in China's administrative and criminal enforcement system.
- ***Technology Licensing:*** USITO companies continue to be concerned about governmental interference in licensing agreements. The Chinese government has publicly articulated a policy to limit royalties for patented technologies paid to foreign companies and to promote the domestic development of essential intellectual property.
- ***Technical Standards Setting:*** China's move to require WAPI, security standards for office equipment and other standards and its onerous information security requirements indicate a clear trend to promote indigenous technology, developed outside the international standards development system. This trend now appears to be increasingly institutionalized within Chinese government agencies and regulators.

Additionally, certain “voluntary” standards developed with little transparency have been made mandatory through various administrative measures and created barriers to trade.

- ***Customs Valuation:*** USITO continues to be concerned that, as USTR noted on China's compliance with its accession agreements several years ago, despite China's issuance of a measure "requiring duties on software to be assessed on the basis of the value of the underlying carrier medium." China has not uniformly implemented this measure.
- ***Conformity Assessment & Type Approval:*** Due to China's current type approval process for telecommunications equipment, through which companies must submit products to a less than fully transparent and burdensome conformity assessment process to obtain permission to sell their products in China, USITO urges China to simplify and consolidate redundant tests, shorten testing periods and eliminate unnecessary functionality tests. Ideally, China should streamline its type approval process to one certification process, combining the NAL, RTA and CCC certification processes. Additionally, China should publish and maintain an easily available web-based list of testing requirements and specifications.
- ***Information & Cyber Security:*** China's attempt to build technical prowess in this area—from 1999 encryption regulations to recent compulsory certification requirements for information security products (CCCi)—has again been done outside the international standards arena, leading to the creation of technical standards and schemes which veer greatly from global approaches, creating unnecessary and burdensome market access barriers. China has increasingly been adopting information security rules that are more stringent than necessary, like the Multi-Level Protection Scheme (MLPS) and office equipment security requirements.
- ***Government Procurement:*** In recent years, a number of Chinese government procurement practices and policies have been implemented that appear to be in conflict with the principles of the WTO GPA. USITO members are also concerned about China's second offer to join WTO GPA and hope to see China present a firm timetable for its timely accession.
- ***Environmental Standards and Compliance Regulations:*** We are concerned that Chinese officials may, inadvertently or otherwise, create trade barriers through the enforcement of environmental related standards, such as Energy Efficiency Standards and Environmental Standards, and compliance regulations such as RoHS and WEEE.
- ***Communications Services:*** As noted in our previous submissions, since China's WTO accession, some aspects of the communications services market have changed for the better. But the continued strong resistance to more extensive market opening appears to indicate uncertainty at the highest levels about how to resolve industry

problems and the role foreign players should have in the reform process.

II. China’s “Indigenous Innovation” Policy Drive

A. SUMMARY

China’s official high-level focus on innovation is understood and welcomed by our industry. It will play a vital role in achieving the goal of establishing an Innovation Society by the year 2020, as set out in high level policy commitments. Bolstered by strong legal institutions, including robust intellectual property laws, the U.S. information and communications technology (ICT) industry has made significant contributions to advancing innovation and boosting economic growth. However, there is legitimate concern that the campaign to promote “indigenous innovation” is being applied to industrial policies and measures that systematically favor products and services of Chinese companies over those of foreign invested companies. This can be seen in a number of areas ranging from the development of national standards and conformity assessment, to competition policy and local favoritism in government procurement.

In October 2009, several ministries jointly issued the *Notice on Launching the Accreditation of National Indigenous Innovation Products in 2010* and the *2009 Indigenous Innovation Products Accreditation Measures*, which established the link between Indigenous Innovation Products Catalogue and government procurement preferences. The criteria to get a product into the catalogue included a trademark originally registered in China as well as Chinese intellectual property, essentially shutting foreign products out of the government procurement area for several high-tech sectors. While China has since backed away from creating a national product catalog as a result of wide-spread international opposition to the program, many policies that encompass China’s Indigenous Innovation drive are structural, with direct consequences for market access and the ability of U.S. and other foreign firms to compete on a level playing field in China. Preference policies that favor one technology over another—or one product over another—are counterproductive to promoting long-term successful innovation.

USITO urges the Chinese government to encourage an environment that enhances opportunities for innovation in China, including the promotion of non-discriminatory and merit-based procurement and full and open competition in the Chinese market. USITO and the ICT industry would like to see commitment by the highest levels of Chinese government to “create an equitable environment for the operation of foreign businesses in China and enable foreign businesses to enjoy national treatment like their Chinese counterparts” be implemented.

In addition, USITO continues to recommend a focus on building global innovation capacity rather than so-called indigenous innovation. The discussions between the US and Chinese governments at a senior level on indigenous innovation should continue to serve as a broad umbrella in which a number of industrial policies can be addressed

as mentioned below. To this end, USITO recommends the US government think of creative ways to address the issues of indigenous innovation and techno-nationalist policy making in a way that would attract multiple Chinese stakeholders.

III. Intellectual Property Rights

The public statements by senior officials in the Chinese government that enforcement of intellectual property (IP) rights is a priority have been followed closely. These statements reflect a growing appreciation, at the highest levels, that an effective IP regime is an essential obligation of China as a major global leader and as a WTO commitment, as well as to promoting meaningful economic development domestically.

Unfortunately, below these senior levels, there continues to be a serious lack of consistent and effective measures to build on what has been some initial steps in recent years to pass improved intellectual property laws and regulations in the areas of copyright, patents, semiconductor masks, trademarks (including domain names), and business proprietary information.

For the US ICT industry, piracy and counterfeiting at the wholesale and retail level, and over the Internet, remain at significant levels due to inadequate penalties, uncoordinated enforcement among local, provincial, and national authorities, and the lack of transparency in China's administrative and criminal enforcement system. Indeed, the appropriation of IP in China has occurred on such a massive scale that it continues to influence international prices, disrupt supply chains, changed business models, and probably permanently alter the balance between tangible and intangible values contained within commercial products.

USITO remains committed to work with the Chinese government to achieve deterrence of piracy in practice, including through meaningful criminal penalties and greater administrative penalties, as well as on the research, drafting, and revisions of China's intellectual property laws. This includes working to ensure that recent decisions of the WTO regarding enforcement and market access are effectively implemented.

Closely related to these troubling IP policies is the regulatory framework emerging around the development of technical standards, the use of IP in China's standards, and competition policy. These policies also raise serious questions about China's WTO/TRIPS commitments, which oblige signatories to protect private intellectual property rights. For example, there have been recent efforts on the part of technical standardization committees in China to force transfer of printing and information security technology IP to domestic companies.

A. ENFORCEMENT

Enforcement actions are to be taken in a manner that assures China's commitments under the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) to provide copyright owners "effective action against any act of infringement in intellectual property rights covered under this Agreement" (Article 41) and if the infringement amounts to "willful trademark counterfeiting or copyright piracy on a commercial scale" to provide for criminal penalties including imprisonment and monetary fines sufficient to provide a deterrent to future acts of piracy (Article 61).

In past reports, the USITO has noted several positive developments in the area of enforcement of IPR, including the adjustment to thresholds and penalties for IPR infringement, as well as some successes in bringing civil actions, including several brought by foreign companies in Chinese courts. Despite these steps, effective criminal or civil enforcement remains wholly inadequate.

USITO is aware of published reports that indicate that, since China joined the WTO, just over two dozen criminal cases have led to convictions, far from a meaningful level of enforcement that results in deterrence in practice. Confounding efforts to show progress, China still does not report criminal cases involving copyright as a distinct category. The problems of enforcement also include a lack of progress in the enforcement of corporate end user piracy.

The US government will recall the commitments that China has made at the Joint Commission of Commerce and Trade (JCCT) in recent years and which remain unfulfilled and should continue to be pressed as a high priority. For example, in 2006, China made a commitment at the JCCT that was widely reported and well received: it would begin to ensure use of legal software by the government (at the national, provincial and local levels) and state-owned (and state-invested) enterprises. Nevertheless, it appears that a significant number of government agencies and enterprises still rely on pirated and unauthorized software. Any initial increase in sales that occurred after these commitments have now lost momentum. Of deep concern are reports that when China has sought to implement this commitment, it has done so in a manner that encourages the licensing and use of "indigenous" software and discourages licensing and use of software offered by foreign companies or developers. It is essential that China take steps to implement these JCCT and other commitments by actually purchasing a license for the software to be used, and then actually using the software that is acquired – without discriminating between Chinese and foreign producers and products. Also, in 2006, China committed to prohibit the sales of personal computers (PCs), whether manufactured in China or imported, without legal operating systems. This commitment was a significant milestone, given China's growing demand for PCs, now among the largest markets in the world. USITO understands that the initial result of the commitment was a demonstrated increase in legitimate software sales during the first year. However, results since that time show a remarkable lack of progress on this front. At a minimum, the government of China should redouble its efforts to purchase such PCs for its own use, and concrete steps to

ensure effective reporting and implementing of this commitment overall should be remain a high priority. Even with the lowering of the criminal thresholds, which USITO has noted in previous submissions, effective enforcement will not become a reality until there is inadequate attention, investment and training by the Public Security Bureaus (PSB). We restate our concern that the PSB needs to treat criminal enforcement of IPR offenses as a top priority. The experience to date is that enforcement remains slow, cumbersome, and rarely results in deterrent fines. Although Chinese authorities have undertaken some administrative enforcement actions against pirates, the government's refusal to share information about the actions it has taken or the ultimate outcomes of these actions makes it very difficult for rights-holders to assess the deterrent impact of China's enforcement efforts. As noted above, it appears that only a handful of criminal cases have been prosecuted and concluded in recent years since China's accession to the WTO under the criminal piracy provision, Article 217, involving a U.S. copyrighted work.

Thus, even with some recent successes in bringing civil actions, meaningful sentencing in criminal courts continues to be ineffective and does not result in actual deterrence, as required by TRIPS Articles 41, 50, and 61, which states that China must provide enforcement that deters further infringement, must allow for effective civil search orders, and must provide specific criminal remedies that act as a deterrent to continued theft of intellectual property. USITO appreciates the actions taken by USTR to bring cases before the WTO. USITO stands ready to work with both the U.S. and Chinese governments to use the information gathered in this process to help identify priorities for enforcement actions.

Finally, the IPR provisions in the Criminal Code have not been revised since 1997, even after China joined the WTO in 2001, and even though other key IPR laws, including the Patent Law, Trademark Law, and Copyright Law, have been amended since 2001 to bring them into compliance with China's TRIPs commitments. We believe the IPR provisions in the Criminal Code should be revised to be fully compliant with TRIPs—most importantly, to provide criminal penalties “that are sufficient to provide a deterrent” (TRIPs, art. 61) against piracy and counterfeiting. For example, Chinese courts currently interpret the “for profit” requirement that exists under Article 217 of the Criminal Code in a manner that is significantly narrower than the “on a commercial scale” requirement of Article 61 of TRIPs. As a result, it is effectively impossible to obtain criminal remedies against corporate end user software piracy (despite the clear commercial impact and purpose of such piracy), hard disk loading software piracy, and online software piracy. Such loopholes should be fixed either by amending the IPR provisions in the Criminal Code or by clarifying its scope in a new judicial interpretation. Otherwise, China will continue to violate its obligations under Article 61 of TRIPs to provide criminal remedies “sufficient to provide a deterrent” to these forms of commercial-scale piracy.

The various commitments made by the Chinese government in recent years are

important steps, and are a strong basis for the Chinese government to take concrete action and provide reliable information on actions to improve IP enforcement. USITO members remain focused on the need to see an improvement in the operating environment.

B. SEMICONDUCTOR LAYOUT DESIGNS AND ANTICOUNTERFEITING

Semiconductor companies typically spend 15 percent or more of revenue on research and development, making IPR protection of utmost importance. As the World Semiconductor Council (WSC) stated earlier this year, “Semiconductor producers invest a very high percentage of their revenues in R&D and the intellectual property (IP) that results is the lifeblood of these companies. Failure to adequately protect IP is damaging to the semiconductor industry and ultimately impedes the technological progress that has benefited consumers around the world.”¹

While semiconductor companies rely on patents, copyrights, and trademarks to protect much of their IP, semiconductor layout design protection provides unique legal rights that are particularly useful in certain circumstances. This form of protection is specifically included in the TRIPS agreement as a separate category. China adopted regulations to protect semiconductor mask work (layout design) IP in 2001. As China’s market and industry continue to grow, the successful implementation of this law becomes ever more important. At this point in time, USITO is not aware of any serious layout design violation cases.

The China Semiconductor Industry Association (CSIA) is a member of the World Semiconductor Council (WSC). The WSC has an IP Task Force that is composed of IP experts from all the major semiconductor producing regions. Through this task force, the WSC has laid out a position on the implementation of national layout design laws, such as clarifying the law in light of recent improvements in automated design tools that allow semiconductor layout designs to be made by copying a protected layout design with virtually no intellectual effort.

The WSC has also laid out a multi-pronged approach to address counterfeiting of ICs and other semiconductors. The typical counterfeit semiconductor case involves buying a semiconductor (or reclaiming a semiconductor from recycled computers or other electronic equipment), scrapping off the label on the semiconductor package, and remarking the semiconductor with a different brand, faster speed, or different part number that fetches a higher price. A counterfeit semiconductor can result in a consumer paying for a fast computer but getting a slow computer, or an inexpensive semiconductor causing an expensive computer to have reliability problems. Of more concern is that counterfeits cause reliability problems in applications involving health and safety, including medical equipment, automotive or aerospace applications, or

¹ The World Semiconductor Council currently is composed of the European, Japanese, Chinese Taipei, Korean, Chinese, and U.S. semiconductor industries. The WSC Joint Statement cited in the text was issued on May 11, 2006 in San Francisco.

communications infrastructure for first responders.

In late September, the WSC and the Government Authorities Meeting on Semiconductors plan to hold a Customs Workshop to discuss semiconductor counterfeiting problem. China's Customs Agency should be encouraged to aggressively follow up on the ideas that will be discussed at the workshop to seize counterfeit products and take actions leading to the arrest counterfeiters and counterfeit traders.

C. POLICY ISSUES

USITO continues to register concern about Chinese government involvement in discussions of compensation for intellectual property and policies that are seemingly designed to disadvantage non-Chinese intellectual property holders. Intellectual property arrangements should be a consideration only when government agencies are providing subsidies and loans or approving market listings. We reiterate the following positions, which have become more manifest since we first reported them in 2006:

- ***“Replacing foreign technologies” should not be a national policy priority.*** The government's energetic efforts to undermine the prices of international technologies do not support a general policy of respect for property rights.
- ***The rights of patent pools should be narrowly construed.*** We urge all of China's technical committees to adopt reasonable IPR policies based on the China Electronic Standardization Institute (CESI) IPR template negotiated in late 2006. Much effort went into developing that template to provide guidance to technical committees on how to properly balance the rights of IP holders and the users of a standard. (CESI controls/supervises approximately 50 technical committees that cover almost all IT standards development activities.) IT Technical committees also should assure their members that patents they license as part of a patent pool for a given standard will not be used in other standards.
- ***Clear distinctions should be drawn between value-added telecommunications services and provision of software.*** There is an increasing tendency for a sale of software to be treated as provision of value-added telecommunication service, bringing it into a more restrictive regulatory arena. In several cases, following reclassification of the software sale, the providers were told that renewed market access was contingent upon technology transfer to a domestic competitor.

D. MISAPPROPRIATION OF FINANCIAL INFORMATION

USITO appreciated the steps that USTR took, including bringing the case to the WTO, to challenge China's restrictions and requirements that China imposes on financial information services and service suppliers (FISPs). As we have noted in our prior

recommendations, it was essential that China implement its (1) obligations, upon joining the WTO, regarding "Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services (CPC 8131)" and (2) assurances, reached in an understanding in 1997 to prevent abuses by Xinhua, the Chinese state news agency, in its multiple roles as:

- market regulator,
- commercial competitor in the market it regulates, both itself and via its affiliate Xinhua Finance, and
- commercial partner and agent for some FISPs in respect of Xinhua marketing certain FISP information services in China

It is essential that the implementation of the Memorandum of Understanding (MOU) entered into between the US government and Chinese government deliver on its commitment to assure transparent, non-conflicted, and non-discriminatory treatment of financial information service providers (FISPs) by transferring regulatory responsibilities for financial information to a regulator that is clearly market-neutral. In that regard, the US government should closely monitor and review the "Provisions on Administration of Financial Information Services in China by Foreign Institutions" issued in April 2009, for consistency with these commitments and the MOU.

IV. Market Access and Technical Barriers to Trade

A. TECHNOLOGY LICENSING

The U.S. ICT sector continues to be concerned about governmental interference in licensing agreements. The Chinese government has publicly articulated a policy to limit royalties for patented technologies paid to foreign companies and to promote the domestic development of essential intellectual property. China seeks to foster the domestic development of innovative technologies and IPR in part through technology mandates or promotion of unique national standards. This policy is also implemented through direct or indirect interference by Chinese authorities in licensing negotiations between Chinese and foreign technology companies. Such interference is a dramatic departure from how business is conducted and technology transfer arrangements are concluded in the global market.

MIIT has effectively precluded foreign companies that own essential IPR for third-generation ("3G") wireless communications standards from negotiating technology licenses and royalty agreements directly with Chinese companies, which is the customary business practice globally. Rather, at the risk of being denied access to the Chinese market, foreign companies have been pressured to enter into negotiations involving royalty rates and other licensing terms with a committee led by

the China Academy of Telecommunications Research (CATR), a government institution subordinate to MIIT. China's goal is to use its superior bargaining power to force foreign patent holders to accept unreasonably low royalties that are not based on the economic value of the underlying patented technology and that are significantly below prevailing rates in other markets.

These governmental practices are inconsistent with the fundamental rights conferred by patent to technology owners and constitute an express violation, or at least nullification or impairment, of TRIPS patent provisions. In addition, Chinese government-imposed limitations on 3G royalties operate as impermissible price controls that are not authorized under China's protocol of accession to the WTO. There have been no signs of any change in China's policy on this issue since the 2004 JCCT meeting, where China promised not to interfere in royalty negotiations at least for 3G licenses. The U.S. Government should continue to press China on this matter by (i) clarifying that its 2004 commitment extends to all government and quasi-government personnel, and is not limited to "Chinese regulators" alone; and (ii) expanding that commitment, based on WTO requirements, so that it does not apply solely to 3G licenses. Chinese manufacturers should be permitted to negotiate directly with foreign IP holders. Otherwise, the PRC government will continue to find ways to interfere in royalty negotiations.

Indeed, the Supreme People's Court (SPC) recently provided guidance to the Liaoning Higher People's Court, which was adjudicating a case in which the plaintiff alleged infringement of its patent that had been incorporated into an industrial standard issued by the Ministry of Construction. On July 8th, the SPC noted the following:

Whereas the standard-setting authorities in China have not established public disclosure and use rules of patent information in relevant standards, if a patentee engages in the setting of a standard or agrees having the patent incorporated into a national, industrial or local standard, it would be deemed that the patentee permits others to exploit the patent while implementing the standard; Others' such exploitation/implementation of the patent does not constitute patent infringement provided by Article 11 of the Patent Law. *Patentee may ask the exploiter/implementer to pay a fee for use of the patent, but the amount of fee should be significantly lower than the normal license fee.* In case that the patentee commits to give up the fee for such exploitation of the patent, that commitment should be followed. (Emphasis added)

B. TECHNICAL STANDARDS

Under the guidance of the "Indigenous Innovation drive," many Chinese officials and

agencies have called for the promotion of technological standards with “self owned IPR” as well as the imposition of domestic standards. USITO members are concerned about the potential for compulsory licensing of intellectual property deemed essential for a national standard. Moreover, the mandatory imposition of standards limits competition between standards that embody differing capabilities. Limiting competition impedes innovation.

USITO recognizes China’s desire to foster domestic innovation; however, China’s policies have led to the mandating of regulations and standards (such as requirements on information security product certification which incorporate by reference a multitude of domestic standards, as well as potential cell phone battery/headset/phone book standards) that are developed outside of international standard setting processes with no transparency. Mandatory adoption of national standards impedes innovation by restricting both the ability of Chinese companies to serve other markets as well as foreign importers to serve domestic markets.

In addition, China’s move to require WAPI, office equipment security standards and its onerous information security requirements indicates a clear trend to promote indigenous technology which is developed outside the international standards development system. This trend now appears to be increasingly institutionalized within Chinese government agencies and regulators. Furthermore, preferences given to domestic technology producers who are compliant with “indigenous standards” in government procurement also leads to the exclusion of foreign suppliers, particularly as the state owns the telecommunications carriers in China.

USITO Recommendation: Chinese authorities should be encouraged to promote the use and adoption of voluntary, open, international and industry-led standards, as well as promote active participation by Chinese organizations in international standards setting bodies and initiatives.

Consistent with previous USITO observations, China remains focused on developing and maintaining unique Chinese standards that feature Chinese technologies to the exclusion of leading technologies of foreign origin. Rather than relying on commercial demand to drive deployment, China seems intent on steering the market toward specific local technologies. While understanding China’s desire to grow its ICT sector, we are concerned about the manner in which that growth may take place. Technology development should take place in cooperation with – not at the expense of – non-Chinese companies who contribute to China’s technological and economic growth.

We would like to reiterate several principles for the development of technical standards that we believe are important to robust trade and investment. We believe that, in all but exceptional cases, standards should be voluntary and not mandated by government agencies. We also believe that China’s definition of “international

standardization bodies” is too narrow. World-class standards are today developed by a variety of organizations, including organizations that have achieved global prominence because of the international relevance and the broad range of participation in development of their standards. Examples include the Institute of Electrical and Electronics Engineers (IEEE), the Internet Engineering Task Force (IETF), and the Worldwide Web Consortium (W3C). The WTO has outlined requirements for organizations that seek to be considered as developers of international or global standards and we encourage China to recognize the broader WTO definition of “international standardization bodies or systems” contained in Annex 1 of the Agreement on Technical Barriers to Trade (TBT), which in essence includes any standardization body that is open to all WTO members and meets the criteria set forth in the Decision of the TBT Committee on Principles for the Development of International Standards that is contained in Annex 4 to the Second Triennial Review of the Operation and Implementation of the Agreement on Technical Barriers to Trade. USITO also encourages China to follow the attributes of eligibility derived from the WTO principles including, but limited to, openness, consensus, balance, and transparency.

Lest the standards-development activity that is now so important to China’s development be stalled by intellectual property concerns, the China Standardization Administration and China National Institute of Standardization have drafted a set of patent-related standard regulations and disposal rules to address such concerns. USITO commented on both drafts and was invited by both agencies for consultations. Many of the terms in the regulations are vague and unclear, which could hinder the protection of non-domestic IPR owners. Thus, the US ICT industry urges China to:

- (i) Require standards development efforts to be governed by a clear and stable intellectual property policy that is open and fair for both domestic and international patent holders, so patent holders can evaluate the costs and potential risks prior to their participation;
- (ii) Adopt intellectual property policies that allow patent holders to license patents essential to a Chinese standard on reasonable and non-discriminatory (RAND) terms (default terms under the CESI template);
- (iii) Adopt a policy in which the same licensing commitments submitted to international standards also apply to a national adoption of the identical version of the international standard; and
- (iv) Encourage or require only reasonable and necessary patent-disclosure policies.

The simplest approach for China would be to adopt the ISO/IEC or ITU-T patent policy for domestic standardization, since China would need to follow that policy anyway in any ISO and IEC or ITU-T standards efforts. However, intellectual property policy does not need to be uniform for all standards development efforts so long as the policies actually adopted are consistent with these core principles. In that regard, at a minimum, such policies should be based on the CESI template mentioned

earlier.

Finally, while not a WTO requirement, we urge that foreign-owned enterprises be permitted—and encouraged—to participate in Chinese standards-development efforts on an equal and nondiscriminatory basis. In North America and Western Europe, the development of standards has been an open, interactive process, in which enterprises from around the world have participated. The openness of these processes helps account for their undeniable commercial effectiveness and helps ensure that any national standard is not more trade restrictive than necessary. We believe that fair, open, and equal access to participation, including the right to vote, in standards development efforts by Chinese and non-Chinese enterprises alike will result in superior Chinese standards and superior Chinese proposals for consideration by international standards bodies.

C. CUSTOMS VALUATION

As part of its WTO accession agreement, China agreed to undertake the obligation to adhere to the Agreement on Customs Valuation (ACV), immediately upon accession, without transition. China also made commitments that customs valuation will be consistent with GATT AD 4.1 for all products within two years of accession. With respect to digital products, in particular, customs valuation is to be based on the value of carrier medium, and not on another standard (including the value of the content on the medium).

Unfortunately, there continue to be reports of deviation from this international norm and that customs valuation in China continues to vary by customs office for the same product. USITO continues to receive reports that China Customs is attempting to charge duties on royalties and license fees on imported software, contrary to Article 8 of the WTO Valuation Agreement and even though the WTO Commentaries say that they are not applicable to 4.1.

More than seven years since China's accession, these continued reports are unacceptable with the impact of discriminating against software and the type of delivery media chosen by exporters to China. USITO continues to share the concerns reported by USTR that despite China's issuance of a measure "requiring duties on software to be assessed on the basis of the value of the underlying carrier medium," China has not uniformly implemented this measure. The underlying carrier medium for example could refer to the floppy disk or CD-ROM itself. The duties on software are not to be assessed therefore on the imputed value of the content carrier on the underlying medium (e.g., the data recorded on the floppy disk or CD-ROM).

D. CONFORMITY ASSESSMENT AND TYPE APPROVAL

China and the U.S. are among the 52 countries and over 65 National Certification

Bodies (NCBs) participating in the International Electrotechnical Commission's (IEC's) system for Conformity Testing and Certification of Electrical Equipment ("IECEE CB Scheme"). The CB Scheme is an essential vehicle to provide market access for products and eliminate redundant testing of products at multiple laboratories. There are both existing and developing programs within the IECEE that are aimed at improving data acceptance and harmonization of conformity assessment practices across countries. During recent years, China has engaged positively within the IECEE CB Scheme for product safety test report acceptance; however, laboratories in China today are not making the best use of these international programs.

The product testing and certification process in China is significantly more burdensome than in other markets, which increases the costs of exporting products to China. Under China's Network Access License (NAL) there are unnecessary testing requirements that contribute to increasing delays for entry of a product to market and increasing the costs of companies seeking product approval through the NAL process. Ideally, China should eliminate the NAL as a product licensing requirement. However, recognizing the structural/legal problems that would pose, USITO recommends that, for the time being, China reduce the number of tests required by the NAL to a bare minimum. As China's telecommunications operators are already requiring their own tests, it would be more appropriate for the network operators in China to establish their testing/certification needs based on their own technical needs.

As part of reducing these NAL testing requirements, China should eliminate mandatory testing for specific enhancement functions such as WAPI and take a technology neutral approach that does not promote certain technologies. Furthermore, it should eliminate functionality testing from the NAL since the functionality of product is a consumer choice and therefore should be tested by service providers.

Additionally, MIIT's lack of clear labeling requirement rules for type approval is creating inconsistent application of labeling at the provincial level. Although MIIT has told companies that labels can be affixed to packaging, some provincial government officials have required companies to affix the label to the product. Given that NAL labels must be purchased from MIIT directly at a cost of approximately 30 cents per label, this lack of certainty results in millions of dollars in re-labeling costs for particular products. Written and transparent labeling requirements will reduce the amount of re-labeling and thus the significant cost.

China's current certification requirements for telecommunications equipment conflict with its WTO obligations of limiting imported products to no more than one conformity assessment scheme and requiring the same mark for all products (Article 13.4(a) of China's WTO Accession). China has three different licensing regimes—the Radio Type Approval, the Network Access License, and the China Compulsory Certification. Therefore, for a given piece of equipment, it can cost between U.S.\$30,000-35,000 to test

for all three licenses (NAL, RTA, CCC). MIIT indicates on its website that it processes approximately 4000 applications a year, which represents approximately \$140 million in testing fees a year.

USITO Recommendations: USITO appreciates the work of USTR and the Department of Commerce in the 2009 U.S.-China Joint Commission on Commerce and Trade to engage with MIIT to address these concerns. In the meantime, USITO urges the Chinese Government to promote the fuller adoption of the IECEE CB Scheme and streamlining its type approval process by (1) encouraging acceptance of CB Scheme test reports by national laboratories; (2) joining most other countries in participation in the IECEE CB Scheme for (Electromagnetic Compatibility (EMC)); (3) reducing the number of tests required by the NAL to a bare minimum; (4) clarify licensing labeling requirements for products to leave it up to the discretion of the manufacturer, whether it be in the packaging or on the product; and (5) negotiating and concluding a Mutual Recognition Agreement for testing and certification with the United States. Furthermore, new testing and factory audit requirements should also be announced at a minimum 60 days notice to allow for adequate time for industry to make the transition and all testing requirements and specifications should be published and maintained on an easily available web-based list.

E. CHINA'S CYBERSECURITY/INFORMATION SECURITY POLICIES

Over the past several years, China has been working to increase regulation of information security to strengthen protection of information systems. It is apparent that much of China's drive to expand regulation and develop its information security industry has not effectively incorporated global practice and experience in these areas, setting off on a path that will overly and unnecessarily restrict market access for foreign products. China may also disadvantage its own effort to protect information by shutting out some of the world's leading information security products from its market, reducing interoperability and workability and making their systems more vulnerable to risk. Following are a number of specific policies and concerns that the U.S. ICT industry has about China's policies in this area.

CNCA Information Security Testing and Certification Regulations (CCCi)

In August 2007, China issued draft regulations for compulsory testing and certification of 13 information security product categories, including firewalls, routers, smart cards, and operating systems, among others, sold commercially. The testing requires the disclosure of sensitive technical data, including in some cases, source code of software and trade secrets of ICT products. After significant government-to-government and industry-government dialogue with China about these regulations, China agreed in April 2009 to roll back the scope of the regulations from products in the commercial market to products procured by government entities under China's Government Procurement Law. China has also seemingly agreed that SOEs making commercial purchases would not be subject to these regulations; however, as

of this writing, this remains an outstanding issue for definitive clarification by the Chinese government.

This adjustment in scope was a welcome development by the U.S. ICT industry, but the 13 CNCA regulations are still more restrictive than other countries' practices when it comes to regulating information security products procured by government agencies for those products that are not for use in military or intelligence information systems. Moreover, there is concern that China will continue to add product categories to the scope of the regulations. China is in the process of drafting its own mandatory information security standards for eight categories of office products, including printers, scanners, and copiers, among others, though international standards already exist in this area.

In June 2009, the Office of State Commercial Cryptography Administration (OSCCA) issued cryptographic testing criteria for 6 of the 13 product categories in the CNCA regulations. While implementing regulations for this testing have not been issued, when they are, the following categories of products will be required to undergo tests requiring the disclosure of source code and cryptographic protocols: 1) Secure Operating System Products; 2) Secure Database Products; 3) Network Separator and Information Exchange Products; 4) Firewall Products; 5) Secure Router Products; and 6) Smart Card COS Operating Systems Products. This means that in addition to the testing required by the CCCi, these six product categories will face an additional layer of testing that will in effect bar foreign products from the government procurement market. Finally, certain of the six product categories may also be required to use Chinese cryptography modules instead of foreign modules.

In April 2010, the Ministry of Finance, the General Administration of Quality Supervision, Inspection and Quarantine, and CNCA jointly issued the No.48 Circular "Notice on Government Procurement Implementation of Information Security Products," which embedded CCCi regime into government procurement. It states that "all national agencies of all levels, all public institutions, and all organizations using government procurement funds to procure infosec products must purchase nationally certified infosec products," and infosec products sold to government market must get CCC marks issued by CNCA. Procurers and their agents who do not procure according to the requirements will be punished, such as "MOF can repudiate procurement funds."

This circular is a signal that the government is further promoting CCCi from the users' side, i.e., mandating that government agencies must buy CCC certified products. This is problematic since it would shut out foreign products from the government market, the definition of which has long been vague, since China's SOEs are highly controlled by the government. Meanwhile, it remains unworkable for foreign firms to comply with the CCCi regime, and the regulators have yet to address the concerns like source code and design information disclosure, testing lab neutrality,

among others.

Multi-Level Protection Scheme (MLPS)

MLPS is a technical mandate that has been under development for many years and is part of China's overall national information assurance strategy. In June 2007, China issued the *Administrative Measures for the Multi-Level Protection of Information Security*, a mandate that sets down guidelines to categorize information systems according to the extent of damage a breach in the system could pose to social order, public interest, and national security. The mandate also provides detailed technical standards for products used in and management of the information systems, which will be categorized from level 1 (normal systems) to level 5 (extremely important systems related to national security requiring specialized oversight and inspection). Each level comes with its own specific product and management requirements. For example, products in information systems classified at level 3 and above are required to have core technology with independent IPR in China, and the product developers and manufacturers must be invested or owned by Chinese citizens or legal persons. In addition, encryption requirements in the *Measures* may include the mandatory use of Chinese encryption algorithms or divulgence of cryptographic source code. A myriad of information systems, such as those in banks and telecommunication companies (which have been regular customers of foreign suppliers of information security products) will be classified at level 3. Because of the onerous testing requirements involved in obtaining that classification, many foreign security products will likely be excluded from those "critical infrastructure" systems.

The MLPS construction process for a given enterprise begins with an evaluation and assessment of security level for each information system. In the next step a solution is designed to bring the enterprise's information systems compliant to the security requirements of each system's security level. There is a growing number of certified MLPS compliance and solution design experts who are hired to support the design process. Enterprise also generally relies on domestic information security companies that specialize in building these solutions. After the solution is built, the systems' needs are reevaluated and further construction or adjustments may be required. Reevaluation continues on a periodic basis.

The 2007 "Administrative Measures" give important insights into how MLPS may restrict the ability of global ICT companies to effectively compete with domestic Chinese companies, and preclude the ability to offer their products and services on a non-discriminatory basis. The specific concerns found in the "Administrative Measures" include the lack of use of global approaches in the technical basis for conformance, proscribed use of domestic Chinese labs (with potentially inadequate processes and protections), domestic Chinese encryption algorithms, disclosure of source code and other deep level designs, and mandatory use of other indigenous Chinese technologies as conditions for evaluation, certification and access to buying entities. Regarding the relationship of MLPS to the CNCA Information Security

Regulations, MLPS has provisions to facilitate a direct linkage to the CNCA regime. Essentially, under MLPS, all products procured for use in systems designated level three and above must undergo mandatory testing and certification -- and this is not limited to the 13 categories of products. Moreover, since 2008, the Ministry of Public Security (MPS) is now officially using the CNCA testing standards under its product licensing regime.

While all countries, including the United States, are working to determine the best policies to protect their critical infrastructure, China continues to maintain that China has unique security needs, and therefore needs unique security protection systems. Global approaches to information security already exist, and while these approaches are constantly being improved upon, they facilitate global commerce, promote innovation, reduce vulnerability risks, and foster interoperability and workability. We would encourage China, a major global player, to assume a more active role in the international discussion on information and cyber security. Earlier in 2009, China noted that it initiated a study of the Common Criteria Recognition Arrangement (CCRA), and the U.S. ICT industry supports any USG effort to engage China in dialogue on the benefits of the CCRA.

From this year on, MLPS-related language began to appear in Request for Proposals (RFPs) for information technology products and services. MLPS is unlike CCCi, in that there is no official date of implementation. Rather, the impact of MLPS to a given ICT industry company will be felt when their Chinese competition has a substitute that can compete in quality and function, because at that time that competitor can use MLPS to receive preferential treatment of their product in the buyer's procurement process.

MLPS impacts information security products that are substitutable. Substitutable products refer to products where Chinese information security companies have products that can compete with those of foreign products on higher levels of product security, or in other words are vulnerable to a policy of foreign product substitution. Generally, price does not enter into the buyer's comparison of foreign and Chinese-made products because the foreign competitor is barred from competing before a price can be quoted.

Office Equipment Security Requirements

Since early 2010, Technical Committee (TC) 260, in conjunction with the China Electronic Standardization Institute (CESI) under MIIT, convened meetings to discuss the formulation of China's information security standards for office equipment. This standard will cover office equipment and their supplies, to include printers, all-in-one devices, copiers and cartridges.

Concerns about this standardization effort include: First, the standard is very broad,

applying to all markets in China, not limited to government procurement only. Second, the standard does not take into account the core-function encryption test, so it is expanding the scope of coverage beyond what China has traditionally covered in its security standards. In fact, in this case, the standard goes beyond security related issues completely, in that it covers non-security related components of the equipment and supplies, e.g. the cartridge chip. Third, statements have been made that certain components would be disallowed or must be of Chinese origin only. Statements have also been made that all chips in the equipment would need to be of Chinese origin. This goes beyond the requirements China has put forth with any other security related standard. In others, they have required certification but have not outright banned foreign components.

CESI has been the primary drafter of the standard and has used IEEE 2600 as a base, along with input from Chinese companies, in particular Founder and Print-Rite. Foreign OEMs have been allowed to join the group as observers, but have also been able to participate in discussions at the meetings and provide language for the standard. At this point, the standard is a national level voluntary standard, but the foreign OEMs fear it will become required in most RFPs in China and thus become a de facto mandatory standard.

USITO welcomes the fact that China now welcomes foreign firms to be observers of the standardization efforts, and understands China's increasing information security concerns. However, because most consumers and many businesses use low-end office printing equipment and do not require the level of security being addressed in this standard, we suggest the scope be limited to government end-uses where security is the primary factor and not include the general consumer or commercial sectors. The definition of security products should also be in line with the core-function encryption test, which has been applied to all other security related standards. In addition, USITO also wants to ensure that this standard does not institute requirements that have no security value but instead restrict or prohibit U.S. companies' ability to compete fairly in the Chinese market.

V. National Treatment

A. PUBLIC PROCUREMENT

China's Medium to Long Term Strategic Plan for the Development of Science and Technology has focused on the role that public procurement can play in advancing innovation by accelerating the diffusion of innovative products. However, the articulation of the implementation of this strategy released in 2006 and further detailed in 2007 call for the preferential procurement of "indigenous innovation" products. Chinese government agencies at both the central and subcentral level have been tasked with developing both criteria for qualification as an "indigenous innovation product," as well as lists of such products. Such indigenous innovation criteria and lists have great potential to discriminate against foreign products, foreign

owned intellectual products, and firms currently serving the Chinese Government market, i.e. in IT procurement, and outsourcing service procurement.

USITO Recommendation: USITO believes that transparent, merit-based, technology neutral, non-discriminatory and pro-competitive procurement ensures that the government as a user of technology obtains the best goods and services for the best value. Limiting government procurement to products based on nationality of IP ownership or brand registered location or other indigenous innovation factors fails to appreciate the truly global and cross-border nature of innovation and product development, as well as the very substantial and critical contributions that multinational technology companies are making to China's own capacity as a global innovation leader. It is in China's own interest to ensure that its procurement policies are consistent with GPA norms and that China joins the GPA on strong commercial terms both at the central and sub central level.

B. GOVERNMENT PROCUREMENT

1. CHINA'S COMMITMENT TO JOIN THE GPA

USITO is aware that China has made a second offer to join the WTO's Government Procurement Agreement (GPA) in 2010. The fact that the second offer was made in a 3-year interval instead of the 7-years it took for the first offer to be made is a great improvement. Chinese Premier Wen Jiabao at the World Economic Forum's "Summer Davos" commented that China would take an active role in joining the GPA. USITO recommends the US government continue engaging the Chinese government in discussing the issue in the Strategic and Economic Dialogue (S&ED) and JCCT sessions. The US ICT industry recommends that, based on the priorities below, US government officials use the JCCT meeting at the end of November to continue addressing the following concerns:

- An implementation date of 15 years after accession is unique amongst GPA signatories, and has no factual basis for support.
- As for product coverage, the US ICT industry strongly urges that the US government pursue a negative list approach that assumes all products are covered, unless justified otherwise, and that the commitment by China includes a broad coverage of services comparable to that provided by other Parties to the GPA.
- The proposed thresholds are far above those of other signatories to the GPA, and lack a meaningful basis for implementation of China's commitments.
- It is essential that the coverage of entities be meaningful and effective. Some wholesale carve outs lack justification and are unwarranted.
- We urge that the coverage of the commitment be as comprehensive as possible at the central and sub-central government level..

The U.S. ICT industry continues to urge the US government to pursue a comprehensive approach whereby central government entities are included in the commitment predicated on the key underlying laws that establish the organization of the State Council, and that regulate personnel appointments. At minimum, the obligation should include any entity that is subject to the Government Procurement Law.² Sub-central government entities should include (1) the governments of the Administrative Divisions (“Provinces”) (sheng); (2) the governments of the 5 autonomous regions (zizhiqu); (3) the governments of the 4 municipalities³ (shi); and (4) any “body governed by public law”⁴ enacted by these governments (i.e., subordinate entities of the Sub central governments).

It is essential that a meaningful Annex 3 (addressing State-Owned Enterprises (SOEs)) should be included. Much remains to be done in this regard. Moreover, it must be noted that China’s WTO accession agreement included many provisions that directly or indirectly addressed State-owned (and State-invested) enterprises. Specifically:

- China agreed at that time that laws, regulations and measures relating to the purchase by State-owned (and State- invested) enterprises of goods and services for commercial sale, production of goods or supply of services for commercial sale or for non-governmental purposes will be subject to certain WTO rules, and that such laws, regulations and measures would not be considered to be laws, regulations and measures relating to government procurement.⁵
- China also agreed that State-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, such as price, quality, marketability and availability; would be on non-discriminatory terms and conditions; and that the government would not influence the commercial decisions of

² Article II of government procurement law states that the following entities are subject to the *Government Procurement Law*: “Government Procurement” refers to the purchasing activities conducted with fiscal funds by government departments, institutions and public organizations at all levels, where the goods, construction and services concerned are in the centralized procurement catalogue compiled in accordance with law or the value of the goods, construction or services exceeds the respective prescribed procurement thresholds.

³ The governments of the 4 municipalities are considered “provincial-level administrative units under the management of the Central Government,” and approved by the Chinese National People’s Congress. These cities are subject to the laws and administration of the State Council.

⁴ Any “body governed by public law” enacted by these governments is a body:
-- Established for the specific purpose of meeting needs in the general interest, and not having an industrial or commercial character, and -- Having legal personality, and -- Financed, for the most part, by the Provincial, Autonomous or Municipal authorities, governed by public law, or subject to management supervision by those bodies, or having an administrative, managerial or supervisory board, more than half of whose members are appointed by Provincial, Autonomous or Municipal authorities or by other bodies governed by public law.

⁵ See Paragraph 47 of the REPORT OF THE WORKING PARTY ON THE ACCESSION OF CHINA, WT/ACC/CHN/49, 1 October 2001.

State-owned or state-invested enterprises.⁶

The US ICT industry strongly urges that careful consideration of these existing obligations by China regarding State-owned (and State-invested) enterprises be taken into account in the GPA accession talks. It is essential that China's GPA commitments, when finalized, not serve to weaken or undermine these pre-existing commitments. Together, China's GPA commitments and obligations on SOEs should work constructively together to ensure the high level of protections for US IT products and services.

2. GOVERNMENT PROCUREMENT LAW

Chinese government procurement practices and policies continue to be implemented in a manner that appears to be in conflict with the principles of the WTO GPA, whose goal is to ensure open, non-discriminatory, pro-competitive, merit-based and technology-neutral procurement of goods and services so that governments can acquire the best goods to meet their needs for the best value.

For example, China's 2003 *Government Procurement Law* requires that China's government purchase only domestic goods, works and services, with limited exceptions. Moreover, since publication of the "Government Procurement Regulation for Imported Products" (Document 120) in late 2007, the US ICT industry has experienced government sales difficulties and, in extreme cases, entire municipal or provincial governments refusing to purchase "foreign products." Initially, this could be attributed to the lack of understanding regarding Document 120 by key government agencies; however, almost two years later, there is growing concern that these policies will preclude non-Chinese companies from meaningful opportunity to provide products and services in the government market. In the spring of 2008, USITO sent a formal letter to the Ministry of Finance articulating the ICT industry's specific concerns related to Document 120, including the inability of products produced in special customs zones to be considered domestic products.⁷ To date, USITO has not received a response to this letter.

In 2010, *PRC Government Procurement Law Implementation Rule (Request for Comment Draft)* and the *Administrative Measures for Government Procurement of Domestic Commodities (Draft for comments)* have both attempted to define domestic goods for government procurement in such a way that a majority of products produced in China by foreign invested firms or containing foreign owned IPR would be considered non-domestic. China high-rank government officials have committed in various situations "to treat, under its Government Procurement Law, products produced in China by foreign invested enterprises the same as products produced in

⁶ See Paragraph 46 of the REPORT OF THE WORKING PARTY ON THE ACCESSION OF CHINA.

⁷ On July 9, 2008, the Ministry of Finance issued the "Circular of MOF General Office Concerning Issues on Standardizing the Government Procurement of Imported Products". The Circular provided clarification in some areas; however, most of the concerns remained unaddressed.

China by Chinese enterprises” and also appreciates that the US government confirmed at the S&ED “that products produced in the United States by an enterprise established in the United States are treated under its procurement regulations as domestic products regardless of the ownership of the enterprise.” It will be recalled that China and the U.S. agreed at last year’s JCCT “that both sides will work towards ensuring that U.S. invested firms in China and Chinese invested firms in the U.S. will be able to participate in their respective government procurement markets.” It is essential that the implementation of these commitments be monitored carefully to ensure effective results.

The concerns previously raised continue with regard to the U.S. ICT industry experiencing delays and disruptions when bidding on government procurement projects in a number of major cities and at the Provincial level.⁸ Confusion continues to exist between local products and local brands, specifically many of the products produced in China by Foreign Invested Enterprises (FIEs) are indeed domestic products whether or not they are produced under a foreign or domestic brand. In some cases, local officials have interpreted local products as “local brands.” In addition, local governments are under pressure to purchase domestic goods and it is an additional burden for them to justify why they need to buy foreign goods. Evidence persists of lost sales with some bids to SOEs due to these GP provisions. We understand that there has been some official guidance to SOEs to purchase software and equipment from domestic companies.

Yet despite these commitments made by China at the S&ED and on other occasions, there are many government procurement regulatory measures that are being promoted under the guise of “indigenous innovation,” which remain formidable market access barriers. Specifically, in 2009 China’s Ministry of Science & Technology (MoST) had developed a “National Indigenous Innovation Government Procurement Product List” Accreditation Program. According to reports, this list will serve as a reference guide for all levels of procuring entities in China in order to encourage the Chinese government to give a leg up to domestic entities in the procurement process. Of most concern to USITO is the stringent requirement that IPR and brands of the applying product be of Chinese origin. Although in April of 2010, MOST announced the new accreditation program that changed the requirement to IPR and brands to be registered in China, USITO members still found the program to be problematic in its simplistic and unclear requirement. It is highly important that the U.S. government seek clarifications on these measures with the relevant Chinese authorities, with specific regard to China’s transparency commitments made to the WTO.

It is deeply desired that the commitment made by China at the S&ED address these practical issues at the national, provincial and local levels. We note, again, that the

⁸ See The Administrative Measures of the Government Procurement of Imported Products (Document No. 119) and the Administrative Measures for Government Procurement of First Purchase Indigenous Innovation Products (Document No. 120).

experts on the panel of judges play a critical role in determining whether a product is "local" or not. USITO recommends that a high degree of transparency be ensured in establishing the qualifications for those examiners and experts and in their selection and performance of duties. This will help ensure greater confidence in the overall implantation of the new requirements on behalf of all market participants.

USITO strongly believes that keeping China's government procurement market open will send a clear signal to the world that the China is determined to pursue a fully market-oriented economic regime as China strives to win recognition of "full market economy status" internationally.

C. TRANSPARENCY

USITO noted last year the positive steps taken with the 2008 implementation of China's National Ordinance on Openness of Government Information. It has been hoped that this step would act as a catalyst to give individuals and organizations the legal right to request information from the government in an orderly manner. One year later, it is not clear that this effort has produced a more transparent and predictable situation. It is important for the USG to continue pressing China to meet its commitments on government transparency, including those relating to the formulation of industry policies.

Specifically, the long overdue Telecom Law has yet to be completed and the drafting process is opaque. The same lack of transparency affects regulations as regulations continue to be issued without prior public discussion, a most fundamental requirement of a transparent administration. Since regulations directly affect the welfare and opportunities of industry participants and end-users, these groups have a direct interest—and expertise—to contribute to developing sound regulation. Transparent opportunities to participate in China's rulemaking process are mandatory for investors to have confidence in stable investment opportunities.

D. ENVIRONMENTAL STANDARDS IN THE MANUFACTURE OF ELECTRONICS

USITO appreciates and fully supports MIIT's leadership in promoting industry development through information and industrialization. In the past few years, USITO, its parent associations and member companies have been privileged to support and advise the MIIT and other Chinese agencies on a number of issues including environmental rules and regulations, industry policies, as well as industry standards. We appreciate continuous support and receptiveness we received on the issue of China RoHS regulation and USITO hopes it can continue building on this relationship in the future.

We understand that China is looking to the European Union (EU) for regulatory means to manage end-of-life electronic products, including product content bans,

energy efficiency and recycling requirements. Chinese government officials have indicated that one reason for promulgating product stewardship regulations similar in content to those of the EU is to ensure that Chinese manufacturers will be able to export their goods to that large market. EU regulation of electronic products, however, has created significant opportunities for trade barriers to emerge. We are concerned that Chinese officials may, inadvertently or otherwise, create trade barriers of their own through similar regulations.

i) RoHS

“China RoHS” took effect on March 1, 2007. Industry appreciates the openness of the MIIT officials in their regular communication with the industry on the implementation and development of the China RoHS catalogue. The marking and labeling requirements took effect in 2007; however, potential pre-market certification requirements could add significant time-to-market delays, expenses and could in practice create potential trade barriers. In October 2009, the MIIT publicized the first draft catalogue for comment, and USITO had aligned with parent associations and member companies to comment on the draft. USITO had concerns over the definition of each listed product, and suggested for a clarification for custom control and market access control. Despite of industry’s repeated advocacy of this concern, the July 2010 draft China RoHS regulations still included pre-market certification requirements. This emphasizes the need for continuing collaboration.

USITO Recommendations:

- When considering development of the catalogue, following concepts should be taken into consideration:
 - ✓ Technology – Industry needs further collaboration with MIIT to build the Electronic Information Product covered under the catalogue.
 - ✓ Reliability – Industry needs exemptions harmonized to EU RoHS until we have adequate long term information to ensure the reliability of the technology.
 - ✓ Quality - Where a quality issue can disrupt mission critical infrastructure, products should be outside the scope.
- Industry strongly believes that pre-market certification coupled with RoHS compliance could create potential trade barriers and create a significant administrative burden. USITO thus recommends that Chinese government agencies embrace the best practice of self declaration of compliance (SDOC) in the administration of RoHS.
- China’s avoidance of trade barriers, burdensome conformity assessment, and complicated certification requirements that may potentially put foreign invested companies and their products at a disadvantage as compared with their Chinese industry peers. The voluntary certification program proposed by MIIT and China National Certification Administration (CNCA) in May 2010 was advertised as a release on RoHS certification. However USITO members maintained their concerns over the pre-market nature of the program, and the risk of revealing sensitive up-stream suppliers information.

- China’s adoption of international standards, where applicable to the areas covered by the Management Methods. This would facilitate the flow of high-tech products across multiple jurisdictions, including China, that are supported by harmonized requirements, including testing methods, compliance and labeling requirements.
- ii) WEEE

According to the National Development and Reform Commission (NDRC), the “*Administrative Regulation on Recycling and Treatment of Waste Electrical Appliances*” (*China WEEE*), will be promulgated by the end of the year. This regulation takes its core requirements from the EU WEEE, by requiring take back and recycling of certain electronic appliances. The pricing structures for recycling and potential costs to manufacturers remain uncertain. According to NDRC, the five categories are subject to mandatory recycling, while industries representing other categories are encouraged to undertake voluntary recycling. The five product categories will be expanded to include others, over time. Industry remains committed to working with appropriate officials.

USITO Recommendation: Chinese officials should consider requirements that allow smooth market access and efficient environmental protection that promotes the reuse and recycling of products, parts, and materials, and balancing the appropriate responsibilities for manufacturers and retailers.

iii) Energy efficiency has become a priority for China with the central government seeking ways to make China an ‘energy-saving’ society. For the ICT sector, China has finished the standard development for flat screen TV and printers, which will be implemented and released in the near future. Currently, the Chinese National Institute of Standards (CNIS) has been formulating standards for micro-processors computers. Other EE standards CNIS is planning to develop include data center, and servers.

USITO Recommendation:

Industry would welcome an opportunity to work with the U.S. government:

- To effectively share with China those voluntary measures that have delivered the best results in increasing energy efficiency;
- To assist China to establish an optimal balance between compulsory and voluntary regulatory tools; and
- To help China consider adopting workable measures

Industry recommends that energy efficiency labeling remain voluntary and not become mandatory to prevent barriers for companies especially involved in government procurement.

iv) Alignment

The electronics industry has spent hundreds of millions of dollars already in developing technologies to achieve compliance with the EU RoHS Directive. Therefore, as long as the MIIT regulations remain consistent with EU RoHS

requirements, the burden on industry should not be significantly increased. Alignment of any substance restrictions or bans is extremely important to industry and it's the complex and global supply chain. Alignment of conformity assessment procedures (no mandatory requirements for testing, certification of parts, materials and products, and no mandatory requirements for auditing factories) also more easily avoids trade barriers and would be consistent with the spirit of TBT Agreement. We strongly support take-back, recycling, and realistic energy efficiency requirements but caution that requirements imposed without practical consideration of the means of achieving them will create market distortions.

USITO Recommendations:

- Regulations should be open, transparent, non-discriminatory and based on sound technological specifications and market statistics that are verifiable by the public
- Partnerships between governments and industry should be encouraged to make available the benefits of new technologies
- Any nation considering a substance restriction regulation should consider existing international standards and base development of such regulation on life cycle environmental impact analyses
- The high tech industry encourages industry consultations at each stage of regulation development to achieve consistency and transparency.

VI. Communications Services

A. IMPEDIMENTS TO MARKET ACCESS

As noted in our previous submissions, since China's WTO accession some aspects of the communications services market have changed for the better. Foreign investment in telecoms services is no longer banned and we understand that the capitalization requirements may be reduced in the near future. China has begun to clarify some of the bureaucratic grey areas surrounding the provision of value-added services there. But the continued strong resistance to more extensive market opening appears to indicate uncertainty at the highest levels about how to resolve industry problems and the role foreign players should have in the reform process; indeed, it seems that many government-affiliated analysts believe that foreign-participated competition will further exacerbate price erosion and other perceived "problems" rather than help remedy them.

Weak Market Access for International Companies

China limits foreign direct investment in telecommunications to 49 percent for basic services and 50 percent for value-added services (VAS). A further problematic restriction is the requirement that foreign telecom service providers may enter into a

joint venture only with one of the existing state-owned enterprise telecom providers. Market entry opportunities for U.S. telecommunications providers in China are also limited by several additional factors, including an overly narrow definition of VAS for value added network service licensing that is not consistent with generally accepted international practices.

To attract foreign investors, it is essential for China to protect the rights of VAS providers. First, it is critical for VAS providers to have access to basic telecommunications network elements on a non-discriminatory basis and at cost-oriented prices. Indeed, in most liberalized countries, a primary policy reason for distinguishing between basic and value added services is to ensure that basic service providers do not abuse control over essential transport facilities to distort competition in the more competitive value-added markets. Second, it is critical that MIIT interpret the definition of VAS in a manner that is consistent with China's explicit WTO commitment and widely accepted international standards. The definition within China's commitment includes several tests of what qualifies as a VAS. Whereas some of the alternative tests are specific services (*e.g.*, electronic mail, voice mail, electronic data interchange, other of the alternative tests are functionalities that can exist in a variety of innovative services (*e.g.*, code and protocol conversion, on-line information and data base retrieval, on-line information and/or data processing). The inclusion of these functionality tests in the China commitment on VAS is consistent with the VAS definitions applied internationally, and China should follow through to interpret their definition in accordance with international standards and expectations. China also should be encouraged to lift its prohibition on resale.

In addition to encouraging a more expansive licensing approach to VAS in China, the U.S. Government should consider encouraging China to replace the current conservatively applied vertical service classification guidelines (*i.e.*, basic/value-added) with more objective and transparent guidelines for Type I (facilities-based) and Type II (non-facilities based) licenses in order to accelerate service provider market entry. This approach would provide certainty to investors by permitting the provision of any non-facilities based service on the same terms and conditions as VAS, thus allowing companies to innovate and provide services as technology evolves.

China's unreasonably high capitalization requirement for basic telecommunications services has further greatly limited market access. Basic services licenses are subject to US\$146 million capitalization requirement, which is 50 times larger than the capital requirement for China's value added service licensees, and comprises an excessively burdensome restriction that violates Article VI of the GATS. A Foreign Service provider otherwise meeting the licensing qualifications is unlikely to allocate such capital to a new and risky enterprise, and a Chinese joint venture partner is unlikely to divert this capital from its core business. China has already established a precedent for lowering its foreign joint venture capitalization thresholds in other

sectors, including insurance and trading companies, and it should now remove this barrier to market access in the telecom sector.

Furthermore, China has not implemented its WTO Reference Paper commitment to establish an independent regulator. The Chinese government still owns and controls all major operators in the telecommunications industry, and the MIIT still regulates the sector. USITO encourages USTR to place a high priority on working with China to establish a regulatory body that is separate from, and not accountable to, any basic telecoms supplier, and that is capable of issuing impartial telecom decisions and rules. Specifically, it is important that the regulatory body adopts the following: transparent procedures for drafting, finalizing, implementing and applying regulations and decisions; appropriate measures, consistent with the WTO Reference Paper to prevent dominant suppliers from engaging in, or continuing, anticompetitive practices; a defined procedure – as it has done for interconnection – to resolve efficiently and fairly public telecom suppliers' commercial disputes over their agreements; an independent and objective process for administrative reconsideration of its decisions; and appropriate procedures and authority to enforce China's WTO telecom commitments, such as the ability to impose fines, order injunctive relief, and modify, suspend, or revoke a license. USITO also encourages USTR to press China to provide reasonable notice and the opportunity for public comment on proposed regulations. The result: meaningful competition from foreign participants is directly constrained. This holds back service innovation and reliability from reaching world-class levels. In turn, business customers cannot obtain the value-added services they need to run efficient companies. Ultimately, this undermines China's information and communications technology policy goals and deprives Chinese consumers of access to new innovative technologies and of a broader choice of telecommunications services.

One example is that China's policies restrict the use of VoIP to closed user groups. China should allow all VoIP providers to offer services that connect to the PSTN on an unlicensed basis and eliminate joint venture requirements that apply to non-Chinese companies who wish to offer VoIP services in China. Another example is the current MIIT policy prohibiting Wi-Fi 802.11 technology on mobile handsets and mobile phones sold in China. The devices have to be disabled to remove Wi-Fi receivers before being granted a license from the regulator, MIIT. As laptops, desktops, MP3 players, etc. are not subject to such restrictions, most believe that this policy was implemented in order to prevent mobile VoIP usage, which is seen as a threat to the carriers' revenues. MIIT is unfairly restricting consumer access to technology.

USITO believes that China needs to make telecommunications a driving force behind broader economic growth. Policy should be driven on the basis of consumer and enterprise benefits sought rather than on the basis of restricting competition to protect incumbent players.

International companies seek reasonable terms of competition to enter China's market. There is significant interest among foreign carriers and value-added service providers in China. The dearth of FITE applicants is not due to a lack of interest in the market but to unfavorable terms of entry that currently characterize the relevant regulations.

USITO Recommendations: The following critical changes would help stimulate investment and competition in China's value-added telecom services market:

1. The scope of the VAS Catalogue should be expanded significantly to include international connectivity rights.
2. The Catalogue should be worded so as to leave no ambiguity over the scope of permissible services.
3. We recommend classifying basic services as the operation of basic network transmission and access facilities only, with all other services being value-added. This is a common classification scheme internationally.
4. An interconnection regime should be introduced giving licensed value-added service providers wholesale pricing for network facilities and services. This regime would ensure that value-added service providers have access to the basic network facilities they need at pricing levels that enable them to be commercially viable. Such a reform would also make a whole new set of domestic companies available as partners to foreign investors because, without an interconnection regime, investors can deal only with incumbent carriers. Yet these incumbents have shown little interest in establishing FITE JVs.
5. Early drafts of the Telecom Law are disappointingly shallow and lacking in detail about future interconnection access and charging principles for wholesale facilities.. Interconnection regulations are critical to rationalizing competition even among the incumbent players.
6. The draft Telecom Law has been in closed-door debate in China for far too long and should be aired publicly and rapidly implemented. There is substantial data from other liberalized markets that can enable China to rapidly craft and implement an appropriate regime that meets international norms but also embeds appropriate Chinese characteristics.

Finally, we urge the Chinese government to subscribe to the principle of technology neutrality on the part of the regulator. Technology neutrality is a key principle for regulated sectors like telecommunications. Markets and innovation benefit most when ICT manufacturers and suppliers engage in demand-driven competition, standards are openly and competitively developed, and governments do not interfere to choose technology winners and losers.

With China's issuance of third-generation (3G) licenses in January 2009, the Chinese government, through its agencies, research institutions, and state owned enterprises, continues to heavily promote and support its own 3G mobile phone standard, TDSCDMA. China supports TD-SCDMA through subsidization and other forms of

public support, including its recent stimulus package for the ICT sector. USITO is concerned that TD-SCDMA technology receives an unfair advantage in the marketplace, which leads to a competitive disadvantage for foreign technology suppliers, particularly as the state owns the telecommunications carriers in China. USITO urges China to be technology neutral and to allow the consumer market to decide which technologies succeed. Technology neutral policies will help ensure that that one technology does not have an unfair advantage over another.

We appreciate this opportunity to provide our comments and look forward to working with the U.S. and Chinese governments on addressing the issues set out herein.

Appendix: USITO Introduction

USITO is an independent, not-for-profit, membership-based trade association, established in late 1994 to act as the joint office in China of several U.S.-based trade associations representing the high-tech industry. USITO also accepts corporate memberships from those U.S. companies in the information technologies industry that seek direct representation. Currently, USITO has about 50 corporate memberships. USITO assists the U.S. high-tech industry in three areas: policy, research, and events. In policy advocacy, USITO monitors and expresses support for legislation conducive to U.S. exports and investment and promotes further opening of China's telecommunications and information technology markets. The organization does research and writing on issues of cross-cutting interest to U.S. companies involved in China's telecommunications and high-tech sectors. USITO also assists its parent organizations with trade shows, delegations, meetings, and other China-connected events.

USITO comprises a consortium of five U.S. industry associations: the Information Technology Industry Council (ITI), the Software and Information Industry Association (SIIA), the Semiconductor Industry Association (SIA), TechAmerica, and the Telecommunications Industry Association (TIA).

- The Information Technology Industry Council (ITI) is the premier group of the nation's leading high-tech companies and widely recognized as the tech industry's most effective lobbying organization in Washington, in various foreign capitals, and the WTO.
- The Semiconductor Industry Association (SIA), being one of the leading hi-tech associations in America, represents over 85% of the American semiconductor industry and represents their interests both at home and abroad.
- The Software & Information Industry Association (SIIA) is the principal trade association of the software and digital content industry representing more than 500 software publishers, developers, and service providers from around the world.

- Representing nearly 1,500 member companies of all sizes from the public and commercial sectors of the economy, TechAmerica (formed by a merger of AeA and ITAA) is the industry's largest advocacy organization and is dedicated to helping members' top and bottom lines. It is also the technology industry's only grassroots-to-global advocacy network, with offices and partnerships in state capitals across the United States, in Washington DC, Europe (Brussels) and Asia (Beijing) and around the world.

- The Telecommunications Industry Association (TIA) is the leading U.S. non-profit trade association serving the communications and information technology industry. TIA provides a market-focused forum for its 500 member companies, which manufacture or supply the products and services used in global communications. Since its founding in late 1994, the US Information Technology Office (USITO) has grown to become the leading policy-centered independent NGO focused on the ICT industry in China. With its main office in Beijing, USITO provides China ICT industry and policy research and analysis for the US ICT industry.