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Committee on Market Access

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TRANSITIONAL REVIEW MECHANISM PURSUANT TO PARAGRAPH 18 OF THE PROTOCOL ON THE ACCESSION OF THE PEOPLE'S REPUBLIC OF CHINA

Questions from the United States to China concerning Market Access

The following communication, dated 10 October 2003, has been received for the Permanent Delegation of the United States.

Trading Rights

1. In its WTO accession agreement, China committed that it would no longer condition eligibility for trading rights, meaning the right to import and the right to export, on export performance, trade balancing, foreign exchange balancing or prior experience requirements. China committed that it would eliminate these requirements immediately upon its accession (11 December 2001). (Working Party Report, para. 83(c).) China further committed to expand the availability of trading rights pursuant to an agreed schedule covering the first three years of its WTO membership.

First, China committed to make trading rights available to all wholly Chinese-invested enterprises (referred to herein as Chinese enterprises), subject to certain minimum registered capital requirements, to be gradually decreased during a three-year transition period (ending 11 December 2004).

Second, China committed that it would make "full rights to trade" available to joint ventures with minority foreign ownership beginning not later than one year after China's accession (i.e., by 11 December 2002). (See Working Party Report, para. 83.)

Third, China committed that, within two years after its accession (i.e., by 11 December 2003), it would make these same full trading rights available to joint ventures with majority foreign ownership.

Finally, China committed to eliminate its system of case-by-case examination and approval of trading rights and make "full" trading rights available for all wholly Chinese-invested enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships, within three years of its accession (i.e., by 11 December 2004). At that time, China will be required to grant trading rights automatically. As China expressly confirmed, trading rights will be granted in a non-discretionary way, and any requirements for obtaining trading rights will be for customs and fiscal purposes only and will not constitute a barrier to trade.

To date, while China has made progress in implementing its trading rights commitments insofar as they relate to Chinese enterprises, it appears that China has fallen behind with regard to its trading rights commitments insofar as they relate to foreign-invested enterprises. It is the understanding of the United States that China has continued to limit the availability of trading rights for foreign-invested enterprises by imposing conditions on the eligibility of these enterprises, including requirements related to minimum registered capital, import levels, export levels and prior experience.

Since well before China's accession, pursuant to China's *Foreign Trade Law*, foreign-invested manufacturing enterprises have had the right to import inputs for production purposes and the right to export their finished goods, without the need for prior approval. In January 2001, China expanded the import rights of some foreign-invested manufacturing enterprises with the issuance of the *Supplementary Provisions (II) to the Provisional Regulations Governing the Establishment of Investment-type Companies by Foreign Business Investment*. In July 2001, shortly before its accession, China granted limited additional export rights to some foreign-invested manufacturing enterprises with the issuance of the *Circular Concerning the Extension of Import and Export Rights for Foreign-Funded Enterprises*. Both of these measures, however, conditioned trading rights eligibility on requirements related to minimum registered capital, import levels, export levels and/or prior experience, among others.

China treatment of foreign-invested trading enterprises is set forth in the January 2003 *Provisional Rules for the Establishment of Chinese-Foreign Equity Joint Venture Foreign Trade Companies*, which apparently superseded two earlier measures, the *Provisional Rules for the Establishment of Chinese-Foreign Equity Joint Venture Foreign Trade Companies on a Pilot Basis* (Sept. 1996) and the *Regulations on Policies for Pilot Chinese-Foreign Equity Joint Venture Foreign Trade Companies* (Aug. 1997). The new rules permit the formation of foreign-invested trading enterprises (with minority foreign ownership immediately and majority foreign ownership after 11 December 2003), which may import and export all goods (except goods reserved for state trading), but only if certain stringent requirements are met. For example, the foreign investor must have had an average annual amount of trade with China of at least \$30 million for the preceding three years (or \$20 million if the foreign-invested trading enterprise registers in the central or western regions of China). Similar requirements apply to the Chinese investor. In addition, the foreign-invested trading enterprise must have minimum registered capital of RMB 50 million and personnel experienced in conducting international trade.

- (a) Do any measures other than those discussed above govern the trading rights of foreign-invested enterprises?
- (b) Can China confirm that the above statements accurately describe the conditions that must be fulfilled for a foreign-invested enterprise to obtain trading rights? Please explain how conditions relating to minimum registered capital, past import and export levels and prior experience are consistent with the terms of China's accession agreement.
- (c) Please confirm that China will make trading rights available automatically to all enterprises in China and foreign enterprises and individuals, including sole proprietorships, by 11 December 2004.
- (d) Does China intend to circulate for public comment a draft measure establishing its automatic trading rights system, consistent with paragraph 2(C)2 of the Working Party Report? When will the draft measure be circulated?

Value-Added Tax Applied to Semiconductors

2. Despite its national treatment obligations under Article III of GATT 1994, China applies a reduced VAT to integrated circuits designed or manufactured in China, while it charges the full 17 percent VAT on imported integrated circuits. In particular, pursuant to State Council Document 18 and subsequent measures, China provides for partial refunds of the VAT paid on integrated circuits manufactured and/or designed in China, but provides no refund of the VAT paid on imported integrated circuits unless they were designed in China.

- (a) Please explain the reasons for the differential treatment.

- (b) Please explain how the difference in the treatment of imported versus domestic products under these measures is consistent with Article III of GATT 1994.
- (c) According to media reports, a group of Chinese ministries and agencies is evaluating these measures in light of China's WTO obligations. What is the status of this group's review of these measures? When does China anticipate making revisions to these measures based on this group's recommendations?

Value-Added Tax Applied to Diammonium Phosphate

3. The United States continues to have national treatment concerns regarding the *Circular about VAT Exemption Policy for Certain Farming Materials* (No. 113/2001), jointly issued by the Ministry of Finance and the State Administration of Taxation on 20 July 2001, which exempts all phosphate fertilizers except diammonium phosphate (DAP) from China's value-added tax (VAT). DAP, which is produced in the United States, competes with similar phosphate fertilizers produced in China, such as monoammonium phosphate (MAP). This measure discourages use of DAP, for which China committed to permit access under its TRQ commitments, in favor of products that are not imported. The United States has raised this issue with China on several occasions, both at the WTO and bilaterally. However, China so far has not revised the measure in question.

- (a) Please explain the reasons for the differential treatment.
- (b) Is it China's position that DAP and MAP do not compete against one another in China? If so, please explain the basis for this position.
- (c) Please explain how the difference in the treatment of DAP and similar products like MAP is consistent with Article III of GATT 1994.

New Automobile Industrial Policy

4. In paragraph 204 of the Working Party Report, China committed to amend its 1994 Industrial Policy for the Automotive Sector upon accession to make it compatible with WTO rules and principles. China also specifically agreed to eliminate export performance, local content and foreign exchange balancing requirements from its laws, regulations and other measures, and not to enforce the terms of any contracts imposing these requirements. In addition, China agreed that it would no longer condition importation or investment approvals on these requirements or on requirements such as technology transfer and offsets. Previously, China explained that it had revised the Law on Chinese-Foreign Equity Joint Ventures, the Law on Chinese-Foreign Contractual Joint Ventures and the Law on Wholly Foreign-Owned Enterprises to eliminate and cease the enforcement of local content requirements, among other requirements, and that these revisions superseded conflicting provisions in the 1994 Industrial Policy for the Automotive Sector. China also indicated that it was conducting in-depth research and study with a view to issuing a new automobile industrial policy and that it would issue new *Guidelines for Current Development of Automobile Industry*.

- (a) Please describe the status of that effort.
- (b) We understand that an existing draft of the new automobile industrial policy discourages the importation of auto parts. Please explain how China plans to implement this aspect of the new policy, and explain how it would be consistent with China's market access commitments.
- (c) We understand that an existing draft of the new automobile industrial policy seeks to restrict imports of CKDs. Please explain how China plans to implement this aspect of the new policy, and explain how it would be consistent with China's market access commitments.

- (d) We understand that an existing draft of the new automobile industrial policy includes provisions on automobile dealerships that would require separate distribution networks for imported and domestic automobiles. Please explain how these provisions would be consistent with China's national treatment obligations.
- (e) Does China intend to circulate a draft of the new automobile industrial policy for public comment before it is finalized, consistent with paragraph 2(C)2 of the Working Party Report?

Tariff-Rate Quotas on Fertilizers

5. In the Goods Schedule accompanying the protocol of Accession, China committed to allocate specified portions of the fertilizer TRQ for importation through entities other than state trading enterprises. For 2003, please provide information on the total quantity of each fertilizer TRQ (i.e., diammonium phosphate (DAP), urea and NPK) that was allocated for importation through state trading enterprises, and the total quantity of each fertilizer TRQ allocated for importation through entities other than state trading enterprises.

6. In the TRQ headnotes on fertilizer and wool tops (found in Part III, Section A, of China's Goods Schedule), paragraph 6B, China committed that applications for reallocation of uncontracted-for TRQ shall be accepted from 1-15 September, that specific conditions for applying for reallocated TRQ will be published in the official journal one month in advance of the application period, and that new allocations will be assigned by 1 October. Please describe in detail how China is implementing its commitments regarding reallocation of 2003 TRQ.

7. At a 3-4 July, 2003 symposium in Beijing, the Chinese phosphate fertilizer industry reportedly expressed its expectation that the Chinese government would "continue to balance overall volume" of fertilizer imports and suggested that the Chinese government should control DAP imports, in particular, at the level of 3 million tons in 2003. (China committed to an in-quota volume of 5.95 million tons in 2003.) Please confirm that China has fully allocated DAP TRQs for 2003 and has not sought to control the level of DAP imports through administrative means.

Industrial Quotas

8. There is inadequate information on how China has allocated 2003 quotas for autos and other products listed in Table Two of Annex Three to China's Protocol of Accession. In addition, there have been complaints that applicants for auto quota have received only a small portion of the quantity applied for. For each of the products listed in Table Two of Annex Three to the Protocol of Accession, please provide the following information for the 2003 quotas:

- (a) Total quantity of quotas applied for;
- (b) The number of requests for quotas denied;
- (c) Total quantity of quotas allocated to end-users;
- (d) Minimum size of individual quota allocation;
- (e) Fill rates for the quotas;
- (f) Total quantity of quotas allocated to entities that had not previously been allocated quotas; and
- (g) Total quantity of quotas allocated to enterprises with foreign ownership.

Consumption Tax Applied to Imported Goods

9. The United States continues to have national treatment concerns regarding the *Provisional Regulations on Consumption Tax*, which have been in effect since 1993 and have not been amended since China acceded to the WTO. Under those regulations, which apply to a range of consumer products, including spirits and alcoholic beverages, cosmetics and skin and hair care preparations, jewelry, fireworks, rubber, motorcycles and automobiles, China uses a different tax base to compute consumption taxes for imported products and domestic products. This difference in treatment results in consumption taxes for imported products that are substantially higher than those for domestic products. Thus, for domestic products, the tax base for domestic products is the sales amount (apparently the ex-factory price). This amount is multiplied by the consumption tax rate to derive the consumption tax due. In contrast, for imported products, Article 9 sets the tax base as the “composite assessable value,” which is defined as (dutiabale value + customs duty), divided by $(1 - \text{consumption tax rate})$. The resulting amount is then multiplied by the consumption tax rate to derive the consumption tax due. The United States has raised this issue with China on prior occasions, but China so far has not revised the regulations in question.

- (a) Please explain why the tax base used to compute the consumption tax owed on imported goods is different from, and higher than, the tax base used to compute the consumption tax owed on domestic goods.
 - (b) Does China continue to maintain that the computations for domestic products and imported products are equivalent? If so, please explain how these computations can be equivalent when the resulting consumption taxes for imported products are substantially higher than those for domestic products (even after accounting for the difference due to the inclusion of customs duties in the tax base for imported products).
 - (c) Please explain how the difference in the treatment of imported versus domestic products under these regulations is consistent with GATT Article III.
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