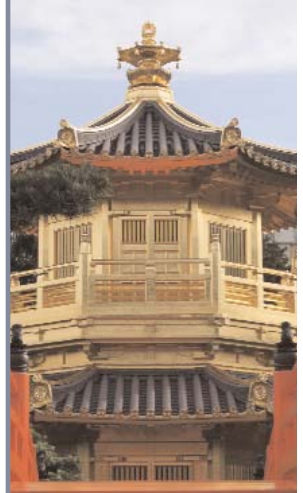


Briefing on Recent Developments Affecting Business with China



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CHINA

Since the accession of the People's Republic of China (China or PRC) to the World Trade Organization (WTO), the bilateral relationship between the United States (U.S.) and China has grown closer and more complex, at the same time that doing business with China has become more expensive and complicated. This briefing is an update on recent developments related to doing business with, and in, China as well as a brief update on another emerging Asian market, and competitor to China: Vietnam.



Recent Issues in China

A. Overview

As China's economy continues to grow, the Chinese government has focused on continuing the development and reform of China's legal system to enable continued economic development with Chinese characteristics. Over the past year, three "macro" themes have emerged in doing business with, and in, China:

- The Chinese government is active in modernizing key statutes and regulations to bring those affecting foreign investment into alignment with China's World Trade Organization commitments and other international standards;
- The government also is fostering strategic outward investment by developing "champion" domestic companies equipped to succeed on the international stage and by opening up channels for outward investment by institutional Chinese domestic investors; and
- Lastly, the Chinese government is exhibiting an increasing ambivalence about the value of foreign investment, especially foreign investment in low value-added and high-energy consuming industries.

As a result, doing business in, and with, China has become more complex and more expensive. China remains an important manufacturing base and, given its expanding middle and upper class, an increasingly important export market for foreign manufacturers. However, a significant number of companies—two-



thirds according to one survey—believe that China is losing some of its competitive advantage in world markets because of increasing costs.¹ Among the issues cited as driving up costs are increased labor costs, higher tax burdens, and lack of consistent implementation and enforcement of law and regulation.² Further, as stated above, the PRC government actively is discouraging the growth of low value-added manufacturing and environmentally unfriendly industries by increasing production costs and limiting foreign participation in certain sectors. Companies active in China will have to confront these issues as they begin, or expand, their relationships in China.

B. Economic/Trade Overview

China's economy continues to grow at an astonishing rate, with year-on-year gross domestic product (GDP) growth estimated at 11.5 percent in 2007 and 11 percent in 2008.³ As part of this growth, China's overall trade surplus has increased, as has its balance of payments surplus. These surpluses are contributing inflationary pressure to China's economy. Nonetheless, China remains one of the world's fastest-growing economies, and the Chinese government's stated goal of modernizing its infrastructure and upgrading its industries is predicted to generate substantial demand for foreign goods and services.⁴ In addition, China's economic growth has significantly improved the purchasing power of Chinese citizens, especially those living in urban areas.

Bilateral trade between the U.S. and China amounted to \$387 billion in 2007, making China the second largest overall trading partner of the U.S., the third-largest U.S. export market, and largest source of U.S. imports.⁵ U.S. exports to China, valued at \$65.2 billion in 2007, have risen by 240 percent since 2001. In 2007, top five U.S. exports to China were aircraft and parts, semiconductors and electronic components, waste and scrap, oilseeds and grain, and resins and synthetic rubber and fibers.⁶

U.S. imports from China totaled \$321.5 billion in 2007, an increase of 16.5 percent over 2006. The top five U.S. imports from China in 2007 were computers and parts, miscellaneous manufactured articles (such as toys, games, etc.), communications equipment, apparel, and audio and video equipment. A significant amount of U.S. imports from China historically have been low-value, labor-intensive products such as toys and games, however, over the past few years, an increasing proportion (at least 25 percent of all imports in 2007) of U.S. imports from China has comprised of more technologically advanced products.

At the end of 2007, the U.S. trade deficit with China reached \$256 billion, the largest the U.S. has with any trading partner, bringing political attention in the United States to issues such as China's failure to fully implement its WTO com-





mitments, especially in regards to intellectual property rights, and other areas deemed to be unfair to the U.S. economy.⁷

In response to this political attention, the U.S. government has filed a number of trade dispute resolution cases against China in the WTO, including China's failure to protect intellectual property rights (IPR) and afford market access for U.S.-generated IP-related products, discriminatory regulations on imported auto parts, and import and export subsidies to various industries in China. Further, the U.S. government reversed a long-standing policy and began to allow countervailing cases to be brought against non-market economies such as China.

C. Recent Developments in Chinese Law

In 2007, the Chinese government continued to develop its legal system to support its vision of development with Chinese characteristics and issued the following selected laws and regulations affecting international trade and business:

Revised Foreign Investment Catalogue. On Oct. 31, 2007, the National Development and Reform Commission and Ministry of Commerce issued a revised version of the *Foreign Investment Industrial Guidance Catalogue (Amended 2007)* (the 2007 Catalogue), effective as of Dec. 1, 2007. The 2007 Catalogue increases the number of industries regulated by the Chinese government and retains the division of industries into the three basic categories: "encouraged", "restricted", and "prohibited." As with prior editions of the Catalogue, industries not listed are considered to be "permitted," and are open to foreign investment unless otherwise specified in other Chinese regulations. The 2007 Catalogue adds several areas to the "prohibited" category, including projects that involve investment in (a) environmentally unfriendly industries; and (b) industries that are deemed to be politically "sensitive." "Environmentally unfriendly" is an undefined term, and there is concern that the term could be flexibly construed in order to restrict foreign investment in projects that produce any measure of pollution or are otherwise too low on the value-added scale, as judged by the PRC government.

Antimonopoly Law. The Chinese government issued the *Antimonopoly Law (AML)* on Aug. 30, 2007, ending a 13-year development process. Broadly speaking, the AML, effective on Aug. 1, 2008, addresses three main areas of competition law: (a) prohibition of anticompetitive agreements; (b) prohibition on the abuse of a dominant market position; and (c) merger control. The AML covers activities in China as well as certain activities outside of China that effect China's domestic market. For example, a merger or transaction involving a company's assets or business in China may implicate the AML, even if the core of such transaction is consummated outside of China. Of particular concern, implementing regulations for the AML have yet to be issued, leaving foreign business to guess at the meaning of several poorly defined concepts and terms therein.

Merger Guidelines. On March 8, 2007, the Antitrust Investigation Office of the Ministry of Commerce issued the *Guidelines for Antitrust Filing for Merger and Acquisition of Domestic Enterprises by Foreign Investors* (the Merger Guidelines) covering merger control filings. The Merger Guidelines apply to domestic transactions



and offshore transactions where a foreign entity purchases a Chinese entity. Importantly, for foreign investors, the Merger Guidelines suggest that a filing, containing sensitive business information, should be filed at the time a letter of intent, or similar undertaking, is signed by the parties to the transaction.

Corporate Tax Code. As will be discussed in more detail, below, in March 2007, the Chinese government unified the corporate tax code to bring foreign and domestic companies within the same tax system pursuant to the *Enterprise Income Tax Law*. Under the new system, the unified corporate tax rate will be 25 percent, and available deductions are unified for domestic and foreign enterprises. The revised tax code ends many of the previous regime's favorable tax policies that were available only to foreign-invested enterprises and re-focuses remaining incentives on supporting specific domestic industry sectors. As a result of the new tax code, some of the costs of doing business in China have increased.

Repeal of Certain Value-Added Tax Rebates. The PRC government, in 2007, began to repeal many of the tax incentives that formerly attached to export activities. For example, on June 19, 2007, the Ministry of Finance and State Administration of Taxation issued *Circular 90*, effective July 1, 2007, that changed the refund process for certain value-added taxes (VAT) charged on goods made in China. Specifically, *Circular 90* (a) terminates VAT refunds that were applicable on products that consume high amounts of energy and resources or cause high levels of pollution in the production process; (b) lowers VAT refund rates for certain low value-added exports; and (c) specifies that a VAT exemption exists only for export sales of certain items such as stamps and peanuts. As will be discussed below, *Circular 90*, and related issuances, increase exporters' cost of doing business in China by doing away with these tax incentives.



Labor Contract Law. Issued on June 29, 2007, and effective as of Jan. 1, 2008, the *Labor Contract Law* (LCL) significantly changes employment relationships in China.⁸ The LCL requires that employers execute written employment contracts with all full-time employees within 30 days of such employees' start date. In addition, the new law contains default provisions whereby an employment relationship will be deemed to be open-ended if a written employment contract is not executed within one year of an employee's start date. The new law specifies that an employment probation period may not exceed (a) one month for a contract with a term between three months and one year; (b) two months for a contract with a term between one year and three years; or (c) six months for a contract with a term exceeding three years or an open-ended contract. The LCL allows for the enforcement of non-competition covenants in contracts with specified senior personnel, although such covenants may not be long than two years. The new law requires an employer to pay severance upon the expiration



of a fixed-term contract that the employer does not renew, unless the employee refuses to renew the contract under the same or better conditions. On May 8, 2008, the State Council issued a draft set of implementation regulations for the LCL, and requested comments from interested parties on such regulations. The LCL, as discussed below, is of significant concern to foreign companies operating in China, and it is unclear whether the draft implementation regulations, or comments on such regulations, will have a clarifying effect.

Property Law. On March 16, 2007, the National People's Congress enacted the *Property Law* that became effective on Oct. 1, 2007. This new law protects private property and, among other things, establishes a uniform system for the registration of real property to be overseen by a local registration authority. The *Property Law* allows parties to challenge registrations made with the registration authority and recognizes the right of parties to mortgage, and grant a security interest in, specified property.

Real Estate Regulations. The *Circular on Further Strengthening and Standardizing the Examination, Approval and Regulation of Direct Investment in Real Property by Foreign Investors* jointly issued by Ministry of Commerce and the State Administration of Foreign Exchange on May 23, 2007 (Real Estate Circular) clarifies certain requirements on foreign investors and foreign invested enterprises in the real estate sector. Pursuant to the Real Estate Circular, the application for the establishment of a foreign invested real estate company is subject to satisfying the conditions that (a) the land use rights or the title to properties have been obtained by the applicant; (b) an option agreement for the grant of land use rights has been executed with a relevant land bureau; and (c) an option agreement for the purchase of real estate has been executed with the owner of the property. The Real Estate Circular confirms that a foreign invested company may not obtain outside loans for a real estate investment if (a) its shareholders have not fully paid in their capital contributions; (b) it has not been granted the a relevant land use right certificate; or (c) the capital fund for the project has not reached at least 35 percent of the total project investment. These new requirements may make it more complex for foreign companies to build new facilities in China.



Partnership Enterprises Law. The amended *Partnership Enterprise Law* (the Revised Partnership Law) came into effect on June 1, 2007 and allows any legal entity to become a partner in a PRC partnership, a potential new business vehicle for foreign investors. The Revised Partnership Law specifies that foreign entities and individuals may form partnership enterprises in China, and confirms that all partnerships receive pass-through tax treatment. Note that state-owned enterprises, listed companies and other specified entities may not be general partners in a partnership, but may be limited partners.



Qualified Domestic Institutional Investors. In 2007, the China Securities Regulatory Commission and other Chinese regulators issued items such as the *Trial Measures for the Administration of Overseas Securities Investment by Qualified Domestic Institutional Investors* that create a Qualified Domestic Institutional Investor (QDII) scheme. Pursuant to these regulations, domestic fund management companies, securities companies, and banks may apply to the CSRC or their primary regulator to become qualified as a QDII upon satisfying certain requirements. QDIIs may invest assets in specified overseas securities, and are part the PRC government’s policy and process to foster outbound investment from PRC entities.

Choice of Law. On July 23, 2007, the Supreme People’s Court issued the *Provisions on Several Issues Concerning the Application of the Law in the Trials of Foreign-related Civil or Commercial Contract Disputes* (Contract Provisions) that clarifies certain choice of law issued related to foreign, or transnational, contracts. Broadly speaking, a choice of law clause specifying foreign law will be honored, provided it is the law most closely connected to the transaction, except where the Contract Provisions or other PRC law requires the use of Chinese law. The Contract Provisions require that the parties must clearly specify their choice of governing law at the time of contract execution or at the time a dispute is filed with a relevant court.



D. Significant Issues in the U.S. -China Trading Relationship

As stated above, the economic relationship between the U.S. and China is not without some controversy. Areas such as China’s currency valuation practices, poor IPR enforcement, and opaque rule-making processes continue to generate tensions in the U.S. -China relationship. This section of the briefing will review a selected group of important issues.

1. China’s Currency Valuation

China’s currency policies remain a significant concern for foreign companies operating in China.⁹ Between 1994 and July 2005, China pegged its currency, the renminbi (RMB) or Yuan, to the U.S. dollar at about 8.28 Yuan to the dollar.¹⁰ While the RMB is no longer pegged to the U.S. dollar, the Chinese government operates what it calls “a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies.” The RMB is still controlled in that it may only fluctuate up to 0.3 percent on either side of the “central parity rate,” set each day. The Chinese government has intervened from time to time in the currency market to manage the RMB’s exchange rate by



exchanging RMB for foreign currency and accumulating foreign exchange reserves. Since China abandoned the currency peg in July 2005, the RMB had appreciated 15 percent against the U.S. dollar by the end of 2007 and indications are this trend will continue.

Critics contend that the RMB is undervalued, relative to the U.S. dollar by between 15 and 40 percent, or an average of 27.5 percent. According to critics of China's currency policies, China's currency policy makes Chinese exports to the United States cheaper, and U.S. exports to China more expensive, than they would be if market forces determined exchange rates. They complain that this policy has particularly hurt several U.S. manufacturing sectors (such as textiles and apparel, furniture, plastics, machine tools, and steel), which are forced to compete against low-cost imports from China, and that this has contributed to the growing U.S. trade deficit with China.

The Chinese government denies that it is manipulating the RMB, and has stated that the exchange rate will become more flexible in a gradual process.¹¹ They maintain that there will be no surprise adjustments to the exchange rate to satisfy pressure from outside China. Chinese officials argue that its currency policy is not meant to favor exports over imports, but instead to foster economic stability. They have expressed concern that abandoning its currency policy could cause an economic crisis in China and would especially hurt its export industries sectors at a time when painful economic reforms (such as closing down inefficient state-owned enterprises and restructuring the banking system) are being implemented. Over the past few years, the Chinese government has implemented steps that are preconditions for greater exchange rate flexibility: (i) liberalizing the capital account; (ii) reforming the financial sector; and (iii) developing new financial products.

Critics of China's currency policies also argue that appreciating the RMB would greatly benefit China by lowering the cost of imports and by balancing economic growth to include greater domestic consumption. However, others have pointed out that pushing China to appreciate its currency could cause it to decrease purchases of U.S. Treasury securities, which might result in higher U.S. interest rates. China is the second largest foreign purchaser (after Japan) of U.S. Treasury securities, which totaled \$406 billion at the end of 2007.

In 2006, the U.S. and Chinese governments held the first Strategic Economic Dialogue, a goal of which is increasing China's exchange rate flexibility. The U.S. Treasury Secretary and other U.S. government officials have raised this issue with their Chinese counterparts in private discussions. The current administra-





tion has criticized China's currency policies on a number of occasions. The Office of the U.S. Trade Representative has not taken action against China's currency manipulation, and the U.S. Treasury Department does not list China as a currency manipulator.¹²

A significant share of trade legislation aimed at China involves efforts to change China's currency policy¹³:

- H.R. 321 (English) would require the Treasury Department to determine if China manipulated its currency and to estimate the rate of that manipulation (if such a determination were made), which then would require the imposition of additional tariffs on Chinese products (equal to the estimated rate of manipulation). The bill also calls on the United States to file a WTO case against China over its currency policy and to work within the WTO to modify and clarify rules regarding currency manipulation.
- H.R. 782 (Tim Ryan) and S. 796 (Bunning) would make exchange rate "misalignment" actionable under U.S. countervailing duty laws, require the Treasury Department to determine whether a currency is misaligned in its semi-annual reports to Congress on exchange rates, prohibit the Department of Defense from purchasing certain products imported from China if it is determined that China's currency misalignment has disrupted U.S. defense industries, and would include currency misalignment as a factor in determining safeguard measures on imports of Chinese products that cause market disruption.
- H.R. 1002 (Spratt) would impose 27.5 percent in additional tariffs on Chinese goods unless the President certifies that China is no longer manipulating its currency.
- H.R. 708 (English), H.R. 1229 (Davis) and S. 974 (Collins) would apply U.S. countervailing laws to non-market economies. S. 364 (Rockefeller) would apply U.S. countervailing laws to non-market economies and make exchange rate manipulation actionable under those laws.
- H.R. 2942 (Tim Ryan) would apply countervailing laws to nonmarket economies, make an undervalued currency a factor in determining antidumping and countervailing duties, require Treasury to identify fundamentally misaligned currencies and to list those meeting the criteria for priority action. If consultations fail to resolve the currency issues, the USTR would be required to take action in the WTO.
- S. 1607 (Baucus) would require the Treasury Department to identify currencies that are fundamentally misaligned and to designate such currencies for priority action under certain circumstances in its semiannual reports to Congress on exchange. If after consultations the country maintaining the designated currency policy fails to adopt appropriate policies, the U.S. would make currency undervaluation a factor in determining antidumping duties, ban federal procurement of products or services from the designated country, bar financing by the U.S. Overseas Private Investment Corporation (OPIC), and would oppose multilateral financing for that country. If the designated country failed to take appropriate measures, the USTR would be required to file a case in the WTO. A modified version of the bill passed the Senate Finance Committee on July 31, 2007.



- S. 1677 (Dodd) would require the Treasury Department to identify countries that manipulate their currencies regardless of their intent and to submit an action plan for ending the manipulation; and gives Treasury the authority to file a case in the WTO. The Senate Banking Committee approved the bill on Aug. 1, 2007.

2. Labor Costs

The availability and cost of human resources is a significant challenge for foreign companies operating in China. According to a recent survey by the American Chamber of Commerce in China, American companies seem to be concerned with three labor issues¹⁴:

- Attracting and retaining high-quality talent is increasingly difficult;
- The LCL, highlighted above, increases costs on foreign employers because of (a) the requirement that employers execute employment agreements with all employees; and (b) a lack of guidelines on the implementation of the LCL; and
- An increasing activism by Chinese trade unions; an activism that has been encouraged by the Chinese government.



According the same survey, employee turnover in China averages 14.7 percent, and that figure rises to above 17 percent in areas such as Shanghai.¹⁵ Staff turnover rates and average salary increase rates are higher in China than nearly any other place in Asia.¹⁶ Staffing pressures are fueled by a combination of high demand (fostered by China's explosive economic growth), graduates without the skills sought by foreign companies (according to estimates from the Ministry of Labor and Social Security, of the 4.16 million graduates in 2006, 1.24 million lack the specific qualifications required for today's job market)¹⁷, and restrictions (through the household registration system) on labor mobility.¹⁸

The LCL also is having a significant impact on employment relations, but is unclear in several key areas:

- There are no implementing guidelines for the LCL defining key terms and procedures;
- It is unclear how work rules and procedures required by the LCL are to be developed;



- Also, it is unclear from the LCL how disagreements between employees and employers over LCL-mandated work rules would be resolved;
- The LCL does not specify how much compensation is required to enforce a noncompete clause; and
- It is unclear how provincial or local labor rules interface with the LCL.¹⁹

As a result of these issues, the uncertainty of complying with Chinese labor standards—not to mention the difficulty and cost of finding appropriate personnel—has increased. As stated above, the State Council recently has requested comments on implementation regulations for the LCL, but is unclear what effect comments would have on the development and interpretation of the LCL.

3. Dumping Issues

Critics of China's trade policies state that the PRC government subsidizes—through preferential bank loans and grants, debt forgiveness, and tax breaks and rebates—a significant number of Chinese industries.²⁰ Also, as discussed above, critics state that China's currency policies are a form of export subsidy. Until very recently, the U.S. Department of Commerce contended that U.S. countervailing laws could not be applied to a non-market economy such as China. However, in November 2006, the Commerce Department decided to pursue a countervailing case against certain imported Chinese coated free sheet paper products. On March 30, 2007, the Commerce Department issued a preliminary ruling to impose countervailing duties (ranging from 11 percent to 20 percent) against the products in question. In deciding to apply U.S. countervailing laws to China, the U.S. Department of Commerce concluded that China's economic reforms have caused some industry sectors to be market-based, enabling the level of government subsidies to be determined.²¹ Depending on the economic sector, an increasing number of countervailing cases involving Chinese exports may be expected.

4. China's IPR Enforcement

The United States has pressed China to improve its IPR protection regime since the late 1980s.²² Under the terms of China's WTO accession, China agreed to immediately bring its IPR laws in compliance with the TRIPS agreement. Although the Chinese government has made great strides in improving its IPR protection regime, much work remains to be done.

China's protection of intellectual property rights remains a significant issue, and affects the scope and scale of foreign companies operations in China. The Chinese government has made significant efforts to implement TRIPs, and, over the past year, the government has intensified its IPR protection programs within China. For example, in July 2007, the Ministry of Public Security (MPS) and the local Public Security Bureau (PSB) conducted "Operation Summer Solstice" in collaboration with the FBI in Southern China. This resulted in a crackdown on an international counterfeiting network and the largest seizure of high-end counterfeit software in China's history.²³



While China has taken active steps to improve IPR protection and enforcement over the past year, criminal enforcement is still not sufficient to change the overall IPR protection environment. Traditional Chinese legal doctrine places IPR infringement in the category of “violations of the socialist market economic order” rather than “property” crimes.²⁴ In addition, certain aspects of IPR laws require amending. For example, the Trademark Law was promulgated in August 1982 and revised in 1993 and 2001 to meet TRIPS requirements. The current draft Third Amendment to the Trademark Law is far more comprehensive than the 2001 revised version, proposing 150 articles for the Trademark Law, a substantial increase from the 64 currently included in the Law.²⁵ The Third Amendment is primarily focused on helping to expedite the trademark registration process and strengthen trademark protection. For example, the draft Third Amendment:


- Creates unreasonable requirements for filing trademark infringement complaints by requiring them to be in written form and indicate the name of infringer.
- Gives the government the flexibility to decide whether or not to confiscate or destroy infringing goods. It only directs the government to remove the infringing trademark labels from the goods without confiscating them.
- Calculates the illegal operation amount based on either the price labeled on the infringing goods or the verified sale price of the infringing goods.²⁶



Perhaps it is not surprising that the Chinese government estimates that counterfeits constitute between 15 percent and 20 percent of all products made in China and are equivalent to about 8 percent of China’s annual gross domestic product.

Despite various efforts on the part of the Chinese government to improve IPR enforcement, the U.S. government filed two WTO cases against China on April 10, 2007. These cases challenge a broad range of China’s IPR policies, and could potentially lead the WTO to authorize the United States to impose a significant level of sanctions against China.²⁷ Specifically, the U.S. WTO complaints against China’s IPR regime involve the following issues:

- The thresholds for criminal prosecutions of IPR violations are too high, meaning the government will only pursue cases it considers to be serious or excessively large, creating a safe harbor for smaller producers or violators. In addition, the thresholds for prosecuting IPR violations are based on the value of the pirated products rather than the value such legitimate products would fetch in the marketplace. Such thresholds make it very



difficult to pursue cases against many commercial producers of illegal IPR-related products.

- China often allows seized imported pirated goods to re-enter the market rather than disposing of them.
- China's copyright laws fail to protect imported works (such as movies) that are under review by Chinese censorship authorities (and must be approved before the works can be distributed in China). As a result, pirated copies of the works can be widely distributed without violating copyright law and thus do not face prosecution.
- Chinese IPR laws do not appear to allow producers of pirated products to be prosecuted unless they also illegally distribute such products.
- China has not abided by its 2001 WTO accession agreement to liberalize its rules on trading rights and distribution services. As a result, U.S. IPR-related products face significant trade barriers in China, and such barriers are a major factor for causing the high rate of piracy in China.

In order to reform its IPR regime, some have recommended that the PRC government²⁸:

- Further strengthen deterrent penalties against IPR infringement and piracy, especially for repeat violators.
- Strengthen cooperation between government agencies in order to work together in fighting against various and well-organized counterfeiting activities vigorously and effectively.
- Clarify China's criminal code to reflect international norms making clear that corporate end user piracy will be a crime.

5. Standards

The development process and conformity assessment procedures of China's standards continue to concern U.S. exporters.²⁹ The government's adoption of unique standards related to homegrown technologies, mandatory application of standards and type testing, and bureaucratic processes for import approval are viewed by many as protectionist in nature. These measures limit foreign products' access to the Chinese market and serve to protect domestic industries from foreign or domestically invested foreign competition.





Standards, particularly in the technology sector, are increasingly used as a tool to help China achieve its industrial policy goals. With the emphasis on indigenous innovation, there appears to be a clear policy of developing, encouraging, and in some cases, mandating development and implementation of homegrown standards to support China's technological development.³⁰ The Chinese government does not generally adopt or accept international or global standards that are already widely used in the marketplace. Further, a lack of transparency and the inability of foreign companies to participate in the development of Chinese standards and technical regulations continue to be concerns and barriers to innovation. The Chinese government fails to consistently use the WTO Technical Barriers to Trade mechanism to provide timely notification of measures and implementing regulations that rely on or refer to voluntary standards.

As a related issue, China's standards development has not kept pace with changes in technology. According to the PRC government, Chinese standards average about 12 years in age.³¹ Government control of standards results in delays and the use of older technologies and testing methods that can in turn lead to inefficient use of energy or raw materials.

Certification and testing of imported products is conducted in an uneven manner compared to similar domestically produced products. Domestic manufacturers are often able to evade or escape scrutiny in the certification and testing of certain special purpose products.



6. Product Quality and Safety

Related to standards issues, China's product quality and safety record is a major concern for U.S. companies.³² Reports throughout 2007 of tainted or unsafe food and consumer products from China raised concerns in the United States over the health, safety, and quality of imports from China. For example, the U.S. Consumer Product Safety Commission (CPSC) announced voluntary recalls by U.S. companies on numerous products made in China; in 2007, over four-fifths of such recall notices have involved Chinese products.³³

The Chinese government has taken significant and rapid steps to prove to the international community it is serious about product safety. The launch of a large-scale campaign by former Chinese Vice Premier Wu Yi addressing product safety in August 2007 clearly signaled that China had begun the long process to reform its quality standards.³⁴ On the U.S. side, President Bush established the Interagency Working Group on Import Safety, which delivered the Import Safety Action Plan in November 2007. Oversight capacity in the U.S. through the CPSC and the U.S. Food and Drug Administration (FDA) is improving.



Over the next few years, accountability disputes—determining the responsible party for safety issues—likely will be the most significant issue for U.S. producers. These disputes are driven by many factors³⁵:

- Much of the corner-cutting by Chinese manufacturers has been a response to constant demands for lower prices. The prospect of rising costs of labor, land and compliance with environmental rules will increase the cost burden that Chinese manufacturers currently face.
- Food and product safety is regulated by a large number of national level ministries and, perhaps more significantly for the enforcement issues, by regulators at provincial and local levels.
- Weak consumer protection laws and poorly enforced regulations, including a lack of inspections and ineffective penalties for code violators, underfunded and understaffed regulatory agencies and poor interagency cooperation

7. WTO Compliance

In joining the WTO, China was required to make immediate and extensive reductions in various trade and investment barriers, but allowed to maintain some level of protection for certain sensitive sectors. For example, China agreed to:

- Reduce the average tariff for industrial goods and agriculture products to 8.9 percent and 15 percent, respectively (with most cuts made by 2004 and all cuts completed by 2010).
- Limit subsidies for agricultural production to 8.5 percent of the value of farm output and eliminate export subsidies on agricultural exports.
- Within three years of accession, grant full trade and distribution rights to foreign enterprises (with some exceptions, such as for certain agricultural products, minerals, and fuels).
- Provide non-discriminatory treatment to all WTO members.
- As discussed above, implement the WTO's TRIPS Agreement upon accession.
- Accept a 12-year safeguard mechanism (available to other WTO members as well) in cases where a surge in Chinese exports cause or threaten to cause market disruption to domestic producers.

While China has made great strides in implementing key aspects of its WTO commitments, such as in reducing tariff rates, there are several areas where China's implementation is not complete:³⁶

- An ineffective IPR enforcement regime (discussed above).
- Industrial policies that attempt to promote Chinese firms (while discriminating against foreign firms).



- Restrictions on trading and distribution rights.
- Discriminatory and unpredictable health and safety rules on imports.
- Burdensome regulations and restrictions on services.
- Failure to provide adequate transparency of trade laws and regulations.

Further, China agreed, when it joined the WTO, to provide a full description of all its subsidy programs, but has yet to do so.³⁷ Also, the Chinese government agreed to make its state-owned enterprises operate according to market principles, but many firms continue to receive direction and subsidies.

As a result of the incomplete implementation of China's WTO commitments, the office of the U.S. Trade Representative (USTR) has initiated five WTO dispute resolution cases against China, two of which have been resolved.³⁸


Cases outstanding include:

- On March 3, 2008, the USTR requested WTO dispute resolution consultations with China regarding its discriminatory treatment of U.S. suppliers of financial information services in China.
- As discussed above, on April 10, 2007, the USTR filed two IPR-related cases against China: the first case charges that China has failed to comply with the TRIPS agreement (namely in terms of its enforcement of IPR laws) and the second case charges that China has failed to provide sufficient market access to IPR-related products, namely in terms of trading rights and distribution services.
- On March 30, 2006, the USTR initiated a WTO case against China for its use of discriminatory regulations applied to imported auto parts, stating that the purpose of these rules was to discourage domestic producers from using imported parts and encouraging foreign firms to move production to China. On Feb. 13, 2008, a WTO panel ruled that China's discriminatory tariff policy was inconsistent with its WTO obligations.



The two WTO cases that have been resolved include:

- On Feb. 5, 2007, the USTR announced it had requested WTO dispute consultations with China over government regulations that give WTO-inconsistent import and export subsidies to various industries in China



(such as steel, wood, and paper) that distort trade and discriminate against imports. On Nov. 29, 2007, China formally agreed to eliminate the subsidies in question by Jan. 1, 2008.

- On March 18, 2004, the USTR announced it had filed a WTO dispute resolution case against China over its discriminatory tax treatment of imported semiconductors. The United States claimed that China applied a 17 percent VAT rate on semiconductor chips that were designed and made outside China, but gave VAT rebates to domestic producers. Following consultations with the Chinese government, the USTR announced on July 8, 2004, that China agreed to end its preferential tax policy by April 2005. However, the USTR has expressed concern over new forms of financial assistance given by the Chinese government to its domestic semiconductor industry.

8. Changes in China's Tax Regime

The Enterprise Income Tax Law (EIT Law) and Implementation Rules (Rules) were introduced in 2007 to “level the playing field” between domestic enterprises and foreign invested enterprises.³⁹ They also serve to steer investment towards protection of the environment, infrastructure projects and certain key industries that contribute to China’s goal of fostering innovation. Of specific concern, the EIT Law provides for a 10 percent dividend withholding tax, among the highest in Asia.⁴⁰ Further, the EIT is a flat turnover tax assessed, in most cases, on gross income and is not a comprehensive VAT system.

As a part of the process of leveling the taxation “playing field,” significant adjustments have been made over the past year to value added taxes (VAT) refund rates, export duties and the qualifying materials/products that can be manufactured for export under processing trade arrangements.⁴¹ These changes have caused immediate increases in the tax burden on exports and to exporters. These changes have increased VAT costs to 13 percent or more of the Free on Board (FOB) sales value from the time when many manufacturers first established operations in China. The recent VAT refund rate change announcements were also perceived as very abrupt, with changes in July 2007 made with less than two weeks’ notice.⁴²

The EIT Law and Rules state that all related party transactions must use arm’s length pricing at internationally accepted standards.⁴³ For the 2008 tax year, companies with such transactions are required to prepare for the first time contemporaneous documentary support. The government is still drafting its guidance on these new requirements so all affected enterprises are still uncertain how to comply. Note that Chinese regulations define “control” for transfer pricing purposes to be 25 percent or more.⁴⁴

The lower 15 percent tax rate under the EIT Law for “new and high-tech” (NHT) companies is intended to drive innovation and investment in line with China’s 2006-2020 Long-Term Innovation Plan.⁴⁵ However, the Rules include an IPR ownership requirement that has the effect of preventing most non-Chinese multinational companies from realizing the benefits.

9. Customs Issues

Approximately 45 percent of all cross-border trade in China consists of processing trade (bonded manufacturing, with no customs duty paid at import/export), while 50 percent falls under general trade (customs



duty-paid at import/export).⁴⁶ The remaining five percent relates to other customs duty-exempt and/or duty-reduced imports/exports.⁴⁷ There have been significant changes to China's customs systems that present challenges to U.S. companies operating in China.

New processing trade and VAT refund changes have⁴⁸:

- Increased the number of prohibited goods for processing trade from 341 to 1,140, the majority from high-energy or environmentally intensive industries.
- Prohibited companies, set up on or after April 26, 2007, in customs special zones from having processing trade arrangements for goods on the prohibited list for processing trade.
- Increased the number of restricted goods for processing trade from 394 to 2,247, mostly in the plastics, textile, cloth, furniture and other labor-intensive industries.
- Disallowed companies set up on or after July 23, 2007, in certain areas from conducting processing trade for products classified as "restricted."
- Required defined A & B grade companies to pay a deposit valued at 50 percent of the total duties and import VAT payable, and required defined C grade companies to pay a 100 percent deposit.



Perhaps most important to U.S. companies, Section 1701 of H.R. 1, "9/11 Commission Recommendations," signed by President Bush on Aug. 3, 2007, stipulates that as of 2012, 100 percent of cargo containers destined for the U.S. must be "scanned" by nonintrusive imaging and radiation detectors at foreign ports of loading or be denied entry into the U.S.⁴⁹ This requirement will have serious repercussions for the global supply chain.



Vietnam

As the costs and regulatory complexity for doing business in China increase, foreign companies have begun searching for alternate jurisdictions in which to start their supply chain and/or to market their products. Over the past few years, Vietnam has emerged as an alternative to China, both as a sourcing point and as an export market. Vietnam has one of the best-performing developing economies in the world, and is undergoing a transformation from a planned economy to one that is globalized and market-based.⁵⁰ This section of the briefing book briefly will review issues related to trade with and investment in Vietnam.

Vietnam's economic reform process, termed a "renovation process" or *doi moi*, commenced in 1986. By the late 1990s, the Vietnamese government could not maintain a consensus in favor of deepening the *doi moi* process. The decisions, in 2000 and 2001, to enter the ASEAN Free Trade Area and sign a Bilateral Trade Agreement (BTA) with the United States, respectively, appear to have created a lasting political consensus favoring international economic engagement and economic reform. This push was effectively endorsed by the leadership changes in 2001. Shortly after signing the BTA, the Vietnamese government enacted a series of measures, including (a) passing a new Enterprise Law; (b) passing a constitutional amendment giving legal status to the private sector; (c) reducing red tape; and (d) creating unprecedented transparency rules requiring the publication of many types of new rules and regulations before they are implemented.



The Vietnamese government strongly encourages foreign investment as part of its development strategy, and the national leadership is committed to improving the business and investment climate for foreign companies. Foreign Direct Investment (FDI) in Vietnam is an integral part of the government's Gross Domestic Product (GDP) growth target of 8.5 percent - 9 percent for 2008. By the end of 2007, Vietnam had attracted \$83.1 billion in foreign investment commitments from 8,590 projects since 1988. In that same period, U.S. businesses received 375 investment licenses for projects worth \$2.8 billion, and the United States was Vietnam's eighth largest investor in 2007. The government's most recent Five Year Plan (2006-2010) sets a FDI target of \$17.5-19.5 billion, from licensed foreign investment projects, by 2010.



A. Effects of Vietnam's Economic Development

Over the past 20 years, Vietnam has been one of the world's fastest-growing countries, generally averaging around 7 percent to 8.5 percent annual GDP growth and 14 percent to 15 percent annual increase in industrial output. Real income in Vietnam has grown 7.3 percent per year over the last 10 years, and it is expected that Vietnam will reach most of the Millennium Development Goals by 2010.⁵¹

Much of Vietnam's growth has been driven by its private sector. Domestically owned private firms employ around a quarter of the workforce and account for over 50 percent of investments made each year.⁵² Private firms now contribute 65 percent of manufactured products and over 70 percent of non-oil exports to Vietnam's economy.

The Vietnamese government recently has deepened economic reforms by:⁵³

- Adopting a new State budget law that has improved public financial management with improved transparency, increased disclosure, and a forum for public consultation;
- Developing legal and regulatory policy frameworks for energy, water, and forestry as well as for investment and enterprises;
- Continuing progress in the sale of state assets through the "equitization," or privatization, of State Owned Enterprises (most of whom are functionally bankrupt), with the goal of completion of the privatization process by 2009; and
- Adopting an aggressive roadmap for financial sector reform.



B. Role of Bilateral Trade and Investment

Against this backdrop, Vietnam is a quickly emerging market, offering ground floor and growing opportunities for U.S. exporters and investors. Strong economic growth, ongoing reform and a large population of 85 million—half of which are under the age of 30—have combined to create a dynamic and quickly evolving commercial environment in Vietnam. One of Vietnam's main investment advantages is its large (over 45 million people), literate (government reports a literacy rate of over 90 percent), inexpensive and young (over 75 percent of the population is under 40) labor force. The labor pool continues to increase by over 1.6 million workers annually due to the post-war population explosion.⁵⁴



Vietnam's exports to the United States increased significantly following the entrance into force of the BTA, increasing from \$1.2 billion in 2000 to \$12.5 billion at the end of 2007.⁵⁵ The most direct impact of the large BTA-initiated cuts in U.S. tariff rates was an increase in Vietnamese exports by 128 percent in 2002 and then another 90 percent in 2003.⁵⁶ This increase was led by a surge of 1,764 percent in apparel exports in 2002, followed by 164 percent in 2003. In the ten months after Vietnam joined the World Trade Organization (WTO), year-on-year bilateral trade flows increased by over 25 percent, including a 75 percent increase in U.S. exports and a 22 percent increase in U.S. imports. The United States is now Vietnam's largest export market according to one study. In 2007 U.S. exports to Vietnam grew by 73 percent to reach \$1.9 billion, while Vietnam's exports to the United States, were up by 24 percent, reaching \$10.6 billion.⁵⁷

Vietnam now predominantly exports manufactured goods to the United States. In 2001, before the BTA, 78 percent of all Vietnamese exports to the United States were primary goods, mainly shrimp and petroleum products.⁵⁸ By 2003, after just two years of BTA implementation, manufactured exports were 72 percent of total exports to the United States, leveling off later at about 74 - 75 percent.⁵⁹ The two largest non-clothing manufactured exports to the United States are footwear and furniture. Among the more important emerging exports from the non-clothing manufacturing sector are data-processing machines, telecommunications equipment, travel goods, and miscellaneous manufactures (including plastic products, toys, and sporting goods). Vietnam's economy is increasingly more oriented toward exports, labor-intensive production, and the private sector.⁶⁰

Over the last decade or so, the most dynamic export sector in East Asia has been electronics. Initially these exports were chiefly household and industrial electronic goods; more recently, computer and information technology electronics have predominated. If Vietnam continues to follow the track of its more developed neighbors, it can be expected to increasingly expand exports of these kinds of electronics. Recent Vietnamese exports of electronics and computer parts illustrate this trend: they skyrocketed from \$492 million in 2002 to \$1.9 billion in 2006, driven largely by Japanese and Korean foreign investment.⁶¹

U.S. firms constitute the single largest source foreign direct investment (FDI) in Vietnam, and U.S.-related implemented FDI is spread among a number of largely capital/skill-intensive sectors.⁶² Roughly half is in the petroleum sector, around one-third in manufactured sectors, and the rest in services, property development, and agriculture. Excluding oil and gas investment, more than 80 percent of U.S.-related implemented FDI is located in three provinces/cities in the south around Ho Chi Minh City (Ho Chi Minh City, Binh Duong and Dong Nai) and two provinces/cities around Hanoi in the north (Hai Duong and Hanoi). Almost 60 percent of all non-oil U.S.-related implemented FDI is done through 100 percent-foreign-owned enterprises, with most of the rest through joint ventures.⁶³

While Vietnam has a large bilateral trade surplus with the United States, it runs a substantial trade deficit overall.⁶⁴ Vietnam's trade surplus with the United States has grown rapidly since 2001, from around \$600 million in 2001 to around \$7.5 billion in 2006. Even with this substantial growth, however, Vietnam accounts for less than 1 percent of the overall U.S. trade deficit.⁶⁵ There is little evidence that this trade surplus is generated from "mercantilist" policies. Instead, the cause appears to be largely structural. Vietnam tends to export most of its products to four major markets, the United States, EU, Japan and ASEAN, while most



of its imports come from Asian economies. Differentiating Vietnam strongly from China, Vietnam has increased its overall imports more rapidly than its exports. Its trade deficit with the rest of the world significantly exceeds its bilateral surplus with the United States.⁶⁶

C. Overview of the U.S.-Vietnam Bilateral Trade Agreement

The United States-Vietnam BTA, which entered into force on Dec. 10, 2001 provides a broad range of benefits for U.S. investment in Vietnam. The BTA accelerated Vietnam's entry into the global economy and eventual membership in the WTO.

The BTA is complimented by a Trade and Investment Framework Agreement (TIFA) signed by the U.S. and Vietnamese governments on June 21, 2007. Under the TIFA the United States and Vietnam will continue to advance the BTA and Vietnam's WTO commitments, explore new initiatives to increase trade in industrial and agricultural products and services, and encourage further investment between the countries.⁶⁷



Pursuant to the BTA, the Vietnamese government made the following commitments:

Trading Rights: Vietnam opened up the right to import and export by allowing (a) all Vietnamese companies the right to trade immediately (as of Dec. 10, 2001); (b) all U.S. invested companies the right to trade, in connection with their operations, immediately; (c) U.S. invested companies the right to trade any products (subject to some exceptions) within three years of the BTA's adoption; (d) U.S. persons to form joint ventures for the purpose of trading (within three years of the BTA's adoption, the maximum U.S. share in such venture was capped at 49 percent, which would be increased to 51 percent by Dec. 10, 2007).

MFN Treatment: Vietnam committed to Most Favored Nation tariff treatment on all U.S. imports.

Tariff Cuts: Vietnam cut tariffs (the typical cut was by one-third to one-half over a three-year period starting on the date of the BTA's entrance into force on a broad range of products of interest to U.S. exporters, including toiletries, film, air conditioners and refrigerators, electrical motors, valves, mobile phones, pagers, and video games.

Non-tariff Measures: Vietnam agreed to eliminate all quantitative restrictions on a range of industrial and agricultural products, over a period of three to seven years from the date of the BTA's adoption depending on the product.

Import Licensing: Vietnam agreed to eliminate all discretionary import licensing requirements in accordance with WTO standards.



Customs Valuation and Customs Fees: Vietnam agreed to comply with WTO rules – using transactions value for customs valuation, and limiting customs fees to cost of services rendered – within two years of the BTA's entrance into force.

Technical Standards and Sanitary and Phytosanitary Measures: In accordance with WTO standards, Vietnam agreed that technical regulations and sanitary and phytosanitary measures must be applied on a national treatment basis, and be applied only to the extent necessary to fulfill legitimate objectives.

State Trading: Vietnam agreed that state trading must be carried out in accordance with WTO rules (state trading enterprises make any sales and purchases only in accordance with commercial considerations).

Intellectual Property Rights: Vietnam agreed to full compliance with the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) in all areas in short time frame, including TRIPs-level Patent and Trademark protection within 12 months of the BTA entering into force, and TRIPs-level Copyright and Trade Secrets Protection within 18 months. Vietnam also agreed to “TRIPs plus” treatment in several areas, including encrypted satellite signals, patent protection for plants and animals, and protection of confidential test data submitted to governments.

Services: Vietnam made several horizontal services commitments, including protecting existing foreign investment licenses through a grandfather provision, allowing foreign companies to lease land, and enabling top managers and salespeople to enter Vietnam and work. In specific services sectors, the Vietnamese government allowed 100 percent U.S. ownership (such as in the accounting, engineering and computer fields). In the distribution sector, the Vietnamese government allowed U.S.-Vietnamese joint ventures from 2004, limited to 49 percent U.S. equity, and no limit after 2007.

Investments: The Vietnamese government granted expropriation protection for U.S. investments in Vietnam, the right to investor-state dispute settlement through the International Centre for the Settlement of Investment Disputes, and the right for foreign investors to freely transfer currency on a national treatment basis. Further, Vietnam agreed to phase out all WTO-inconsistent trade-related investment measures (TRIMs) (such as local content requirements) in five years, and other TRIMs like practices (export performance requirements) over a similar timeframe. In addition, pursuant to the BTA, previous requirements that certain board members of Vietnamese-U.S. joint ventures be Vietnamese were eliminated by 2003, and the types of issues on which board “consensus” must be reached (on which Vietnamese members have veto power) were limited.

Transparency: Vietnam made extensive transparency commitments, requiring the Vietnamese government to provide advance notice of all laws, regulations and other administrative procedures relating to any matter covered in the BTA, and requiring their publication, and an indication therein of effective dates and government contact points. In addition, the BTA requires all laws governing issues covered in the agreement that have not been published to be made public and readily available, and requires designation of an official journal where all such measures will be published. The BTA also requires uniform, impartial and reasonable application of all laws, regulations and administrative procedures. Lastly, the BTA requires formation of administrative or judicial tribunals for review and correction (at the request of an affected person) of all matters covered in the BTA, and affords the right to appeal the relevant decisions.



D. Effect of World Trade Organization Accession

Vietnam became the 150th member of the WTO on Jan. 11, 2007. In December 2006, Congress passed and President Bush signed H.R. 6111 (P.L.109-432), extending permanent normal trade relations (PNTR) status to Vietnam. Through 2015, the Vietnamese government will continue to implement far-reaching economic, regulatory and administrative changes that will provide an increasingly favorable environment for American businesses to enter and expand in the market. Vietnam's commitments in the WTO increase market access for exports of U.S. goods and services and establish greater transparency in regulatory trade practices, enhance economic freedoms and establish a more level playing field between Vietnamese and foreign companies. As part of its WTO accession, the Vietnamese government made the following commitments:

Tariffs: The United States negotiated significant reductions in tariff rates for many important U.S. exports in the context of Vietnam's entry into the WTO. Prior to Vietnam's accession in January 2007, the Ministry of Finance reduced tariffs accordingly in December 2006. As a result, the vast majority of U.S. exports face tariffs of 15 percent or less. Upon accession, Vietnam will bind all tariff lines, creating greater transparency for U.S. exporters, and lower its average bound tariff rate on industrial and consumer goods by 20 percent after full implementation. Vietnam also reduced tariffs to the harmonization rates required by the WTO Chemical Harmonization Agreement for 80 percent of the chemical products covered by the Harmonization Agreement. Also, Vietnam agreed to join the WTO Information Technology Agreement upon accession and, as a result, it has eliminated tariffs on important U.S. information technology exports.

Non-Tariff Barriers: Vietnam has eliminated and committed not to reintroduce any quantitative restrictions on imports or other nontariff measures, such as quotas, bans, permits, prior authorization requirements, licensing requirements or other restrictions having the same effect, which would not be consistent with WTO disciplines.

Trading Rights: Upon WTO accession, Vietnam granted full trading rights (including the right to sell an imported product to any individual or enterprise having the right to distribute such product in Vietnam) to all foreign individuals and enterprises. However, foreign firms and individuals are restricted until Jan. 1, 2009 from importing the following categories of products: pharmaceuticals, motion picture films, unused postage, printed cards and calendars, certain printed matter, machinery for typesetting and print machinery (excluding ink-jet printers), and certain transmission apparatus for radio-telephony (excluding mobile phones and consumer cameras). Foreign individuals and enterprises will be given the right to export rice no later than Jan. 1, 2011.

Distribution: Starting Jan. 1, 2009 the Vietnamese government will allow wholly owned foreign invested companies in most sectors to distribute their own products.

Services: Vietnam has made commitments on a range of services, although in some cases Vietnam reserves the right to limit foreign ownership of service companies. In other cases, permitted foreign ownership is immediately 100 percent (for example accountancy) or is phased in to reach 100 percent after a few years (for example express delivery courier services after five years).



Foreign Exchange: Vietnam will abide by International Monetary Fund and WTO disciplines.

State Enterprises: Commercial business (except for supplying the government) will be conducted on commercial terms without interference from the government. A number of products are listed as subject to state trading enterprises because of consumption restrictions, for cultural and moral reasons, or because they are “natural monopolies”: tobacco products, petroleum, cultural products such as newspapers, journals and audio-visual materials, and aircraft.

Privatization: The “equitization” process will be handled transparently, with the Vietnamese government supplying annual reports while the program lasts.

Pricing and Price Controls: The Vietnamese government will comply with WTO agreements and notify the WTO of actions it takes to control prices.

Policy-making and Enforcing: A number of administrative and legal structures have been introduced or strengthened so that WTO provisions are applied, including the possibility of investigation and judicial review to deal with complaints.

WTO Agreements Dealing with Rules: Vietnam will comply with the Customs Valuation, Rules of Origin, Pre-shipment Inspection, Anti-dumping, Safeguards, Subsidies, and Trade-Related Investment Measures agreements, with some provisions phased in over an agreed-upon period.

Export Restrictions: Vietnam will maintain export controls on some products such as rice, and some wood products and minerals (to prevent illegal exploitation), but will apply controls on these products in a way that conforms with WTO agreements.

Standards: Vietnam will apply the Technical Barriers to Trade, and Sanitary and Phytosanitary Measures agreements as of the date of WTO accession.

Government Procurement: Vietnam will consider signing the Government Procurement Agreement.

Intellectual Property: Vietnam will comply with TRIPs as of its WTO accession date, without any transition period.





E. Challenges In Doing Business With Vietnam

Vietnam's record in implementing its bilateral and international obligations has been good overall, but concerns remain. Specifically,

Protection of intellectual property rights. Since 2002, the Bush Administration has placed Vietnam on its "Special 301 watch list" for poor protection of intellectual property rights (IPR), particularly in the areas of music recordings and trademark protection.¹⁸ The BTA required Vietnam to make its IPR regime WTO-consistent in 2003, and as part of its efforts to accede to the WTO, Vietnam passed a new IPR law in late 2005. Despite this and other legal and regulatory changes, the Vietnamese government's IPR enforcement has been widely faulted.⁶⁸

Regulatory developments. The evolving nature of regulatory regimes and commercial law in Vietnam, combined with overlapping jurisdiction among government ministries, often result in a lack of transparency, uniformity and consistency in government policies and decisions on commercial projects.⁶⁹

Corruption. Corruption and administrative red tape within the government has led to lack of transparency and has been a vast challenge for governmental consistency and productivity.⁷⁰

Labor costs. The pool of skilled labor is drying up and the country's academic centers have been unable to keep up with the demands of a modern economy. Foreign investors cite the shortage of managerial talent and skilled workers as one of the leading challenges for Vietnam. By 2012, Vietnam will set a single nationwide minimum wage. In Jan. 2008, new minimum wages came into effect, generally increasing salaries by 20-38 percent for workers in domestic enterprises and 13-15 percent in foreign enterprises. In foreign-invested enterprises, the new minimum monthly salaries are VND1,000,000 (\$62) in Zone 1 (urban Hanoi and Ho Chi Minh City), VND900,000 (\$56) in Zone 2 (Haiphong, Halong, Bien Hoa, Vung Tau, Thu Dau Mot, Thuan An, Di An, Ben Cat, Tan Uyen, and the suburbs of Hanoi and of Ho Chi Minh City), and VND800,000 (\$50) in Zone 3, that is, in all other areas. Minimum wages are lower for domestic enterprises: VND620,000 (\$39) in Zone 1, VND580,000 (\$36) in Zone 2 and VND540,000 (\$34) in Zone 3. The government may temporarily exempt certain joint ventures from paying the minimum wage during the first months of an enterprise's operations or if the enterprise is located in a very remote area, but the minimum monthly wage in these cases can be no lower than VND800,000 (\$50). Foreign investors can hire and recruit staff directly, but only after exhausting a 15-day period using a state-run employment and recruitment bureau. All personnel must be registered with the Vietnamese government. On July 1, 2007, new Labor Law provisions went into effect introducing an extensive process of mediation and arbitration to deal with labor disputes.

Union activities. In 2007, there were over 300 strikes — most of them in the southern industrial zones and most of them "illegal" under Vietnamese laws (by law, any "legal" strike has to be conducted through the labor union and use the lengthy and complex set of conciliation and arbitration steps). The Vietnamese government rarely takes action against "illegal" strikers. The failure of wages to keep pace with high inflation, which was running at over 10 percent at the beginning of 2008, and poor industrial communications are



often cited as the two principal causes of labor disputes. Employers are required by law to establish labor unions within six months of establishment of any company. All labor unions must be members of the Vietnam General Confederation of Labor, a state-run organization under the Communist Party-affiliated Fatherland Front.

Dumping concerns. Rising imports have led to trade disputes over imports of Vietnamese clothing, catfish, and shrimp. The BTA contained no restrictions on Vietnamese clothing exports to the United States, but a safeguard provision allowed the United States to impose quotas on textile imports in the event of a surge of imports. Similarly, Vietnam's WTO accession agreement does not contain a special safeguard provision. However, criticism of the deal from textile interests and some Members of Congress led the Administration to establish a mechanism to monitor imports of textiles from Vietnam and have the Commerce Department self-initiate antidumping investigations when warranted. On Oct. 26, 2007, the Department of Commerce announced the completion of its first six-month review of the monitoring data, finding that there was insufficient evidence to warrant the self-initiation of an antidumping investigation. The Department also announced it would continue the monitoring program and plans on conducting its second six-month review in March 2008.

Currency concerns. Some in the United States have complained about Vietnam's currency policies, under which the Vietnamese *dong* does not float freely against the U.S. dollar and other currencies. Instead, the State Bank of Vietnam maintains a "managed float" via a daily trading band limiting the fluctuation of the *dong* to plus or minus 0.75 percent, a spread that is up from the 0.1 percent that was maintained in 2001. Under the terms of its entry into the WTO, Vietnam will retain its designation as a "nonmarket economy" until 2019, making it procedurally easier in many cases for U.S. companies to initiate and succeed in bringing anti-dumping cases against Vietnamese exports.⁷¹





Conclusion

This briefing has reviewed the increasing complexities in doing business in and with China and has reviewed the drivers of increased costs associated with doing business in China. Further, this briefing has provided an overview of certain issues associated with doing business in Vietnam, perceived to be China's competitor in drawing labor-intensive investment from foreign investors. If you have any questions about this briefing, please do not hesitate to contact us:

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Endnotes

¹ American Chamber of Commerce in China, *2008 White Paper: American Business in China* (2008) 17 [hereinafter AmCham 2008]. Cham 2008, p. 17.

² *Id.* at 12, 14.

³ Wayne M. Morrison, Congressional Research Service, *China-U.S. Trade Issues* (March 7, 2008) 1-6 [hereinafter Morrison].

⁴ *Id.* at 5.

⁵ *Id.* at 2-4.

⁶ *Id.*

⁷ *Id.* at 2.

⁸ Related to the ECL, in January, 2007, the Ministry of Labor and Social Security issued the *Circular on the Establishment of Record Filing Systems for Employment*, a regulation confirming that all employers in China must complete filing procedures for employment contracts with the labor and social security administrative departments at or above the county level in the employer's place of registration. Such filing must include information on (a) the employer's name, legal representative, type of ownership and organization code; (b) the employees' number, name, gender and identification number; and (c) the dates of commencement and ending of labor contracts signed with employees.

⁹ AmCham 2008 at 18.

¹⁰ Morrison at 12.

¹¹ *Id.* at 12-13

¹² *Id.*

¹³ *Id.* at 28-30.

¹⁴ AmCham 2008 at 44-48.

¹⁵ *AmCham Id. at* 2008, p. 47.

¹⁶ *Id.*

¹⁷ *Id.* at 46. For foreign invested enterprises (FIEs) as a whole in China, the nature of business has trended from low-end manufacturing increasingly to research and development, more sophisticated manufacturing processes operating in global networks, financial analysis, high-tech industries and service-oriented work. As many foreign companies integrate their China business into their global operations, they are expecting their Chinese colleagues to work collaboratively across boundaries, speak fluent English and have an international mindset when approaching problems. The country's schools still favor rote memorization versus practical application. This method of learning does not translate well to daily operational communication, especially in today's complex, global multi-cultural organizations. *Id.*

¹⁸ *Id.* FIEs operating in China tend to be focused in a few concentrated areas in coastal cities. However, the distribution of Chinese universities across China does not correspond to the talent needs. *Id.*

¹⁹ *Id.* at 48.

²⁰ Morrison at 24.



- 21 *Id.*
- 22 *Id.* at 18.
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- 37 *Id.* at 14.
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57 *Id.*

58 STAR-Vietnam, *Assessment of the Five-Year Impact of the U.S.-Vietnam Bilateral Trade Agreement* (2007) 170 [hereinafter STAR-Vietnam].

59 *Id.*

60 *Id.*

61 *Id.*

62 *Id.* at 174-175.

63 *Id.*

64 Manyin at 11-12.

65 *Id.* BTA Implementation Report.



About Williams Mullen

Where Every Client is a Partner

Williams Mullen provides comprehensive legal services to regional, national and international clients. With more than 325 attorneys and twelve offices throughout North Carolina, Virginia, Washington, D.C. and in London, we deliver innovative solutions to support our clients' diverse business activities. Close working relationships with clients have been the foundation of Williams Mullen's progressive approach to law practice since the firm was founded nearly 100 years ago.

Williams Mullen brings together teams by drawing on the resources of not just one office, but all of our offices. Legal needs determine how we structure an individual client's team. Attorneys versed in over 30 different practice areas allow us to assemble versatile and formidable teams. Our technology and staff are configured to support our teams within offices, between offices and in every relationship with our clients.

Practice Areas Include:

Antitrust
Aviation
Business
Business Relocation/Expansion
Business Succession Planning
Communications
Complex Business Litigation
Construction
Consumer Finance
Corporate Finance & Securities
E-commerce
Employee Benefits
Energy
Environmental
Estate Planning
Family Law
Fiduciary Litigation
Financial Services
Franchising & Distribution
Government Contracts
Governmental Affairs
Health Care
Immigration
Intellectual Property
International
Labor & Employment
Land Use
Litigation
Loan Workouts/Creditors'
Rights/Bankruptcy
Maritime
Multistate Corporate Compliance &
Public Policy Group
Patent
Petroleum
Private Equity
Public Finance
Real Estate
Tax Controversy
Tax Law
Technology/IP/Entertainment
Trust and Estate Administration

Recognized Leader

Included in the AMLAW 200--
American Lawyer magazine's
listing of the 200 top law firms
in the United States

96 lawyers named to the 2007
Virginia and North Carolina
"Legal Elite" Lists

Voted one of America's Best
Corporate Law Firms by
Corporate Board Member
magazine

Named as a Leading Law firm
by *Chambers USA* since 2003

Was named a *Go-To Law*
Firm™ by *Corporate Counsel*
magazine in 2006