

WORLD TRADE ORGANIZATION

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Committee on Subsidies and Countervailing Measures

CHAIRMAN'S REPORT TO THE COUNCIL FOR TRADE IN GOODS ON TRANSITIONAL REVIEW OF CHINA

1. The Committee on Subsidies and Countervailing Measures undertook the third transitional review of China pursuant to Paragraph 18 of the Protocol on the Accession of the People's Republic of China (WT/L/432) at its regular meeting on 4 November 2004.
2. Annex 1A to the Protocol requires China to submit information on the following to this Committee: "Pricing Policies": (a) "application of existing or any other price controls and the reason for their use"; and (b) "pricing mechanisms of China's state trading enterprises for exported products". China submitted a notification in this respect on 1 November 2004. It can be found in document G/SCM/N/120.
3. Members had submitted questions in the context of the transitional review. These can be found in documents G/SCM/Q2/7-8 and /10 (double-symbolled as a G/SCM/W document) and Corr. 1, and /11 (questions submitted by the European Communities, the United States, Japan and Chinese Taipei respectively).
4. The statements made at the meeting of 4 November 2004, at which the transitional review was Item M of the agenda, are reflected in the minutes of the meeting, which will be circulated as document G/SCM/M/52. The relevant paragraphs, which reflect the statements made and the discussion at the meeting, are annexed.

Excerpt from the minutes of the regular meeting of the Committee on Subsidies and Countervailing Measures held 4 November 2004, to be circulated as document G/SCM/M/52

M. TRANSITION REVIEW UNDER PARAGRAPH 18 OF THE PROTOCOL OF ACCESSION OF THE PEOPLE'S REPUBLIC OF CHINA TO THE WORLD TRADE ORGANIZATION

1. The Chairman recalled that paragraph 18 of the Protocol of Accession of the People's Republic of China to the World Trade Organization provided that all subsidiary bodies, including this Committee, "which have a mandate covering China's commitments under the WTO Agreement or [the] Protocol shall, within one year after accession review, as appropriate to their mandate, the implementation by China of the WTO Agreement and of the related provisions of [the] Protocol." China was to provide relevant information in advance of the review, including information specified in Annex 1A to the Protocol. China could also raise issues relating to any reservations under Section 17 or to any other specific commitments made by other Members in the Protocol, in subsidiary bodies which had a relevant mandate. The Chairman said that this Committee had to report the results of the review promptly to the Council for Trade in Goods. Review was to take place after accession in each year for eight years, with a final review in year 10 or at an earlier date decided by the General Council.

2. The Chairman said that there were no procedures set out for the conduct of the transition review in the Protocol, except that China was to provide relevant information in advance of the review. In this regard, the Chairman noted that Annex 1A specifies China is requested to provide information on the following to this Committee in accordance with Article 18.1 of its Accession Protocol: "Pricing Policies": (a) "application of existing or any other price controls and the reason for their use"; and (b) "pricing mechanisms of China's state trading enterprises for exported products". He said that China had submitted a notification in this respect on 1 November 2004, which had been circulated as document G/SCM/N/120.

3. The Chairman noted that questions and comments submitted by the delegations of the European Communities, the United States, Japan and Chinese Taipei in the context of the transition review, had been circulated in documents G/SCM/Q2/CHN/7-8 and /10 (double-symbolled as a G/SCM/W document) and Corr. 1, and /11. Before proceeding to these questions, the Chairman opened the floor for any general comments from Members.

4. The delegate of the United States stated that the purpose of this transitional review mechanism was to review China's progress in implementing its obligations under the WTO Agreement and its Protocol of Accession on an annual basis. He noted that now, as the US delegation examined China's third year as a Member of the WTO, the US continued to have many of the same questions and concerns, in the area of subsidies and countervailing measures, that it raised at this time last year and the year before. The US noted that China had yet to provide any notification of its subsidies as required by Article 25 of the Agreement on Subsidies and Countervailing Measures (*SCM Agreement*), and the US delegation continued to see evidence of government support that China had committed to eliminate. In addition, due to China's failure to notify certain legislation, the US did not have a clear picture of China's regime for handling countervailing duty investigations.

5. The delegate of the US observed that China's failure to submit the annual subsidies notification required of every Member of the Committee under Article 25.1 of the *SCM Agreement* is a key concern of the US because of the central and material role that notifications plays in transparency and accountability in international trade. Although China cited administrative difficulties with the start-up of its notification process, the representative of the US commented that this explanation is less compelling three years into China's WTO Membership. While the US (and no doubt other WTO Members) appreciated the challenges of assembling a comprehensive subsidies notification, the delegate of the US noted that the *SCM Agreement* does not provide for exceptions to

the notification requirement. The US noted that in the years since entry into force of the *SCM Agreement*, many WTO Members, including a number of developing countries, had made notable progress in improving their compliance with this obligation, notwithstanding the obvious difficulties. The US urged China to comply with its own obligations on an expedited basis, providing full notification of its subsidy programmes.

6. The delegate of the US stated that China's subsidies to state-owned enterprises running at a loss are illustrative of his delegation's concerns with China's inadequate disclosure before the Committee. These subsidies were to end in 2000 according to China's Protocol of Accession. In 2002, the representative of China told the Committee that these subsidies had been eliminated in 2001. Then, according to the US, during last year's transitional review, China failed to respond to the questions of the US delegation regarding Chinese press reports in 2003 that the government was still working to eliminate these subsidies and that it hoped to do so by 2005. The delegate of the US asked China to provide the Committee with information on these subsidies.

7. The delegate of the US further noted that during China's accession process, Members had raised concerns about the financial contributions provided by China's state-owned banks, including forgiven and non-performing loans. In response to these concerns, China agreed that its state-owned banks should be run on a commercial basis and be responsible for their own profits and losses. Since last year's transitional review before this Committee, however, certain developments had raised serious concerns. The US observed that in December 2003, China undertook two massive bank bailouts, injecting USD 45 billion into the Bank of China and the China Construction Bank. In China's Northeast region, in Heilongjiang Province, USD 4.4 billion of non-performing loans unpaid by state-owned enterprises had been written off. The US delegation noted that, while the US did not take issue with China's development objectives, it had grave concerns with the significant subsidization that pursuit of those objectives has entailed, and with the potential adverse trade effects resulting directly or indirectly from this subsidization. The US commented that the huge, unserviceable debts and non-performing loans represented in these transactions signal severe economic viability issues; yet, the Government of China continued with its policy of subsidizing these enterprises. Continued intervention by the Chinese government in this manner, according to the US, thwarts the development of institutionalized market mechanisms in China.

8. The delegate of the US stated that despite its commitments under its Protocol of Accession to eliminate all subsidies prohibited within the meaning of Article 3 of the *SCM Agreement*, it appeared that China continued to provide subsidies contingent upon export performance and/or on the use of domestic over imported goods. In the questions posed by the US delegation to China under Article 25.8 of the *SCM Agreement*, the US identified several subsidy programmes in China that appeared to fall under the prohibited category as well as subsidy programmes providing other types of assistance to a wide range of industries, including forest products, textiles, semiconductors, and agriculture. The US noted that the volume of programmes it had identified highlighted the need for China to comply with its commitments on prohibited subsidies as well as its notification obligations.

9. The US noted that China issued a revised Foreign Trade Law and Anti-Subsidy Regulations this past year. During the May 2004 meeting of the Committee, China indicated that certain implementing rules had been annulled. The US stated that it did not know whether other rules had taken their place. As a result, significant uncertainty surrounded China's countervailing duty regime. The US delegate expressed hope that China would soon notify all outstanding measures and help to clarify this situation through its responses to its questions.

10. The US stated that its submission for this transitional review also outlined a series of questions concerning price control mechanisms in China. The number of questions asked and the additional information sought highlighted US concerns with China's apparent difficulty in meeting fundamental transparency obligations. The US expressed hope that China would provide comprehensive and forthcoming responses to its price control questions.

11. Finally, the US expressed appreciation for the difficulty and sensitivity of many of the steps that China must take to honor its obligations under both the Protocol of Accession and the *SCM Agreement*. However, after three years as a Member of the WTO, the US was of the opinion that the Committee should be reviewing China's progress towards meeting those obligations, not its rationales for non-compliance. The US looked forward to China's full and forthcoming responses to its transitional review questions before the Committee, as well as to its recent request under Article 25.8 of the Agreement.

12. The Chairman thanked the United States for its statement and invited other delegations to make comments.

13. The delegate of the European Communities stated that in preparing for this agenda item, he had reviewed the minutes of last year's Committee meeting, and in particular, the opening statements made by his delegation regarding the very same agenda item. The delegate of the European Communities noted that it was striking that his delegation could have used the statement of last year for this year. The delegate of the European Communities commented that this was striking but also disappointing. In his opinion, this meant that no progress had been made on compliance by China with transparency obligations since last year. The delegate of the European Communities noted that the consequences of China's lack of progress were non-compliance by China of WTO rules in a critical area, and an imbalance of information available on subsidies for economic operators. The delegate of the European Communities stated that these were serious consequences and that they continued to be of serious concern to the EC.

14. The delegate of the European Communities mentioned that his delegation took very good note of the point made by the US on the recent worrying developments in China's financial sector involving significant bail-outs of state-owned banks. The delegate of the European Communities stated that his delegation would listen to China's replies on these issues with great interest since subsidies to the financial sector may have direct knock-on effects on other sectors of China's economy.

15. Finally, the delegate of the European Communities commented that his delegation submitted a set of questions on apparent subsidies schemes, noting that for many of these information found on the internet indicated that many appeared to be prohibited subsidies. The delegate of the European Communities stated that his delegation had also reiterated questions on subsidies to copper scrap imports, which was a matter of particular concern to the EC and an issue that had already been raised by the Japanese delegation, in the context of discussion on a preceding agenda item.

16. The delegate of the European Communities looked forward to China's replies to these questions. He stated that he wanted to make one point very clear: it should not be the EC's task to search for Chinese subsidies on its own. Instead of surfing the web to search for subsidies, the EC's task should be to pose questions on China's WTO subsidy notification, like for any other WTO Member. The delegate of the European Communities stated that his delegation believed that this would be in the interest of everybody in the Committee including China. He urged China to bring the Committee to a position of doing so sooner rather than later.

17. The Chairman thanked the European Communities for its statement and invited other delegations to make comments. The delegate of China was invited to take the floor to respond to the questions and comments that it had received.

18. The delegate of China thanked the Chairman for giving her the floor to address the Committee on the implementation of China's commitments and to respond to the questions raised by Members.

19. Before turning to the specific questions asked by the Members, the delegate of China stated that she wanted to first provide an overview of the action China had undertaken in the lead up to this review. Pursuant to Article 32.6 of the *SCM Agreement*, the Chinese government notified to the Committee the newly promulgated regulations of the People's Republic of China on countervailing measures in G/SCM/1/CHN/1/Suppl.3 and submitted information on price control and export pricing policies in the light of the requirements listed in Annex 1A to the Protocol of Accession of China. The delegate of China stated that she hoped this information would present Members with a clear picture of China's countervailing legislation and relevant pricing mechanisms.

20. The delegate of China noted that her delegation had, prior to this review, received a number of questions and comments from Members with explicit concerns about China's implementation of its obligations regarding subsidy notifications. The delegate of China thanked the Members for their questions and stated that it was her delegation's belief that these questions and comments would help it collect information on domestic subsidies so as to further improve the implementation of the transparency obligations.

21. As regards the notification of subsidies, the delegate of China stated that she wanted to draw the Committee's attention to the following: first, paragraph 10.3 of the Protocol of Accession stipulates that China shall eliminate all subsidy programmes falling within the scope of Article 3 of the *SCM Agreement* upon accession. Since China's accession, China had implemented this commitment seriously and completely, and it had eliminated all export subsidies and subsidies for import substitution. China had provided numerous clear explanations of this position in written format in two prior transitional reviews conducted by this Committee. At present, China did not maintain export subsidies or import substitution subsidies of any form. China therefore could not undertake any obligation of further notification in these two areas.

22. Secondly, pursuant to Article 25 of the *SCM Agreement*, China had made all notifications on subsidy measures maintained and subsidies to be phased out. These notifications were made in Annexes 5A and 5B to the Protocol of Accession of China. The two notifications reflected the situation with respect to Chinese subsidy measures accurately and completely. The delegate of China noted that these two notifications are still current and effective, and that they fulfil the notification requirements under the *SCM Agreement*.

23. Thirdly, China emphasized that, as was the case in all other WTO Committees, it placed great importance and undertook much effort in implementing its transparency obligations. Since its accession to the WTO, China had been actively collecting subsidy information. China had invited WTO experts on subsidies to various exchange and consultation activities conducted by the competent Chinese authorities, with the most recent session being held last August. However, the delegate of China noted that there was more than one authority responsible for the administration of subsidies in China, and that information collecting and sorting is a complex and time consuming exercise. The delegate of China stated that many Members face the same problems, even some developed Members.

Questions with respect to the VAT rebate granted for imports of copper raw materials

24. The representative of China stated that this policy was based on a joint notice of the Ministry of Finance and the State Taxation Administration. It applied only to copper raw materials, specifically copper waste and scrap, copper ore concentrates and raw copper imported by copper producing enterprises with a production capacity of more than 30,000 tonnes per year. The delegate of China explained that the detailed procedure for obtaining the refund is as follows: when eligible enterprises import copper waste and scrap copper ore concentrates and raw copper, import duties including tariff and import VAT are levied by customs. After clearance of all import customs procedures, the enterprises filled in an application form for refund of import duties, which after verification by local customs authorities, are submitted to the Ministry of Finance and copied to the General Customs Administration. The Ministry of Finance together with other relevant authorities

then undertook a verification process. It would then respond, by formal correspondence, to the local customs office with a copy of the correspondence being sent to the local customs administration and other relevant authorities. The local customs office would then refund 30 per cent of the collected import VAT making specific reference to the formal correspondence from the Ministry of Finance. The delegate of China commented that, as he had explained, all of the procedures implementing the VAT refund policy are therefore clear and transparent.

25. The delegate of China noted that based on information he had received from the relevant authority, 40 enterprises benefited from this policy in 2003. At this stage, the total value refunded was still unclear because some of the enterprises in question had not yet been refunded. As to the impact of this policy on international trade, the delegate of China stated that China did not accept that this policy deteriorated the international trade environment for copper raw materials. The delegate of China explained that 2.67 million tonnes of copper ore concentrates were imported in 2003; and that of this amount, only 360,000 tonnes (or 13.5 per cent of imports) benefited from the VAT refund scheme. Furthermore, of the 3.16 million tonnes of copper waste and scrap imported into China last year, only 39,000 tonnes (or 1.2 per cent of imports) benefited from the VAT refund scheme. The delegate of China wondered how such small amounts could adversely affect the international trading environment for copper, and stated that the world was undergoing a shortage of copper raw materials, not because of China's VAT refund scheme, but because many mines reduced and/or closed production in response to a fall in prices in the late 1990s and also because of the later recession in the world economy. The delegate of China stated that there was no ground to allege that China's policy led to the shortage of copper supply in the world market.

26. As regards the consistency of this policy with WTO rules, the delegate of China stated that, after detailed study, China believed it did not violate WTO rules. The delegate of China noted that the Chinese authorities had started a review of the policy and that, up to now, no definite conclusions have been reached.

Questions with respect to the semiconductor industry

27. The delegate of China confirmed that a National Development and Reform Commission official made an announcement some time ago regarding the semiconductor industry. However, the delegate of China pointed out that this announcement only concerned considerations related to the changes to be made to the previous policy which was terminated. The aspects of the policy being considered included providing full VAT refund for export of semiconductor and integrated circuit products and also other support measures regarding research and development and training, etc. The delegate of China stressed that these features of the policy were only under consideration. They had still to be translated into government decrees and notices, before they could be published and implemented. The delegate of China stated that when published and implemented, these policies would be WTO-consistent.

Questions with respect to special economic zones

28. The delegate of China stated that China did maintain some preferential tax programmes for foreign investors in the special economic zones, and economic and technological development areas. These policies were included in Annex 5 of China's Accession Protocol. These were being implemented and some may have undergone some adjustment since China's accession to the WTO.

29. As regards the questions from Members citing information collected from media reports, the Chinese delegate mentioned that the WTO is an organization where Members discuss government policies and measures. He stated that the Chinese government undertook no obligation to verify information published on non-official websites, and it did not accept that such information could be a basis for making accusations against China's policies. The delegate of China noted that given the size of China, it was virtually impossible to verify all of the information in the media. Furthermore, the

delegate of China noted that a lot of the information coming from these sources was either inaccurate or outdated. For example, in the semiconductor case, the information that was published reflected only intentions or considerations but not actual implemented policy. In the Heilongjiang Province matter, an extremely important fact was neglected. For non-performing loans, the Chinese government had followed the practice that the creditor banks and debtor enterprises should come to a resolution through negotiations and consultations between themselves. When restructuring non-performing loans, the creditor banks in China now followed commercial principles, taking into consideration the repaying ability, asset quality of the debtor, and their own ability to absorb the losses. The delegate of China stated that in the restructuring process, the government would neither assume the losses nor provide subsidies to the creditor banks. With respect to the Heilongjiang Province matter, the debt of the state owned enterprises was dealt with in the exact same fashion, *i.e.* on a commercial basis. According to China, the statement that Heilongjiang Province agreed to write-off RMB 36 billion worth of non-performing loans unpaid by state owned enterprises was not true. Non-performing loans involved in that case were only RMB 18 billion. At present, only the Industrial and Commercial Bank of China had begun negotiations with the SOEs in Heilongjiang Province. No scheme has been implemented.

Questions with respect to reform of the financial sector

30. The delegate of China stated that the Chinese delegation did not think the details of this reform were related in any way to the mandate of the Committee. However, to facilitate Members' understanding of the efforts and resolve of his government, the delegate of China stated that he would provide the following information: reform of China's banking system had been considered for some time, and it was recognised that it could not be completed overnight. The delegate of China commented that relevant experience would need to be accumulated, step by step. The delegate of China stated that the Chinese government had previously adopted a number of reforms toward state owned banks, and with these efforts, commercial banks in China, whether state owned or not, were already operating under commercial conditions. Government intervention has been reduced to a minimum level.

31. The latest reorganisation and injection of capital into the Bank of China and the China Construction Bank were considered to be one of the steps needed in the overall reform of the banking sector in China. The delegate of China noted that compared with previous reform measures, the capital injection measures of December 2003 were designed and implemented with commercial considerations in mind. The State, through the Central Weijing Corporation, injected USD 45 billion into the two banks to increase their capital funds, with future dividends expected as a return on this investment. The delegate of China explained that the action taken was, in nature, an investment, not a subsidy. With this capital injection, the Bank of China and the Construction Bank of China were reorganised into shareholding companies. Corporate management mechanisms had been introduced, the banks' operations and assets had been restructured, quality of assets improved, and the capital sufficiency rate increased. The delegate of China commented that these initiatives were aimed at fully commercialising the operations of the two banks and would enable China to accumulate further experience for additional reform of the Chinese banking system.

32. The delegate of China noted that there was no major difference between this reform carried out by China and reforms carried out by other WTO Members. Any such reform involved a write-off of non-performing loans. If these types of reforms were labelled subsidies, then this issue was definitely not unique to China.

Questions with respect to pricing administration

33. The delegate of China stated that no new law, regulations or other measures had been taken to change the listing in Annex 4 to the Protocol of Accession, apart from what was explained in last

year's review – *i.e.*, that vegetable oil was no longer subject to pricing controls. The delegate of China also stated that China had not implemented any new pricing controls.

Questions with respect to steel and steel scrap pricing

34. The delegate of China stated that prices for steel and steel scrap were fully liberalised in 1999, and that copper and copper scrap pricing had also been liberalised.

Questions with respect to the pricing mechanism for water

35. The delegate of China stated that although water was still subject to state pricing, the pricing mechanism had been reformed to reflect market forces and the availability of resources. The delegate of China provided the following details with respect to China's pricing mechanism reform: it was aimed at establishing water pricing mechanisms that fully reflect water scarcity in China, focusing on water saving, reasonable allocation of water resources, higher efficiency of water utilisation, and facilitation of the sustainable utilisation of water resources.

36. The delegate of China noted that the principles underlying a reasonable water pricing mechanism included: first, combining water price adjustment with water price structure improvement, establishing a multi-level pricing system according to the capabilities of different users. Secondly, water pricing should take into consideration the adjustment of water pricing facilities so as to realise a reasonable allocation of water resources. Thirdly, reflecting reasonable utilisation of water resources with water pollution prevention to encourage recycling of waste water. Fourthly, realising sustainable development of water suppliers through the construction of water saving facilities and providing reasonable compensation for their cost, facilitating the construction of water savings projects and promoting water savings technologies. Fifthly, combining the water pricing mechanism with the operational mechanism of water suppliers, pushing forward the operation on a commercial basis as enterprises and industry strengthen cost control through the pricing mechanism and bring into play market mechanisms.

Questions with respect to protective pricing

37. The delegate of China stated that the basic principles of protective prices were set out in: The Law of the People's Republic of China on Pricing. The purchase prices of grains were in general subject to supply conditions of the markets. It was only when there was a major change in the demand/supply situation, in such a way that it was deemed necessary to guarantee market supply and to protect the interests of the peasants, that protective prices would be applied.

Questions with respect to the price of coal and oil

38. The delegate of China stated that the price of coal was completely subject to market mechanisms. As regards the prices of land oil, state pricing had been eliminated. The price was now determined by enterprises according to commercial negotiations. The price of offshore oil was determined by the market. The current pricing mechanism for crude oil applies regardless of geographical, industrial or enterprise differences.

39. In conclusion, the delegate of China stated that it was not hard to imagine the difficulties encountered by China as a new Member of the Organization to prepare a full and comprehensive subsidy notification. China cited such difficulties during its accession negotiations, and these were recognised in the Working Party Report. Therefore, the delegate of China continued, it was important to realise that China was making all possible efforts. The delegate of China stressed that China had never stated that it would not comply with its transparency obligations. What China had said was that, as a new Member, it faced a lot of difficulties, like other Members with better capabilities and more experience. For instance, the US and the EC notifications of their domestic support for 2000 and

2001 were only received in March of 2004. In China's view, this was also a three year delay. The delegate of China stated that he was highlighting this example not to excuse China's delay in making its notification, but so that Members knew that pressure on China on this point would not resolve the challenges it faced. Some of these challenges included needing to educate all of the officials working on subsidies policies in China. In August of 2004, the Secretariat had held a detailed technical workshop with over 20 participants in China. The delegate of China thanked the Secretariat for all the assistance provided. Other difficulties included domestic negotiations.

40. The delegate of China commented that every Member had its own problems, and he asked why was it so difficult for other members to recognise the challenges currently faced by China, particularly as a new Member. Finally, the delegate of China stated that China was in a better position today than last year, noting that the spirit of cooperation from the relevant Ministries was increasing. He hoped that the members would be able to understand China's difficulties.

41. The delegate of China said he was surprised to see that questions from the delegation of Chinese Taipei were listed in the agenda for the meeting. The delegate of China noted that his delegation had not received any questions from Chinese Taipei. The delegate of China said his delegation could not assume any obligation at this meeting to respond to questions which have never been delivered to the Chinese delegation.

42. The Chairman thanked China for its responses and asked if any other delegations wanted to take the floor.

43. The delegate of Chinese Taipei said he appreciated the detailed responses provided by the Chinese delegation. He stated that the questions from Chinese Taipei were very clear, as set out in document G/SCM/Q2/CHN/11. The delegate of Chinese Taipei stated that, if necessary, he could read through all of the questions in order to facilitate the Chinese delegates' provision of a response.

44. The delegate of China requested that the questions of Chinese Taipei be delivered to his delegation.

45. The Chairman asked if there were any other delegations that had any questions or comments.

46. The representative of Japan mentioned that, despite the statement of the Chinese delegate that its copper ore VAT refund system was WTO-consistent, the delegation of Japan was still concerned about the programme. The delegate of Japan noted that Japan's copper smelting industry believed that this system increased the price of copper in the international market, and accordingly, Japan's industry had been adversely affected. The delegate of Japan recalled that at last year's Committee meeting in October, the delegation of China mentioned that it was ready to undertake a bilateral exchange of views on this subject. In this regard, the delegate of Japan mentioned that a vice-minister level conference between the Ministry of Commerce of China and the Ministry of Economy, Trade and Industry of Japan was held in May this year, where China stated that it was considering the future treatment of the VAT refund system for copper, including a partial elimination of the system and that it would be ready to provide relative information at a later stage. The delegate of Japan commented that China should provide it with all of the information relevant to this issue, including information on the said elimination.

47. The representative of the United States initially responded to four points made by China. First, as regards the statement of the delegate of China that the notification provided in the Protocol of Accession reflects accurately and completely the current situation and satisfies China's obligations under the *SCM Agreement*, the delegate of the US stated that his delegation could not accept that a notification that was supplied in the course of accession satisfied an ongoing obligation of all WTO Members. Secondly, as regards China's comments relating to US reliance on media reports for information about China's subsidy policies, the delegate of the US stated that the solution to this problem was for China to

provide a notification. China was the best source of information with respect to its subsidies programmes. The delegate of the US noted that the WTO was three years into China's membership and China had still not tabled its first subsidies notification. Thirdly, according to the US delegate, China made the point that it was making a much better effort now than in the past. However, the delegate of the US stressed that despite these apparent efforts, there were no concrete results. He noted that last year the US delegation suggested that China submit a partial notification so that the Committee could satisfy itself that there was some movement towards China meeting its obligation under the *SCM Agreement*. Finally, the delegate of the US noted that China made the point that a US notification is three years behind. The US delegate commented, and suggested that the Secretariat confirm, that the US was up to date with respect to its notifications, in the same way as the EC.

48. As regards the specific comments made by the Chinese delegate with respect to Members' reliance on third-party sources of information, the representative of the US noted the existence of an OECD report entitled "China in the World Economy, the Domestic Policy Challenges". The delegate of the US noted that this report was based on information that post-dates China's accession to the WTO. The delegate read from Chapter 18, entitled "The current tax system and priorities for reform". On page 625 of the report, the third paragraph read as follows:

"The current tax system excessively relies on revenues from tax (VAT, business tax, consumption tax). Revenue from income taxation has been seriously eroded by the generous tax incentives provided to foreign and domestic enterprises and by the high threshold in personal income tax. ... some of the tax incentives are clearly violating WTO rules and need to be removed."

49. The delegate of the US quoted further from page 633 as follows:

"Foreign invested enterprises exporting 70% or more of their output in a given year are eligible for a 50% tax reduction in that year, even after the expiry of the normal tax holiday."

50. The delegate of the US described what he believed was the overall tax incentive referred to in this report: a foreign investment enterprise in China was granted an exemption of all income taxes for two years beginning with the year it starts making a profit. Three years after that, it was granted a 50% per cent reduction in taxes. These tax incentives were not contingent upon export performance. The same company was entitled to a 50 per cent reduction of income taxes after this five year period if it exports 70 per cent or more of its output. The delegate of the US noted that these programmes provide a powerful incentive for firms to locate in and export from China. The US delegate further commented that his delegation would argue that the latter set of income tax reductions were inconsistent with the *SCM Agreement*.

51. The delegate of the US then read a passage from page 634 of the report regarding a programme described in the report as a "tax refund on reinvestment".

"Foreign investors or foreign invested enterprises that invest their share of profits in China for a period of no less than five years, may obtain a tax refund of 40% of the income tax paid on the amount of reinvestment. If the reinvestment is made in establishing or expanding an export oriented enterprise or a technologically advanced enterprise, the tax refund is 100%."

52. The delegate of the US noted that the main point he wanted to make was that there was no disagreement whether these programmes had existed in the past. There was some doubt about whether they still existed. The OECD report said that they existed today. An Economist Intelligence Unit report, dated February 2004, described the same programmes. Thus, the delegate of the US commented that two separate independent organisations both stated that the subsidy programmes described continue to

exist today. He stated that all the US was asking China to do was to provide the Committee with information on the legislative measures China had undertaken to eliminate at least these two subsidies upon accession.

53. On the issue of Heilongjiang Province and the northeast revitalisation programme, the representative of the US recalled that the Chinese delegate mentioned that the banks were working on a commercial basis and that any loan forgiveness that had taken place had been decided by the banks and by the banks only. The US delegate commented that if indeed that was the case, it was puzzling to see some of the characteristics of the northeast revitalisation programme. For instance, the central government intended to spend USD 12 billion this year on interest rate reductions to fund technological upgrades of 100 state-owned enterprises in the region. The central government and the provincial governments had also decided to set up a northeast revitalisation bank that would finance low interest loans to state enterprises. The industries that had been targeted in the northeast region were petrochemicals, machinery and equipment and other industries that make up the traditional core of these economies. The US delegate asked the Chinese delegation to explain the rationale of this revitalisation programme in light of the statement that the assistance coming from banks in that region was commercially based. The US delegate stated that his delegation was unclear about the USD 12 billion interest rate reductions granted to companies in traditional sectors of the economy, given that China was trying to revitalise a programme along market economy lines, and trying to improve resource allocations. The US delegate commented that one could think it would be understandable to establish a financing vehicle, if the financing was directed towards the promotion and development of small and medium sized enterprises. One would also understand why the Chinese government would want to finance the social cost of a structural adjustment. But, the delegate of the US continued, it was unclear why the Chinese government would do what the government is doing now.

54. The representative of the European Communities stated he fully supported the position taken by the US with respect to the statement made by China that the annex to its Accession Protocol contains an adequate and complete notification. The delegate of the EC respectfully disagreed with China on this point, in particular, because the Chinese delegates informed the Committee at the meeting that several of the programmes pertaining to special economic zones contained in the Annex have been modified. The EC delegate stated that, as he has mentioned in previous meetings, the Annex to the Accession Protocol could be a useful starting point for making a partial notification, if further elaborated and updated. This would be a major improvement to the current situation where there was nothing to review.

55. The delegate of the EC stated that he found China's failure to respond to Questions 3 to 7 of the EC's questionnaire, on grounds that the Chinese government was not in the business of verifying information found by other Members on websites, disappointing. The EC delegate recalled that he did not ask China to verify any websites. What was asked was to respond to certain information that had come to the attention of the EC delegation. The EC delegate asked China to provide a response to his questions, and in particular, whether or not such subsidy programmes existed, yes or no, and if they existed to describe them in more detail.

56. With respect to the copper imports scheme, the EC delegate said that he did not hear an exact reference in the Chinese delegate's address to a text or a law which would describe the copper VAT reimbursement scheme. The delegate of the EC also commented that it would have been interesting to receive information on the value of refunds granted under the scheme for years prior to 2003, given that the Chinese delegate had stated that the system was in place since 2000 and figures for 2003 were not available. The delegate of the EC stressed that, firstly, the overall figures of raw material imports had to be looked at over a longer time period, where a strong upwards trend of imports could be observed and, secondly, the figures cited by the Chinese delegate appeared to comprise the overall tonnage of raw material and did not reflect the copper content. The numbers held by the EC showed that 30 per cent of copper scrap imports and 50 per cent of the copper concentrate imports had benefited from the system. The price reduction for Chinese smelters obtained through the VAT

refund had also to be seen in terms of treatment and refining costs and the metal content. Finally, the delegate of the EC stated that the trade distortion in this measure resulted from higher buying prices for raw materials which were possible through the subsidy to the Chinese smelters and which were not reflected in equally higher prices for the finished product. The EC delegate concluded by stating that the EC considered that this trade distorting subsidy practice had caused it and other Members' industries serious prejudice and should therefore be eliminated.

57. The representative of Japan noted that the Japanese government was of the view that the VAT refund scheme could also have an adverse impact on the Japanese industry. He commented that his country was interested in acting jointly against this scheme with the EC, who shared a common concern about this scheme. The delegate of Japan urged China to review the situation.

58. The delegate of China thanked the Members for the questions raised. The delegate of China took note of the concerns and stated that these concerns would be transmitted to the relevant departments in Beijing. Recognising the limited time allocated for transitional reviews, China noted that it was willing to discuss SCM issues either before or after this review.

59. The representative of Japan thanked China for providing information on its laws and regulations on CVD investigations. However, he noted that China should provide this information according to the procedures set by this Committee. Otherwise WTO Members could not share information on this important issue.

60. The representative of the United States stated that it was troubling that China did not provide responses to the very substantive questions forwarded by the Members. The US delegate commented that his delegation found this development disturbing. He noted that the US was willing to work with China over time, and also willing to work bilaterally, but China needed to realise that the issues that had been raised were not going to go away.

61. The representative of the European Communities supported the statements made by Japan and the US. The EC expressed disappointment that the review process was cut short. The delegate of the EC noted that the Committee was left hanging in the air with respect to a large number of the questions asked, and Members did not really know when the answers would be provided. Any reaction from the Chinese delegation about when they intend to respond to those questions would be very much appreciated. Finally, the EC delegate indicated that his delegation was willing to work bilaterally with the Chinese side to add more value to the review process.

62. The Committee took note of the statements made.

63. Turning to the Committee's report on the transitional review, the Chairman noted that there were no guidelines for the report contained in the Protocol. Following the review at last October's regular meeting, the Chairman, acting on her own responsibility, had prepared a brief, factual report, with references to the documents concerned, and attaching the portion of the minutes of the meeting which related to the transitional review. The Chairman asked Members whether this procedure should be followed again.

64. The Committee so agreed.
