

**Committee on Subsidies
and Countervailing Measures**

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

1. The Committee on Subsidies and Countervailing Measures undertook the fourth 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 27 October 2005.
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 26 October 2005, which has been circulated in document G/SCM/N/135.
3. Members had submitted questions in the context of the transitional review. These can be found in documents G/SCM/Q2/CHN/12 (European Communities), G/SCM/Q2/CHN/13 (Japan), G/SCM/Q2/CHN/14 (United States) and G/SCM/Q2/CHN/15 (Canada, Mexico and the United States).
4. The statements made at the meeting of 27 October 2005, at which the transitional review was Item F of the agenda, are reflected in the minutes of the meeting, which will be circulated as document G/SCM/M/54. 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 on 27 October 2005, to be circulated as document G/SCM/M/54.

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

1. The Chairperson 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 have a relevant mandate. 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 Chairperson noted that there were no procedures set out in the Protocol for the conduct of the transition review, except that China was to provide relevant information in advance of the review. In this regard, Annex 1A specified that China was 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". China's notification, received on 26 October 2005, had been circulated as document G/SCM/N/135. Written questions and comments had been submitted in the context of this transitional review by the European Communities (G/SCM/Q2/CHN/12), Japan (G/SCM/Q2/CHN/13), the United States (G/SCM/Q2/CHN/14) and Canada, Mexico and the United States (G/SCM/Q2/CHN/15). Before proceeding to these questions, the Chairperson opened the floor for any general comments.

3. The delegate of the United States said that the WTO was in the midst of its fourth annual transitional review of China's efforts to implement the commitments that it made in its Protocol of Accession to the WTO. In the United States' view, the transitional review remained an important and useful mechanism serving both the interests of China and the interests of other WTO Members. The transitional review mechanism provided Members with the opportunity to seek clarifications regarding China's policies and practices. China, in turn, had the opportunity to clarify its policies and practices with the goal to prevent misunderstandings that could lead to trade frictions. The transitional review mechanism also allowed Members to convey to China their views, expectations and concerns regarding China's efforts to comply with its WTO obligations. China then had the opportunity to explain its views and to inform Members about how it had addressed their expectations and concerns. In other words, the transitional review mechanism was an important and useful exercise in transparency, one of the fundamental principles underlying the WTO Agreement.

4. The purpose of the transitional review before this Committee was to review, on an annual basis, China's progress on implementing its obligations under its Protocol of Accession and the SCM Agreement. Unfortunately, as Members neared the end of China's fourth year as a Member of the WTO, it remained nearly impossible to evaluate the extent to which China's subsidies regime was in compliance with WTO disciplines. Despite assurances China had given before the Council for Trade in Goods during the transitional review conducted in 2003 China had still not provided its long-overdue subsidy notification as required by Article 25 of the SCM Agreement. In addition, more than one year ago, the United States had submitted a request to China under Article 25.8 of the SCM Agreement seeking detailed information on a number of subsidy programmes that had come to its

attention (G/SCM/Q2/CHN/9). Article 25.9 stated that questions that a Member receives under Article 25.8 shall be answered as quickly as possible and in a comprehensive manner. The programmes subject to the questions posed by the United States under Article 25.8 supported a wide range of industries in China including forest products, textiles, semi-conductors and agriculture. China, however, still had not provided any responses to that request. The absence of a timely response was troubling.

5. Even more troubling were the subsidy programmes that China appeared to maintain, as demonstrated by the growing number of questions that the United States and other Members had posed to China, both through the transitional review mechanism and under Article 25.8 of the SCM Agreement. Members continued to see evidence of government support that China had committed to eliminate. Based on available information, it appeared that China continued to provide tax incentives and preferential bank financing to producers of agricultural and industrial goods that were contingent upon export or the use of domestic over imported goods, despite a clear commitment by China four years ago to eliminate all prohibited subsidies upon its accession to the WTO. It also appeared quite clear that China continued to provide subsidies to loss-making state-owned enterprises, despite making statements to this Committee in 2002 that these subsidies had been eliminated in 2001 as China had indicated it would do in Annex 5 to its Protocol of Accession. In past transitional reviews before this Committee, China had dismissed as baseless the claims of the United States that these subsidies continued, arguing that multiple media reports and websites were unreliable. One new source could now be added to the long and varied list of publicly available sources describing China's continued subsidization of loss-making state-owned enterprises, the OECD's *2005 Economic Survey of China*. The United States again urged that China provide information on these subsidies.

6. The delegate of the United States stated that it also appeared quite clear that the Chinese Government continued to provide massive subsidies to state-owned banks and the state-owned enterprises to which they lent, despite China's contention that these banks and enterprises operated on a commercial basis and were responsible for their own profits and losses. For example, China claimed during last year's transitional review that the Government's \$45 billion capital infusions into the Bank of China and the China Construction Bank in 2003 constituted investments, not subsidies, but this claim was exceedingly difficult to accept in light of those banks' financial performance in the previous five years, which had been characterized by repeated capital injections by the Government and bad-debt transfers to government-owned asset management companies. It seemed clear that the Government was not seeking to invest in investment-worthy companies either in December 2003 or in prior years. Rather, the Government was trying to keep the banks afloat and the loss-making state-owned enterprises they supported, regardless of cost. An example of the type of lending that could result from these large and repeated infusions had received widespread attention recently when a state-owned oil and gas company had sought to acquire a foreign competitor. Two state-owned banks had offered what appeared to be billions of dollars of preferential financing to facilitate the acquisition. Even though the acquisition had not take place, the United States found it objectionable that the terms and conditions under which the financing was apparently offered were inconsistent with commercial considerations. It was difficult to reconcile the terms and conditions of this financing with China's repeated claim that banks in China now extended loans on a purely commercial basis and operated free from government influence and control. The United States was very concerned about what these offers of non-commercial financing said about how credit was allocated in China.

7. The United States also understood that state-owned banks were extending subsidized financing for large-scale investment projects in China which were designed to increase the competitiveness of state-owned enterprises, particularly in the Northeast, in industries such as oil and gas, petrochemicals, iron and steel and ship-building. In the United States' view, continued intervention by the Chinese Government in this manner thwarted the development of institutionalized market mechanisms in China. It also made little sense from an economic restructuring point of view for the Government to support continued production by firms of products that were the primary cause

of the region's problems. Resources should be flowing out of and away from large inefficient state-owned enterprises in heavy industries to support the growth and development of small and medium-sized enterprises and new industries. Unfortunately, the bank financing to state-owned enterprises in the Northeast was doing exactly the opposite, frustrating a more efficient allocation of scarce resources and sustaining obsolete state-owned enterprises that continued to drain resources from the region and the rest of China's economy. While the United States did not take issue with China's goal of revitalizing the Northeast region, it had grave concerns with the significant subsidization the pursuit of those objectives entailed and with the potential adverse trade effects resulting directly or indirectly from this subsidization.

8. The delegate of the United States considered that similar concerns applied as well to China's recently released iron and steel industry development policy ("Steel Policy") and were highlighted in the joint submission from Canada, Mexico and the United States for this transitional review (G/SCM/Q2/CHN/15). This Steel Policy detailed a series of objectives and initiatives for managing the development of China's state-owned steel enterprises. These objectives and initiatives included a broad range of very specific directives which demonstrated the government's intention to intervene directly and extensively in key sectors of the economy, such as steel. In particular, the Steel Policy prescribed the number and size of steel producers in China, where they would be located, the types of products that would and would not be produced and the technology that would be used. Subsidies were an integral part of the Steel Policy. In particular, Article 16 of the Steel Policy specifically provided for state support in the form of tax refunds, discounted interest rates, research and development and other policy support from major iron and steel projects utilizing newly developed domestic equipment. The United States agreed with the goal of an efficient rationalized steel industry envisioned by China's new steel policy but was concerned about the implementation of this initiative to the extent that it relied on import substitution measures, dictated industry outcomes, and involved governments making decisions that should be made by the market place. The likely outcome of the Steel Policy was more inefficiency and not less and greater distortions in world steel production and trade. While the United States was aware that the steel policy might be intended in part to address China's ballooning production capacity and China's recent emergence as a net steel exporter, it had been the United States' experience that subsidy-driven industrial policies rarely resulted in expeditious or market restructuring. Rather, they created a significant market distortion and exacerbated trade frictions.

9. With regard to the area of countervailing measures, the delegate of the United States commended China for taking an important step in notifying its countervailing duty laws and regulations. The United States had had an active and on-going exchange with China regarding these laws and regulations and was encouraged by the transparency that such an exchange promoted. His delegation looked forward to China's written responses to its most recent set of follow-up questions (G/SCM/Q1/CHN/57). The United States remained concerned that China's current countervailing duty regulations lacked sufficient detail to make clear to interested parties what procedures the administrative authority would follow and conduct in countervailing duty cases.

10. The delegate of the United States said that one final area addressed in his delegation's submission for this transitional review involved price controls. In this regard, the United States had asked a series of questions seeking clarification or updates regarding the pricing of coal, rice, steel, copper scrap, fertilizer and water.

11. The delegate of the United States concluded by saying that the United States' chief concern at the time of this year's transitional review emanated from China's continuing and seemingly growing use of subsidies, including prohibited subsidies. When coupled with China's on-going failure to submit a subsidy notification required of every WTO Member and answers to the questions posed by the United States under Article 25.8, this raised serious questions about how committed China was to meeting its obligations under its Protocol of Accession and the SCM Agreement. The United States

appreciated the difficulties and sensitivities inherent in many of the steps that China had to take to honour its WTO obligations. However, other Members faced similar challenges. He therefore urged China to take immediate action to demonstrate its commitment to the WTO subsidy disciplines. The first step should be the submission of China's long-overdue subsidy notification and of answers to the Article 25.8 questions which the United States had submitted in 2003.

12. The delegate of Japan stated that his delegation totally agreed with the view of the United States on the importance of the transitional review mechanism in the WTO system. As reflected in the written questions submitted by his delegation (G/SCM/Q2/CHN/12), Japan was interested in getting answers with regard to two aspects of China's position in the subsidies area. The first aspect was the notification of subsidies. While the subsidy notifications required by Article 25 of the SCM Agreement were of great importance for the purpose of improving transparency, China had not yet provided any further subsidy notification after its accession to the WTO. With reference to a statement by China at last year's Committee meeting that it was internally collecting information for its subsidy notification, he asked China to indicate the timing of its full subsidy notification. Second, Japan was interested in China's VAT refund scheme for copper. The Japanese industry, especially the smelting copper industry, had serious concerns on this VAT refund scheme. If, as China had stated, the refund scheme was WTO-consistent, any detailed information or documents would be greatly appreciated in order that Japan could explain the scheme to its industry and allay the industry's concerns regarding this scheme. In light of statements made last year by China that it was reviewing the refund scheme and considering its possible abolition, he asked whether there had been further developments in this regard.

13. The delegate of Canada shared the views of the United States and Japan on the importance of the transitional review mechanism. Canada also shared the concerns expressed by Japan, the United States and the European Communities, in writing, regarding the failure of China to fulfil its obligations by providing a new and full notification of its subsidies. Canada therefore encouraged China to provide such a notification as soon as possible. Canada was participating in this transitional review mechanism with a joint submission with Mexico and the United States regarding China's Steel Policy announced last July (G/SCM/Q2/CHN/15). Given the importance of China's steel production, this new policy could have repercussions on the world market, including Canada's industry and markets. Canada's concerns were centred on the degree of intervention of the Chinese Government in the direction and decision-making of its steel industry, and Canada questioned the compliance of such intervention with the commitments undertaken by China in the Accession Working Party Report. Canada was therefore looking forward to receiving clarifications from the Government of China on the issues raised in the submission.

14. The delegate of the European Communities fully supported the statements made by the United States, Japan and Canada and shared all the concerns they had expressed. He appealed to China to strictly comply with its obligations resulting from the WTO membership, particularly in the area of subsidies, including the provision of the long-outstanding subsidy notification. He hoped that at the present meeting China would provide meaningful replies to questions posed by the European Communities and other Members. While he realized that China, according to the agreed procedures, had no obligation to supply written replies, it would already be very helpful to have a room document with the properly prepared answers.

15. The delegate of Mexico stated that like the previous delegations, Mexico was concerned about the Steel Policy of China and was also expecting the notifications on subsidies which China should have presented. His delegation looked forward to receiving answers from China to the questions asked jointly by Canada, Mexico and the United States on China's Steel Policy.

16. The delegate of China stated that while he had taken note of the comments and concerns raised by Members with regard to the issue of China's subsidy notification, in previous years his

delegation had repeatedly stressed the enormous difficulties facing China in the information-gathering process for the preparation of such a notification. China was firmly committed to the principle of transparency in this regard. The serious practical problems and difficulties raised by the preparation of the subsidy notification had been recorded during the accession negotiations in the Working Party Report and had also been recognized by many Members in this Committee. During the last three years, China had been educating and training officials in relevant government agencies and mobilizing them to review through hundreds of pieces of regulations, department rules and policies to examine whether they were relevant to the SCM Agreement. This process had so far concentrated on the central government level. Questions raised by Members on some specific policies and measures, including the questions raised by the United States under Article 25.8 of the SCM Agreement, were all taken into account in this internal information-gathering process. There had been intense discussion on all the technical details of the information gathered to determine whether particular measures fell within the scope of the notification obligation, in view of the fact that the SCM Agreement required only notification of subsidy programmes which were specific, as defined by the Agreement. As a result of these efforts of the last years, China was now in the process of finalizing a draft of its subsidy notification, which at this stage was still in Chinese. China would submit this notification without prejudice to its position as to whether the policies and programmes to be notified were subsidies or whether they were specific, as defined in the SCM Agreement. Subject to inter-agency procedures and translation, which was extremely important and required absolute accuracy to reflect exactly what the policies were and to avoid misunderstanding, China was prepared to submit the full subsidy notification to the Committee before the end of this year. With this notification China would like to clarify as much as possible its policy in this regard and reiterate its strong commitment to the fundamental WTO principle of transparency to which China had always adhered since its accession.

17. The delegate of China stated that on some of the questions raised by Members in their written questions, for example with respect to developments in the financial sector, China had strong reservations as to whether they fell within the mandate of this Committee or whether they were subsidies or specific. However, in a spirit of co-operation and professionalism, China had in the past few years provided information with regard to the reform process of China's banking and financial sector and would continue to do so at the present meeting. The delegate of China also pointed to the fact that some Members had repeatedly raised the same questions, which had disturbed China's internal efforts to gather the information necessary for the submission of a subsidy notification. On some of these questions, Members would find relevant information in the minutes of previous Committee meetings. Some of the questions posed by Members had only arrived at China's Permanent Mission very shortly in advance of the meeting, which had caused great difficulties for China in preparing comprehensive and detailed answers. Nevertheless, in a spirit of co-operation and transparency, China had made every effort to coordinate the relevant competent authorities to address these questions.

18. The delegate of China then proceeded to answer specific questions submitted by the delegations of Canada, the European Communities, Japan, Mexico and the United States.

Countervailing duty legislation

19. Regarding China's laws and regulations on countervailing measures, the delegate of China noted that the Foreign Trade Law, revised on 6 April 2004, which had been referred to by a Member as not being notified, had been notified to the Committee on 22 November 2004 (document G/SCM/N/1/CHN/1/Suppl.4). While there were no "Anti-Subsidy Regulations" in China, it was possible that the Member had used this term to refer to the regulations of the People's Republic of China on countervailing measures, which had been revised on 31 March 2004 and which China had notified on 18 October 2004 (document G/SCM/N/1/CHN/1/Suppl.3). In addition to the above laws and regulations, China's existing laws and regulations on countervailing measures included: (1)

provisional rules for initiation of countervailing investigations, (document G/SCM/N/1/CHN/1/Suppl.1), which had come into force on 13 March 2002; (2) provisional rules on questionnaires in countervailing investigations (document G/SCM/N/1/CHN/1/Suppl.1), which had come into force on 15 April 2002; (3) provisional rules for the conduct of public hearings in countervailing duty investigations (document G/SCM/N/1/CHN/1/Suppl.1), which had come into force on 13 March 2002; (4) provisional rules for on -the-spot verifications in countervailing investigations (document G/SCM/N/1/CHN/1/Suppl.1), which had come into force on 15 April 2002; and (5) rules on investigations and determinations of industry injury for countervailing measures (document G/SCM/N/1/CHN/1/Suppl.2), which had entered into force on 15 January 2003. As the newly promulgated regulation was still under translation, China would notify it to the Committee once the translation was finished.

VAT refund scheme for imports of copper raw materials

20. The delegate of China stated that China had provided detailed information on the VAT rebate scheme for copper raw materials in last year's transitional review mechanism of this Committee. Considering the crucial importance of copper on national economy and national security, the purpose of this VAT refund scheme was to improve the technology and management of the copper refinery industry. China's imports of copper raw material only accounted for a small proportion of the world's total trade in copper and would not distort the international market. At present, the policy was under review.

Preferential tax treatment of foreign-owned enterprises

21. With regard to the preferential tax treatment of foreign invested enterprises, the delegate of China considered that such preferential treatment of foreign investment was a common practice internationally and was not specific in nature, as defined in the SCM Agreement. Detailed information on the preferential tax treatment of foreign investment was already contained in Annex 5 of China's Accession Protocol. To remain consistent with the existing notification, and to clarify further China's policies, China would include this detailed information on preferential tax treatment for foreign investments in its forthcoming subsidy notification. Some of the specific provisions in the existing legislation were also being examined in the context of China's tax reform, which was currently under preparation. A major step to be taken in this reform was to unify the income tax system for domestic enterprises and enterprises with foreign investment, following the principles of fair competition and national treatment. In that process, consistency of China's tax policies with the SCM Agreement would also be stressed and observed.

Measures applied by local governments

22. The delegate of China stated that there were great difficulties in collecting relevant information on policies applied at various levels of local government in China. However, the available information indicated that the supportive policies of China's local governments referred to by a Member were of two types. First, in order to promote and harmonize the economic development of under-developed areas and raise their agricultural productivity, local governments formulated policies to enhance the reconstruction of the agricultural infrastructure, to subsidize the introduction of new species, to promote new technology and technical training, to purify and upgrade the local superior species and to establish service systems, such as the prevention and cure for plant diseases and insect pests, the information supply system, the quality standard and testing systems, etc. Second, some policies of local governments might be supporting the small and medium enterprises (SMEs), to explore international markets, such as supporting SMEs to attend overseas exhibitions, to acquire certifications from various quality or environmental management systems, to advertise and market overseas, to organize training and seminars as well as to bid for overseas projects. Such measures to support SMEs were widely adopted by many Members. The delegate of China pointed out that the

reimbursement of export credit insurance fees referred to by a Member in its questions was not contingent on export performance.

Northeast revitalization policies

23. The delegate of China stated that the policy of revitalization of the former industrial regions in Northeast China had been adopted in 2003, and mainly included the following practices: first, to start pilot projects on the perfection of urban and township social security systems in the Northeast area. Second, to expedite the bankruptcy process of the state-owned enterprises. Third, to reform investment systems in the Northeast to simplify and transfer to the lower levels, the process for the review and approval of investment projects. These policies were not so-called industrial policies, which might favour certain industries, but formed part of a general policy meant to deepen the reform of the investment system and to establish the urban and township social security systems and thus speed up China's transformation to a market economy. With regard to the two examples of the revitalization programme raised by a Member, the delegate of China stated that the policy on the strategic restructuring and technical transformation of key enterprises in areas such as oil, petrochemical and iron in Northeast China, carried out by the Commission of State-Owned Assets Administration, was just a guideline focussing on the reform and reconstruction of the central enterprises and was not mandatory. The enterprises were free to take their own decisions on their operations. Regarding the example mentioned by a Member of the provision by branch of the Export-Import Bank of RMB 5 billion of export credits to companies in Northeast China, the delegate of China stated that the applicable interest rates were in conformity with the OECD Arrangement on Officially Supported Export Credits and that these export loans were not only granted to the enterprises in the Northeast but were granted to enterprises all over the country under the same conditions.

Financial sector reform

24. The delegate of China stated that although her delegation did not consider that this Committee was the right venue to discuss China's ongoing financial sector reform, she would provide information in the interest of transparency. China currently was engaged in a fundamental reform of its financial system, including simultaneously: (1) the continuation of the reform of the stock-holding system of the commercial banks, such as the Bank of China, the Construction Bank of China, the Industrial and Commercial Bank of China (ICBC) and the Bank of Communication; (2) encouraging the commercial banks to attract strategic investment; (3) reform of the rural credit agencies; (4) strengthening of administration with regard to the provision of social credit; (5) improvement of the payment and settlement system; and (6) combating money laundering. All these policies would create a solid commercial environment for the commercial banks in China.

25. The reform of the stock-holding system of the commercial banks mainly involved two aspects, financial restructuring and the improvement of corporate governance. Financial restructuring included resolution of the problem of non-performing loans and the introduction of certain paid-in capital. Thus, as an example, she explained that the People's Bank of China had acquired ICBC's doubtful loans and transferred them to the financial assets management companies by inviting public bidding. According to the regulations on the financial assets management companies, these companies were not banks, but state-owned financial institutions to acquire, manage, and dispose of the non-performing loans of the state-owned banks. The bidding prices offered by the financial assets management companies were reasonable and close to the real price of the non-performing loans. On the other hand, in April 2005 Huijin Investment Company had invested \$15 billion into ICBC. China's financial supervisory organs strictly supervised and examined ICBC in order to secure this paid-in capital and its reasonable re-pay.

26. The delegate of China stated that while the financial restructuring was under way, the state-owned commercial banks were improving their corporate governance mainly by two means. First, establishing a separate and healthy operation and function of the shareholders meeting, board of directors and board of the supervisors and enhancing the effective monitoring and coordinated development of the three boards. Second, diversifying the shareholding structure. For example, the Construction Bank of China had introduced Bank of America and Asia Financial Shareholding Company as its strategic investors. These commercial banks were also seeking to become listed. As the state-owned commercial banks were now transformed into shareholding commercial banks by means of the reform of their stockholding systems, they had become the real market players which were profit-oriented with the maximization of the shareholders' interest as the goal of their operation. Therefore, the reformed state-owned commercial banks would issue loans in a market-oriented manner consistently with the principle of cost efficiency. Meanwhile, China was also making efforts to develop the capital market, which would result in the decline of the proportion accounted for by banks in the financing of enterprises. The Government was also experiencing a change of role in the administration of the banking sector during the process of the reform of these state-owned commercial banks stockholding system. The Government did not intervene in the operation and business decisions of the reformed banks, but focused on the macro aspects, such as the establishment of the financial market and the supervision system, financial stability and the prevention and handling of financial crises.

State-owned enterprises

27. The delegate of China stated that the subsidies provided to certain state-owned enterprises which were running at a loss, as listed in Annex 5(b) of China's Accession Protocol, had been phased out in 2001. The subsidy programme had not been included in the Government's budget since 2001. The Chinese Government had never made the statement referred to in the news report cited by a Member. The attempted acquisition by a Chinese state-owned enterprise referred to by a Member involved a business decision based on commercial considerations made by the enterprises and the banks. In China, state-owned commercial banks and state-owned enterprises operated as independent market players, bearing full responsibilities of their own interests and losses. They were eligible and able to negotiate and sign the financing contract according to their own risk evaluation. In this respect, she stated that the allegation that a loan to a state-owned enterprise in the energy sector referred to by a Member was inconsistent with commercial considerations was not verified. To grant a loan not based on commercial considerations was not consistent with China's requirements in the reform of state-owned commercial banks and other state-owned enterprises. China was very disappointed to see that this acquisition attempt of the Chinese company based on commercial considerations had not, in return, been treated by the other party in accordance with commercial considerations.

Price controls

28. The delegate of China stated that the Law of the People's Republic of China on Pricing did not contain a termination date or expiration date of China's pricing administration policy and that during the past year China had not issued new laws, regulations or other measures to eliminate or reduce the price controls listed in Annex 4 to its Protocol of Accession. Among the products subject to the state guidance pricing list in Annex 4, the prices of grains, cotton and vegetable oil referred to the base price of the bidding and auction through which the government sold its reserves of these products. Regarding the products covered by Annex 4, changes had occurred in 2001 in that except for oil used by the army, the prices of lamp-kerosene, naphtha, and fuel oil in China were not subject to state guidance pricing anymore, and were now determined by the market. Therefore, these products should be deleted from Annex 4.

29. The delegate of China then provided information on particular goods and services subject to state guidance pricing. Processed oil was a scarce resource of crucial importance to the national

economy and people's lives. With regard to fertilizer, she said that at present, the fertilizer distribution system in China was based on the market mechanism under the administration of the government. China was presently establishing a pricing system on silkworm cocoons which was mainly market-oriented under the government administration. China's transportation service charges had not changed. With regard to charges for professional services and charges for commission agents' services, she stated that because China's professional services market was still in the initial stage of its development, the degree of marketization was rather low. This explained why the Government had to establish criteria and determine the scope of fluctuation of the services charges, while the exact charge of each service provided by the service provider was determined by the two parties themselves. Regarding charges for settlement, clearing and transmission services of banks, she said that the service situation in China had now further improved, as foreign banks had gradually entered into the Chinese market. At present, with the exception of RMB basic settlement services, which were closely related to the general public, most of the charges of the bank services were open to be decided by the market. With respect selling prices and renting fees of residential apartments, she stated that prices of low-price residential apartments meant for the low income residents were still subject to state guidance pricing, whereas prices of other commercial residential apartments were decided by the market.

30. The delegate of China stated that China had not adopted any new price control measures during the past year on products and services not included in Annex 4, including steel and steel-based scrap, copper and copper-based scrap.

31. In accordance with China's existing pricing laws and policies, the price of coal was now determined in the market through negotiations between the suppliers and demanders. China's long-term development plan with respect to coal, electricity power and natural gas was reflected in documents that provided overall guidance rather than mandatory instructions. The State Development and Investment Corporation was engaged in many industries, including the energy sector. Its operations were completely based on market considerations and in this respect this company was not different from other enterprises.

32. Regarding the new pricing policy for electricity, the delegate of China stated that by the end of last year the National Development and Reform Committee had adopted a policy which provided for the price of electricity to be adjusted in light of the price of coal. According to this new policy, the price of electricity per kilowatt had been raised by 2.5 cents RMB in April 2005.

33. The delegate of China stated that the purpose of the reform of China's pricing policy on tap water was to address the problems of the lack of water resources in China, to save water, to enhance the efficiency of water usage and to improve the sustainable development of the water resources. In recent years, the reform on pricing policies of the tap water had produced a significant effect. From 2002 to 2004, the per capita senior residents usage of water had declined by approximately 10 per cent. The major policy measures envisaged as part of the further reform of the pricing policy of tap water, were to enlarge the scope of collecting the water fees and to raise the price standard to a reasonable level; to gradually raise the tap water price for water construction projects; to reasonably adjust the water price to the urban citizens; to try and take the disposal fee as the priority in reform; to reasonably decide the price of the re-used water; and sixth, to reform the calculation of the price of water.

34. The delegate of China said that since 2004 the price of grains, including rice, had been liberalized. The fertilizer and grains protection fee was consistent with China's commitment in its WTO Accession Protocol. In recent years, the acquiring price of grain in China had been decided mainly by the markets. The Government established the lowest acquiring price to protect the income of the farmers only when the decline in the grain market had been too significant. However, since

2004, the market price of grain had been higher than the acquiring price set by the Government and the lowest acquiring price had therefore not been used.

35. With respect to fertilizer, China had adopted policies aiming to further develop the productivity of fertilizer production in China, to enhance the distribution of fertilizer and to enhance the reserves of fertilizer. In order to stabilize the grain market China had adopted measures to adopt the lowest acquiring price on the grain, to encourage different kinds of enterprises to enter the market and acquire the grain, and to enhance the market evaluation of the price on grain. These policies applied to the following products: grain, wheat and corn.

Steel policy

36. Regarding China's recently announced Steel Policy, the delegate of China stated that in light of the changed situation and market requirements of China's steel and ore industry, China had issued a steel and ore industry development policy in July 2005. The Steel Policy mainly aimed at strengthening the whole industry through encouraging advanced techniques, structure adjustments, better distribution, system reform and changes of growing method. The policy provided for overall guidelines and did not involve compulsory regulations for individual enterprises. It provided that the Chinese Government would encourage strategic convergence of the steel and ore industry with methods such as merging and acquisition, restructuring and mutual holdings. Market rules played a major role during the merger and acquisition practice, so that each party could benefit from these processes. Banks and firms operated on their own following the market mechanism. Because of the nature of the Steel Policy as an overall guideline, the Chinese Government never demanded any specific bank service providing for firms during the merger and acquisition process. Regarding the question raised on the provisions contained in Articles 16 and 18 of the Steel Policy, the delegate of China stated that her delegation had already provided information in the transition review which had taken place in the Import Licensing Committee. She stressed that since the guidelines had been formulated, the Chinese Government had not provided any government support in any form for the use of domestic equipment.

37. The Chairperson welcomed the announcement by China that it would shortly submit a subsidy notification.

38. The delegate of the European Communities stated that the need to repeat certain questions was due to the lack of sufficiently detailed answers from China. In this respect, he reiterated his delegation's interest in knowing the exact legal provisions pursuant to which the VAT refund was applied and in detailed information on how the system worked. Regarding the issue of preferential tax treatment of foreign-owned enterprises, he pointed out that Article 75(7) of the Rules for the Implementation of Income Tax of the People's Republic of China clearly provided that companies that exported more than 70 per cent of their production would receive the benefit of 50 per cent reduction of the company tax. He again asked China to indicate whether this provision still existed, whether or not it had been eliminated, and how it was compatible with the obligations of the SCM Agreement. The European Communities considered this to be a prohibited subsidy, which was specific by its very nature, even if available to all companies. His delegation was looking forward to China's subsidy notification. If this preferential tax programme was mentioned in that notification, this would enable his delegation to ask written questions and receive written answers.

39. With respect to the question of whether banking issues were within the competency of this Committee, the delegate of the United States said that as a general matter it was widely recognized that state-owned banks were, in essence, acting as the government when they were providing loans and that, to the extent that those loans were preferential or below market rates, that constituted a subsidy. He drew attention to certain paragraphs in the Working Party Report on China's accession. Paragraph 172 stated that "when state-owned enterprises, including banks, provide financial

contribution they are doing so as government actors within the scope of Article 1.1(a)". Paragraph 173 stated that "Members of the Working Party have identified state support through the banking system, notably government-owned banks in the form of policy loans, the automatic roll-over of unpaid principle and interest, for given and non-performing loans and the selective use of below-market interest rates". The Report also stated that China was attempting to make government-owned banks operate on a commercial basis. Thus the issues that were discussed in the Working Party were the very same issues which Members continued to discuss in this Committee in the context of this transitional review mechanism.

40. The delegate of the United States echoed the views of the European Communities regarding the issue of tax benefits contingent upon exports. It was somewhat disturbing to hear China's response that tax benefits that were provided only to exporters were widely available, and therefore were not specific, when in fact, according to the SCM Agreement, benefits that were contingent upon export performance were deemed specific. These tax benefits that were contingent upon export were prohibited subsidies and the United States looked to their termination in the near future.

41. With respect to the statement of the delegate of China that the Government no longer intervened in bank operations and was only concerned about the macro environment and about macro policy design, he recalled that when the Committee discussed the Northeast revitalization programme in 2003 and when the point was made that many of the bad debts of the state-owned enterprises in that region were being forgiven, the Chinese delegate had responded by saying that the settlement of those bad debts was a matter between the banks and the state-owned enterprises and that the Government was not involved. The Chinese delegate had basically stated that the banks recognized that the loans would not be repaid and were negotiating with the state-owned enterprises for any kind of cash repayment or any non-cash payment that the banks could extract from them. In light of that response, he wondered why those banks would continue to lend to the various state-owned enterprises that they had just had problems with in terms of these bad debts. In the absence of government intervention, it was hard to explain why a commercial bank would negotiate or settle bad debts with state-owned enterprises and then proceed to lend new money to them.

42. The delegate of Japan agreed with the European Communities that China's response with regard to the VAT refund scheme for copper raw materials was not satisfactory because of its lack of detail. Japan expected China to provide detailed documentation on this scheme. He hoped that in its forthcoming subsidy notification China would as soon as possible provide all the information presented at this meeting in accordance with the agreed standard format.

43. The delegate of Canada stated that the task of delegates and interpreters would be simplified if China could make its answers available in writing. His delegation looked forward to China's subsidy notification.

44. The delegate of Mexico reserved the right to have responses from China in writing and to raise further questions, especially in respect of the Steel Policy.

45. The delegate of China stated that he did not have much to add to the lengthy responses provided by his delegation. Thus for example, with regard to the follow-up question of the European Communities on specific provisions of China's existing legislation, his delegation had already indicated in its earlier intervention that these provisions were currently being examined in the context of China's tax reform and that China's forthcoming subsidy notification would contain information on China's preferential tax treatment of foreign investment. His delegation had taken note of the issues raised in the follow-up questions and comments of various delegations and would take them into consideration in preparing China's subsidy notification.

46. The delegate of the United States rephrased his earlier question with respect to benefits that are contingent upon export. It was the understanding of the United States that there were several Chinese tax programmes that were contingent upon exportation and which his delegation therefore considered to be prohibited subsidies. He asked China if it would accept the interpretation that benefits received that were contingent upon exportation were specific and were export subsidies. The delegate of the United States also reiterated his question on the issue of whether or not there continued to be government involvement in the decisions of state-owned commercial banks. He recalled in this respect that during the transitional review conducted in 2003 when the United States had raised questions about debt forgiveness that was benefiting large state-owned enterprises in the North-east region, the delegate of China had responded that the debt forgiveness being granted to the state-owned enterprises was part of a private settlement negotiated between the banks and those enterprises. If one took that as given, it was very hard to explain why the same banks would continue to lend to the same enterprises to finance projects involving the upgrading the technology of those enterprises. Thus the question was how those banks could continue to loan to the state-owned enterprises in the North east region if in fact the Government did not intervene in the banks' decisions and operations.

47. The delegate of the European Communities stated that he concluded from the statement of the delegate of China that the specific provision which he had mentioned regarding preferential tax treatment of foreign investment was still in force.

48. The delegate of China said that he was not in a position at this stage to respond to the specific question raised by the United States because of language difficulties he had not been able to catch details of the question and that he would refer this question to his authorities.

49. The Committee took note of the statements made.

50. The Chairperson noted that the Protocol of China's accession to the WTO did not contain guidelines regarding the report to be provided by the Committee on the transitional review. Following the review conducted at the meeting in November 2004, her predecessor, acting on his 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. She proposed that the Committee follow the same procedure again this year.

51. The delegate of China said that his delegation did not consider it necessary to attach the relevant portion of the minutes of this meeting to the report but that it was not opposed to following the previous practice of the Committee.

52. The delegate of the United States, the European Communities and Japan stated that the relevant portion of the minutes of this meeting relating to the transitional review should continue to be attached to the report submitted to the Council for Trade in Goods.

53. The Committee agreed to proceed as proposed by the Chairperson.
