



# LTI Newsletter

Bringing you the Latest Developments in U.S. and Chinese Strategic Trade Compliance Policy

Summer 2010

**An Executive Note**

Dear Friends and Partners,

It has been another busy quarter in China. Typically, the summer months are a bit slower as they are marked by family vacations and a sweltering heat that can dull the senses. This summer has been quite different. Chinese Customs has dramatically increased its working hours for the summer to include some weekends in order to process shipments in a reasonable time. The U.S. Embassy in Beijing has also been open for extra weekend hours in order to process the huge inflow of visa applications. Although we may look a bit ragged these days, we see the unusual summer pace as a positive sign that trade and the global economy is again on the upswing.

In this quarter's newsletter, you will see a range of updates across our usual categories of topics. What may be less evident, however, is the gradual convergence of all of these issues, particularly in Asia. We are seeing companies begin to trend towards more deeply integrating the various elements of their sales, legal, trade compliance and logistics functions. This trend has been particularly evident in China, where the role of the Government is exceptionally strong and government owned and invested companies dominate the commercial markets. Due to the major presence of the Chinese Government in business, we have found that foreign companies in general are finding it more and more difficult to gain an understanding of China's trade laws and policies and how they will impact their business operations in China.

For example, there seems to be more focus lately on China's export control system, where the majority of dual-use items covered on the lists have been linked to the Chinese HS Code. Companies fear that tying these items to the HS Code will lead to Chinese Customs requiring export licenses for items falling under the HS Code, even though they are outside the scope of the dual-use lists. The Ministry of Commerce (MOFCOM) should be able to provide assistance in clearing up such issues, but this will certainly delay shipments regardless of how quickly and effectively MOFCOM deals with it. With other countries in Asia, such as Malaysia, also looking to utilize the HS Code as part of their implementation and enforcement strategy for export controls, this may be an area of growing concern.

Standards is another area where HS Codes are having an impact because import license and standards certifications are tied to the HS Codes. Because of the correlation between standards and HS Codes, Chinese Customs holds shipments until they receive the required licenses, certifications or exemption notifications from the appropriate Chinese Government authority. In either case, days if not weeks are added to the time required to clear a shipment through Chinese Customs.

These are just two examples of problems foreign companies are dealing with in China. In general we are finding that compliance with trade laws in China is becoming increasingly complex, and companies are having to spend more time and resources to deal with them. Despite these increasing difficulties, we hope you find this summer newsletter beneficial and you keep cool through these hot summer months.

- John, Nina and Amanda

## **Trade and Policy Developments**

### **China re-submits Application to Become Member of the GPA**

After the U.S. threatened to prohibit imports from China because of the concerns over China's protection of its domestic industries through their preferential procurement policies, China, re-submitted an application to the WTO agreement on Government Procurement (GPA) in July. The U.S. Trade Representatives (USTR) are responding positively to China's second proposal, but those familiar with the application process doubt the offer will be accepted because China still insists on protecting certain areas of economic activity. The GPA emphasizes transparency so China's approach to the application leaves many GPA members feeling frustrated. Leaders in the American Trading sphere agree that the second proposal is a big improvement, but ultimately want China to join on terms that are not only commercially meaningful, but also similar to those of other parties. As of now the two biggest concerns about the latest proposal are 1) China does not offer foreign companies access to local government and state owned enterprise procurement contracts, and 2) China is only offering government construction contracts to foreign companies if the construction project is three times higher than most other GPA members. Demetrios Marantis, the Deputy U.S. Trade Representative, said the U.S. will "work with China and other GPA members to ensure China's terms of accession are comprehensive and comparable to that of other GPA parties" before China becomes a member.

## **U.S.-China 2010 Strategic and Economic Dialogue Strategic Track Outcomes**

The U.S.-China Strategic Economic Dialogue (S&ED) held its second round of Strategic Track Dialogue at the end of May 2010. The S&ED Dialogues were established in 2009 as a means to increase overall relations between the U.S. and China. As President Obama seeks to double U.S. exports within the next five years, it is even more important to improve relations with China -- the fastest growing economy. The countries discussed bilateral, regional and global issues, as well as energy security, climate change, UN peacekeeping, counterterrorism, and law enforcement during break out sessions. The Dialogue resulted in 26 detailed outcomes, including the signing of multiple memoranda, scheduling of meetings and events, and agreements. The Memorandum of Understanding between the Department of Homeland Security, U.S. Customs and Border Protection, and the General Administration of Customs of the People's Republic of China Concerning Bilateral Cooperation on Supply Chain Security and Facilitation was signed, and there was agreement to enhance cooperation on battling illegal trafficking of nuclear and radioactive materials. The U.S. and China agreed to schedule a round of dialogues on security, arms control, and non-proliferation prior to next year's S&ED as well. Encouraging progress in China's emergency response system, the U.S. Coast Guard is also set to organize a maritime search and rescue and training program exchange in China. Other outcomes highlighted stronger innovation policy, fair procurement treatment, removal of trade barriers, domestic consumption growth, elimination of fossil fuel subsidies, and stronger financial systems.

The Dialogue lasted two days, and resulted in benefits for both countries. As two of the world's largest powers, the U.S. and China relations are vital in the effort to achieve economic growth and peace. In concluding joint statements, China's Vice Premier Wang said "We are now able to manage our differences and problems arising in the course of growing economic relationship with a more rational and mature manner. While upholding to our respective principles, we have better understood our positions." U.S. Secretary of State Hilary Rodham Clinton followed in her concluding statement by saying that after a fairly unsteady relationship earlier this year, the U.S. and China dialogue has put the bilateral relationship back on track.

For U.S. Department of State's full list of S&ED Dialogue Outcomes view the following link:

<http://www.state.gov/r/pa/prs/ps/2010/05/142180.htm>

## **U.S. Reserves Right to Contest China's Implementation of WTO IPR Ruling**

After three years of hearings before a WTO dispute settlement body, the U.S. and China in March reached a procedural agreement on measures affecting protection and enforcement of intellectual property rights (IPR). It effectively preserves America's right to challenge China's IPR protection compliance. Under the agreement, both parties are required to hold consultations within 18 days if the U.S. decides to dispute China's compliance with a WTO IPR ruling. If no mutually acceptable understanding is reached, and a

complaint is lodged by the U.S., a panel would be established at the next meeting of the dispute settlement board. China is required to accept this with no objection. Reports from both sides are to be circulated within 90 days of the panel's establishment as well.

### **Geithner Notes World Bank Transferred More Voting Rights to China**

In April, U.S. Treasury Secretary Timothy Geithner noted that many members of the World Bank agreed to transfer more voting rights to developing countries. In 2008, after the World Bank's first restructuring phase, developing countries' share of the total World Bank voting slots rose to 44%. At the 20 Country Pittsburgh Financial Summit Meeting in September of 2009 and the Istanbul Development Conference of October 2009, the World Bank Shareholders agreed to increase developing nations' voting rights to 47% of total voting rights.

On April 22, World Bank president Mr. Robert B. Zoellick noted that the current world economic conditions and government territorial situation is changing. He also stated that in order to adapt the status quo, developing countries must have greater representation in global institutional legislative affairs. This meeting marks the first time in the World Bank's 20 plus year history that the body will increase internal capital. At the same day, the World Bank and International Monetary Fund (IMF) held the Joint Development Committee Meeting. China's voting rights increased to 4.42% from 2.27%, making it the third largest shareholder of the World Bank, behind Japan and the U.S. China's Minister of Finance, Xie Xuren remarked that the voting rights revision at the World Bank Development Committee Meeting is an important historical benchmark. China's larger share of voting rank will strengthen its already vital role in the World Bank.

### **U.S.-China Joint Statement on Energy Security Cooperation**

On May 25, the U.S. – China Joint Statement on Energy Security Cooperation was published. The two countries pledged to ensure energy security, to work together to stabilize international energy markets, and to ensure a diversified energy supply. Both countries will work to improve energy market transparency to stabilize energy markets and continue to use market mechanisms to meet their energy needs. China and the U.S. will encourage the development and utilization of unconventional energy resources and clean energy, and will promote the use and development of electric vehicles. China affirms that it is willing to work with the U.S. on nuclear technology transfer practice.

The 5<sup>th</sup> U.S. – China Energy Policy Dialogue and the 10<sup>th</sup> U.S. – China Oil and Gas Industry Forum will be held in September to reinforce the cooperation. More collaborations, dialogues, and forums will be conducted, and enhanced in order to advance world energy security.

## **Hearing on “China Information Control Practices and the Implications for the United States”**

On June 30<sup>th</sup>, a public hearing of “China’s Information Control Practices and the Implications for the United States” was held by the U.S. – China Economic and Security Review Commission in Washington, D.C. The hearing mainly focused on China’s State Secrets Law, U.S. securities laws on Chinese companies, and the control of the Internet. The Chinese Law can create problems for Chinese companies listed on the American exchange markets. U.S. Securities law requires disclosure of company information that could be interpreted as being in conflict with the Chinese State Secrets Law. Listed Chinese companies with large U.S. investment such as Baidu, a Chinese internet search and technology company, are being questioned about their governance and compliance practices. The amended State Secrets Law, which went into effect October 2009, remains unclear in scope, and has the potential to become a powerful tool that could be broadly applied.

## **Civil-Military Integration in the People’s Republic of China**

Civil-Military Integration (CMI), a practice that emphasizes the benefits of joint military and commercial dual-use production and development, is not a new concept in China. The Chinese government has employed this practice as a means of modernizing the lagging production capabilities of the defense industry over the years across numerous industries, including aerospace, aviation, ship-building and IT/telecom applications. CMI influenced growth in China in the 1990s, as many of the one-time weapons manufacturing facilities in China were converted to produce products with commercial end use. At the peak of this practice in the 90s, over 80 percent of the defense industry output was estimated to have commercial applications.

Today, China is trying to change the direction of the technology transfer to a process that emphasizes the transfer of commercially developed technologies into military end uses. China has been investing heavily in university R&D centers, private enterprises, civilian research institutes and the government to aid in the development of military technologies. The Department of Civil-Military Integration Promotion under the Ministry of Industry and Information Technology (MIIT) is responsible for promoting and implementing such plans.

## **WTO Issues Trade Policy Review for China**

The WTO released its third Trade Policy Review (TPR) for China on May 31, 2010. Through TPR, the WTO strives to create transparency and collaborative environment among WTO members. In the recent TPR, China’s trade policies and practices, as well as the impact they have on the multilateral trading system were covered extensively by WTO Secretariat. Similar to the last review of China two years ago, the WTO encouraged China to apply its role as the world’s third largest trader and assume a more significant leadership role in the organization. In his speech addressing the review, Ambassador Michael Punke, U.S. Permanent Representative to the WTO Geneva, suggested that China begin its involvement with the Doha

Development Agenda (Doha Round). “It is vital for China, like other major emerging economies, to accept the responsibility that goes along with its power and influence. We believe that sustained engagement, including bilateral negotiations between the United States and China, is critical to building momentum for a successful conclusion to a balanced and ambitious Round,” Punke said.

While the report acknowledged the economic and social challenges facing China, it emphasized the importance and benefits of change for the country’s trading system. The TPR suggested revision of trade laws as well as a Government role in reducing regulations, customs procedures, and other barriers to trade. In addition, the report emphasized that improving their international standards and indigenous innovation policies will be of great benefit to China. The TPR proposed that China act quickly to adopt the suggestions. By accelerating progress, China will increase its own economy as well as the global economy at an even faster rate.

For full Secretariat and Government reports, visit the WTO website at:

[http://www.wto.org/english/tratop\\_e/tpr\\_e/tp330\\_e.htm](http://www.wto.org/english/tratop_e/tpr_e/tp330_e.htm).

## **Agriculture Update**

### **USDA Issues Temporary Plant Pratique to American Bean Oil Exported to China**

On June 9<sup>th</sup>, USDA stated that it would temporarily issue a plant pratique to American bean oil exported to China, in order to promote exports of American bean oil. At the same time, China would inspect American bean oil for insect damage. According to data from China Customs, China imported 2.391 million tons of bean oil in 2009, including 1.835 million tons from Argentina and 53,900 tons from the U.S. From January to April 2010, 120,500 tons of bean oil had been imported from Argentina, with a decrease of 73.22% from the same period in 2009.

By issuing the temporary plant pratique, the U.S. hopes to take advantage of the lack of a trade agreement between China and Argentina on import of bean oil and gain a larger share of the Chinese market.

### **China Agreed and Lifted Pork Ban to U.S.**

On March 18<sup>th</sup>, the USDA announced that representatives from the U.S. and China had reached an agreement on the resumption of pork exports to China. Officials from the USDA and the USTR had a meeting with Chinese representatives in Beijing and reached an agreement. According to the USDA, once the document is finalized, pork trade will resume immediately.

The National Pork Producers Council (NPPC) hailed the official Chinese Government announcement on May 14<sup>th</sup> that China would resume accepting pork imports from the U.S. Any pork produced on or after May 1<sup>st</sup> would be eligible for export to the Chinese market. At present, the Chinese domestic pork product supply is 50 million tons per year.

## **Customs Update**

### **Chinese Customs Reports Trade Trends**

According to data released by Chinese Customs on May 10, 2010, from January to April 2010 China's foreign trade was USD 855.99 billion, an increase of 42.7% compared to the same period in 2009. USD 436.05 billion was from exports, while USD 419.94 billion was from imports. The trade surplus was 78.6%, a decrease of 78.6%.

The European Union was China's biggest trading partner, with a total trade value of USD 137.77 billion, while the United States was China's second biggest trading partner, with a total trade value of USD 107.18 billion. Japan was China's third biggest trading partner, with a total trade value of USD 88.66 billion.

## **Standards Update**

### **CNCA and MIIT jointly announced the Implementation Opinion on the RoHS Voluntary Certification Program**

MIIT and the Certification and Accreditation Administration of China (CNCA) announced a plan to use a Nationally Promoted Voluntary Certification Program for RoHS on May 18, 2010. This will be the first step in developing a mandatory program for China RoHS China Compulsory Certification. If the Voluntary Program goes well for certifying products listed in the first RoHS Catalogue, MIIT will use the certification model, including testing measures, testing time and other detailed certification information, to draft the China RoHS certification implementation regulation.

CNCA planned to implement this Voluntary Certification in July if everything goes well. This means that companies can voluntarily choose to adopt this model for testing their products. If MIIT, CNCA and the companies all accept the results from the Voluntary Certification during the trial testing period, MIIT and CNCA will use this certification model in the China RoHS certification. If not, MIIT and CNCA will continue modify the certification regulation.

From July 13<sup>th</sup> to the 15<sup>th</sup>, conferences were held in Shenzhen and Suzhou to promote the scheme. So far, only a few domestic manufacturers are planning to apply for this certification and no foreign companies have applied.

## **Export Control Update**

### **BIS Amends EAR to Add Advanced Micro Devices China, Inc., to List of Validated End-Users**

On May 10, 2010, the Bureau of Industry and Security's (BIS) final rule amending the Export Administration Regulations (EAR) to include a new Validated End-User (VEU) became effective. The amendment allows Advanced Micro Devices China, Inc. to receive exports, re-exports and transfers of certain items as an Authorization VEU. Advanced Micro Devices (AMD) was established 4 decades ago, and opened its China headquarters in Beijing in 2004. The company is in the business of silicon and software, designing accelerated processing units for PC computers.

VEU Authorization is a method of increasing high technology exports to those companies who have a proven record of meeting trade requirements and exporting products for civilian use. The authorization allows VEUs to receive certain eligible export controlled items without individual validated licenses, so it significantly shortens export waiting time by removing the individual license requirement. VEU Authorization is available only for qualified end-users in China and India. Of the current 8 approved VEU companies, 7 are located in China, 6 of which are in the semiconductor industry.

### **Malaysia's Export Control Law: A Step Forward, But How Big?**

Malaysia has been a favorable smuggling hub for WMD related procurement networks. With weak transshipment controls, many WMD related materials are transited via Malaysia before reaching the final destinations, such as Libya, Pakistan and Iran, in order not to arouse suspicions from original suppliers. After years of being criticized for giving insufficient attention to its nonproliferation-related trade controls, Prime Minister Najib Razak of Malaysia announced the Strategic Trade Act at the Nuclear Security Summit in Washington, D.C., in April. The new law is intended to strengthening the country's ability to restrict the exports and transshipments of weapons of mass destruction (WMD) related materials.

The Malaysian Trade Ministry (MITI) Strategic Trade Bill includes catch-all provisions for unlisted items and harsh penalties for violations. The Order, which MITI is currently drafting, will contain the control list, prohibited and restricted end-users, and exemptions. MITI is reportedly using the EU control list as a foundation for Malaysia's control list, and they are expected to apply HS codes to the controlled product categories, as China does with its export control lists. Malaysia has targeted September for issuing the Order and December for implementation.

## **Update to the Strategic Goods Control List in Singapore**

On April 1, 2010 Singapore Customs enacted Strategic Goods Control Order 2010. The new Order is an updated version of the 2009 Order, including new entities, deleted definitions, and clarity changes. Annual Orders are a means of regular strategic goods updates and compliance with international practices.

Singapore Customs defines strategic goods to be “conventional arms, military equipment and goods relating to the development, production and use of nuclear, chemical and biological weapons, as well as certain dual-use goods that are high technology items that have both civilian and sensitive military applications.”

Affected strategic goods transactions include exports, re-exports, transshipments, and transits.

Singapore made changes to the Munitions List and Dual-Use List in various sectors, including: Special Materials and Related Equipment, Materials Processing, Electronics, Computers, Telecommunications, Information Security, Sensors and Lasers, Avionics, Marine, and Aerospace.

While Singapore is considered to be one of the most liberal trading regimes in the world, changes in the Strategic Goods List should not be overlooked. As the world’s busiest port, managing over 130,000 vessels annually, export controls take substantial effect. Singapore is also a member of multiple Free Trade Agreements, including ASEAN-China (ACFTA), CSFTA in China, and USSFTA in the United States.

## **Trade Agreements**

### **Restructuring and Further Trade Liberalization is Key to Sustaining Growth**

China has made some attempts to further liberalize its international trade and investment regime as a means for sustaining economic growth. For example, China has increasingly pursued bilateral and regional free trade agreements. One such agreement is the Free Trade Agreement between Mainland China and Taiwan in air and maritime transport and postal services. In addition, the following is a list of other developments in China’s trade system restructuring:

- Some restrictions on Foreign Direct Investment in telecommunications and tourism have been relaxed to encourage foreign investment;
- The tax system has also been reformed to unify the enterprise income tax rates and transform the Value Added Tax system;
- Import barriers have fallen but export restrictions are still tight;
- The quality inspection exemption system has been suspended to strengthen the SPS regime;
- Trade-related laws have been reviewed and revised including the anti – monopoly law and the patent law; and
- Efforts to improve enforcement of IPR protection are being made.

With substantial trade system liberalization and restructuring, China aims to continue on its track to sustain economic growth trends.

## **India Develops Security System for Telecommunications Products after China's Claims of Discrimination**

After the Chinese Government's protests against India's trade blocks on Chinese telecommunications vendors, the Indian Government has requested that the Department of Telecommunications develop a security audit system through a third party in order to restart trade with China. Since the beginning of this year, the Indian Government began blacklisting Chinese telecom equipment companies, due to fear of spying technology within the products. While no official ban had been released, telecom carriers in India were required to obtain security approval in order to buy Chinese telecom equipment. For months, no Indian carrier was allowed such approval. In May, the Indian Government went one step further, ordering two of China's largest telecom producers, ZTE and Huawei, to disclose complete details of ownership and source code. As India is China's tenth largest trading partner, there was much concern in China regarding the issue. Approximately 10% of ZTE and Huawei's total income in 2009 came from customers in India. The Chinese side viewed India's bans as discriminatory, and a breach of WTO regulations.

In response to threats of discrimination, India's Department of Telecommunications recently announced selection of fifteen international security firms to certify foreign telecom equipment, one of which is British Telecom. The system will end delays for Indian customers and keep Chinese carriers from losing business. All telecom imports to India must go through a security evaluation before being purchased by Indian companies. The Department of Telecommunications has developed an extensive list of equipment requiring security clearance. The system is only said to be in effect for 12 months, until the Indian government develops a domestic certification agency or allows Indian companies to use self-certification.

## **China and ROK Wrapped Up Government-Industry-University Joint Study on FTA**

The joint study report on the Republic of Korea Free Trade Area was published on June 1<sup>st</sup> after four years of research by the two governments, businesses and academia. It has been an important step in the promoting free trade between the two countries. The recommendations are aimed at promoting the mutual benefits for both countries. The report recommends further negotiations based on the following principles: 1) consistency with WTO rules; 2) elimination of tariffs and non-tariff barriers in all areas; 3) liberalization in all areas; 4) consideration of sensitive sectors; and 5) promotion of sustainable development. The FTA discussion now focuses on trade in goods and services, on investment and other areas such as government procurement, intellectual property rights, competition policy, sanitary and phytosanitary measures, technical regulation and standards. It was recommended that in order to maximize the benefits of the FTA, a dispute settlement mechanism should be included as well.

## Kentucky Corner

Spring is an especially beautiful season in Kentucky and we were lucky to bring two high profile groups to experience Kentucky's "Unbridled Spirit" firsthand. The first group was led by the China National Coal Association to attend the 2010 Coal Prep Exhibition and International Coal Congress in Lexington April 25-30. China's delegation included more than 100 coal industry representatives looking for ways to penetrate the U.S. market. The Kentucky China Trade Center organized an investment seminar in the State Capitol with the Kentucky Cabinet for Economic Development and a reception was hosted in their honor. The second group was an inaugural "familiarization" (FAM) tour for a group of eight Chinese travel agencies to Kentucky. Air transportation was generously provided by United Airlines while on-the-ground costs were covered by Alltech, 21C Museum Hotel and local convention and visitor bureaus. If the unusually long lines at the U.S. Embassies and Consulates around China are any sign, our recent visitors are just the beginning of a major increase in business and leisure travel to Kentucky over the coming years.

## LTI News

LTI launched a formal internship program this summer, and we were pleased to have an exceptional group of student interns join us for the summer months. We would like to take this opportunity to thank Megan Degenfelder, Chris March, and Alexandra Lo for their hard work this summer. They have all been instrumental in many LTI projects, and we look forward to welcoming them back to China again in the future.

LTI has also hired new staff in its Beijing office and welcomes Lv Cheng and Geng Jinghui to join the Market Access and Customs teams respectively.

Finally, in June of this year, LTI celebrated its Fifth Year Anniversary at the grounds of a former Chinese police training facility on the outskirts of Beijing. We celebrated this occasion with a BBQ feast, outdoor games and competitions, and ended it with the obligatory karaoke contest. We are all proud to say that we have made it past the critical five year mark, and hope to be here for many more years to fill all of your trade, market access, and compliance needs!