

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

Questions from the UNITED STATES to
CHINA Concerning Subsidies and Price Controls

The following communication, dated 28 September 2005, is being circulated at the request of the Delegation of the United States.

Subsidy Notification

1. Article 25 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement) requires all Members to notify any subsidy as defined in paragraph 1 of Article 1, which is specific within the meaning of Article 2, granted or maintained within their territories. During the 31 October-1 November 2002 meeting of the Committee on Subsidies and Countervailing Measures (the Committee), China stated that it would submit the required notification when the information was accurate and complete (G/SCM/49). During the 18 November 2003 meeting of the Committee, China declared that it was unable to provide a specific time frame for completion of its notification (G/SCM/111). At the 25 November 2004 Council on Trade in Goods meeting (G/L/722), China stated that it planned to submit its subsidies notification in 2005. To date, China has failed to notify any of its subsidies. The United States therefore urges China to comply with its obligations under Article 25 of the SCM Agreement, which are reiterated in the Working Party Report accompanying China's Protocol of Accession, to provide a full accounting of any subsidies it maintains. A subsidy notification, as required by all WTO Members, helps to ensure the transparency that is so vital to the functioning of the world trading system. Please indicate when China intends to submit its subsidy notification.

Export Subsidies

2. The United States has documented several instances where China appears to administer programmes that may provide subsidies contingent upon export. (See, for example, G/SCM/Q2/CHN/2; G/SCM/Q2/CHN/8; and "China and the WTO: Accession, Policy Reform, and Poverty Reduction Strategies", edited by Deepak Bhattasali, Shantong Li, and Will Martin, 2004.) The Working Party Report on the Accession of China (WT/ACC/CHN/49, paragraph 167), states "that China would, by accession, cease to maintain all pre-existing export subsidy programmes and, upon accession, make no further payments or disbursements, nor forego revenue or confer any other benefit, under such programmes. This commitment covered subsidies granted at all levels of government which were contingent, in law or in fact, upon an obligation to export". The commitment

made by China did not allow for the phase-out of such subsidies or for the continued allowance of programmes already in place for a specific period of time.

- (a) Please clarify the status of all export subsidy programmes maintained in China.
- (b) What steps is China taking to eliminate all export subsidies?
- (c) When does China intend to eliminate all export subsidies programmes as it is obligated to do?

Export Support to Agricultural Products

3. In its Protocol of Accession, China agreed that it would “not maintain or introduce any export subsidies on agricultural products”. (WT/L/432, Part 1, paragraph 12.1.) However, China still appears to maintain several export subsidy programmes for agricultural products. For example, Jiangxi Province has issued policies to encourage exports of agricultural products. Under these policies, according to the Ministry of Commerce (MOFCOM) website, the province provides capital support for exporting bases and leading exporting enterprises; grants discount loans for exporters; assists small/medium sized enterprises in attending international exhibitions and new product promotional activities; grants cash rewards for exporters with annual export revenue of US\$5 million (growth of the export revenue should exceed 30%); reimburses 20% to 30% export credit insurance fees for exporters. The province provides capital support for export-oriented projects and technological upgrading projects and provides loans to enterprises presenting export orders or export letters of credit. The province also guides enterprises in avoiding export credit risks and assists them in reducing export costs. In another example, Henan Province set up a special purpose fund to encourage the export of foreign exchange-earning agricultural products. The special purpose fund reportedly provides low-interest loans for processors of agricultural products which met specific direct export volume levels. The support provided pursuant to these and other provincial and central government policies appear to be inconsistent with the commitments contained in China’s Protocol of Accession and with its obligations under Article 3 of the SCM Agreement not to maintain export subsidies.

- (a) Please clarify how these programmes are compliant with China’s Protocol of Accession and with China’s obligations under the SCM Agreement.
- (b) Please indicate when China will notify these programmes.

Northeast Revitalization Industrial Policies

4. China has undertaken increasing industrial policy actions with regard to the Northeast area of China. These policies, often under the auspices of “Northeast Revitalization”, seem to provide potentially unfair advantages to businesses locating to or operating in Northeast China. For example, a report on the MOFCOM website noted that the Dalian Branch of the Export-Import Bank would provide RMB 5 billion of export credits to companies in Northeast China to enter global markets. The report went on to explain that since November 2003 “low-cost credit provided by the bank has saved the enterprises [RMB] 150 million interest”. In addition, in 2004, according to China’s State Property Commission, China was carrying out “strategic restructuring and technical transformation of key enterprises in the areas of oil, petrochemical, iron and steel, automotive, shipbuilding and aircraft products manufacturing sectors in Northeast China in a bid to establish production bases of advantage industries”. While efforts at restructuring the economy to operate on a more commercially driven basis are admirable objectives, these and other reports indicate that China continues its industrial policy drives, especially in the Northeast region, with potentially problematic aid and assistance, as well as direct government intervention in specific Chinese manufacturing industries.

- (a) Please provide a complete description of China's industrial policy as it relates to the Northeast region of China.
- (b) Please identify any corresponding laws and regulations.
- (c) Please clarify how China's policies in the Northeast are market-driven and undertaken on a commercial basis.
- (d) Will these programmes be included in China's subsidies notification as required by Article 25 of the SCM Agreement?

Banking and Financial Sector

5. In the Working Party Report accompanying China's Protocol of Accession (WT/ACC/CHN/49, paragraph 172), China's representative "pointed out that China's objective was that state-owned enterprises, including banks, should be run on a commercial basis and be responsible for their own profits and losses". China's representative also stated that "[t]he state-owned banks had been commercialized" Meanwhile, the Chinese government's efforts to place the "Big Four" state-owned commercial banks (the Industrial and Commercial Bank of China, the China Construction Bank, the Bank of China and the Agricultural Bank of China) on a sound commercial footing have been ongoing since 1994. Despite these efforts, it appears that bank lending on terms inconsistent with commercial consideration has continued unabated and government bailouts of the banks have grown over time in frequency and magnitude. Since 1998, these banks collectively have reportedly benefited from repeated government capital injections and non-performing loan purchases in excess of \$250 billion. Thus, while the Chinese government's attempts to improve corporate governance, loan classification standards and prudential rules and regulations are well-intentioned and are welcome, it appears that more fundamental reforms and stronger enforcement are still needed, particularly on the institutional side.

- (a) Is China contemplating more fundamental reforms? If so, what are those plans? If not, what are China's plans for placing the Big Four banks on a sound commercial footing?
- (b) In the context of China's unfinished banking sector reforms, and in view of the fact that banks account for a large share of investment financing in China, what are the government's expectations for the newly initiated efforts to reform the investment regime, with respect to making bank lending more consistent with commercial considerations?

6. During last year's transitional review before this Committee, the United States raised a number of questions about China's persistent bailouts of the Big Four state-owned banks and the large number of non-performing loans involved, particularly a \$45 billion injection by the central government into the Bank of China and the China Construction Bank in 2003. At the time, China stated that, compared with previous reform measures, the 2003 injection measures were designed and implemented with commercial considerations in mind (G/SCM/115, paragraph 31). While some recent reports have suggested that non-performing loans in China have decreased, we remain concerned that the lending policies of the Big Four state-owned commercial banks are carried out on a non-commercial basis. It appears that state-owned banks continue to make policy-driven loans that are not commercially justified, and when those loans fail, the loans are written-off and passed to the asset management companies to be dealt with. The recent inauguration of Huida Asset Management Ltd., set up to specifically deal with the non-performing loans of the state-owned People's Bank of China is one such example.

- (a) Please describe how loans are sold from a state-owned bank to an asset management company. Please also explain how the value of such loans from a state-owned bank is determined.
- (b) Please describe the operation and functions of China's asset management companies.

7. During last year's transitional review, China stated that its banks were operating under commercial conditions, and that government intervention had been reduced to a minimum (G/SCM/115, page 7). However, in May 2005, China injected \$15 billion of foreign exchange reserves into the Industrial and Commercial Bank of China (ICBC), which in April 2005 had acknowledged that about 19 percent of its loans were non-performing.

- (a) Please provide details on the Chinese government's \$15 billion infusion into the ICBC.
- (b) During last year's transitional review, China stated that government support for the Bank of China and the Construction Bank of China had resulted in these banks' conversion into shareholding companies (G/SCM/115, paragraph 31). Please explain whether the recent infusion into the ICBC resulted in a similar share conversion.
- (c) On what terms were these conversions undertaken?
- (d) How did the role of the Chinese government in the operation of these banks change following these interventions?

State-Owned Enterprises

8. The United States continues to seek responses from China to questions raised in connection with last year's transitional review before this Committee (G/SCM/Q2/CHN/8, paragraph 6) regarding loss-making state-owned enterprises. Please provide responses to these questions.

9. In addition to China's statements in the Working Party Report accompanying China's Protocol of Accession (WT/ACC/CHN/49, paragraph 172) "that China's objective was that state-owned enterprises, including banks, should be run on a commercial basis and be responsible for their own profits and losses", China also stated that "[t]he state-owned banks had been commercialized and lending to state-owned enterprises took place exclusively under market conditions". In one recent example, state-owned banks supported the efforts of a state-owned company in the energy sector to acquire the assets of a US firm. This support reportedly included approximately \$13 billion in loans that appeared to be on terms that were inconsistent with commercial considerations. Please explain how this type of support to a state-owned enterprise is consistent with China's Working Party Report statements regarding the operation of state-owned enterprises and the role of state-owned banks.

10. According to MOFCOM's website, "China needs to find ways to support certain state-owned enterprises (SOEs) to help them remain competitive in the retail distribution market. MOFCOM will seek to address problems such as the need to consolidate tax tables and tax payments made by chain stores and other policy obstacles, will reduce or exempt certain SOE distribution firms from repayment of non-performing loans, and provide a debt-to-equity swap policy. The policies will support firms' trans-regional development, make good use of domestic and foreign trade development funds, provide subsidized interest for technical innovation loans, and accelerate infrastructure development." These statements indicate that China's state-owned enterprises have benefited and will continue to benefit from preferential government treatment. Please describe how this policy is consistent with the statements made by China in the Working Party Report.

Price controls

11. China stated in document G/SCM/N/120 that the Law of the People's Republic of China on Pricing is the legal basis of China's pricing administration and pricing policies.

- (a) Is there an expected termination date or expiration date of China's pricing administration policy? If so, when will that be?
- (b) Please describe any new laws, regulations or other measures, including administrative actions, that China has issued or taken to eliminate or reduce the price controls listed in Annex 4 to its Protocol of Accession during the past year.

12. Annex 4 of China's Protocol of Accession also lists the goods and services subject to government guidance pricing.

- (a) Have any goods or services been removed from this list, or has the pricing mechanism otherwise changed, such as from guidance pricing to free-market pricing or direct price setting during the past year?
- (b) Please describe the macroeconomic or social circumstances justifying the continuation of guidance pricing on each of the goods or services that remains subject to government guidance pricing.

13. According to Annex 5A to China's Protocol of Accession, a programme listed as "Subsidies from Local Budget Provided to Loss Making State-Owned Enterprises" provides subsidies to severely loss-making state-owned enterprises due to either the fixed price of the products they produce or the increasing cost of exploitation of the resources and restructuring of state-owned enterprises.

- (a) Please identify the enterprises that are producing goods at fixed prices.
- (b) What policy actions is the Chinese government taking to allow these enterprises to operate without the need for subsidization?
- (c) If these firms are selling at market prices, please explain the need for continued subsidization.

14. Has China implemented any new price controls or other regulatory measures affecting pricing with regard to any goods not listed in Annex 4, especially industrial inputs such as steel or steel-based scrap and copper or copper-based scrap during the past year?

15. At last year's transitional review before this Committee, the delegate from China stated, ". . . the price of coal in China is completely subject to market mechanisms". The United States understands, however, that certain local governments in China continue to regulate the price of coal supplied to power generators.

- (a) Please clarify the pricing situation with respect to coal.
- (b) Please describe the Chinese government's continued plans for the development of the coal and power industries, including the role of the State Development and Investment Corporation.
- (c) We note that, in April 2005, the Chinese government announced a new pricing policy with regard to electricity. Please provide additional details on this new policy.

16. In last year's transitional review before this Committee, the delegate from China explained that while water remains subject to state pricing, the pricing mechanism has been reformed to reflect market forces and the availability of resources. The delegate from China further explained that the government's goal is water prices that fully reflect resource scarcity and encourage efficient and sustainable use. Please explain the water pricing reforms that the Chinese government has implemented in the past year and the progress made toward achieving the government's water pricing goals.

17. The report of then Premier Zhu Rongji on the tenth five-year plan (2001-2005) states that "farmer's surplus grains were purchased without restriction at a protective price". The United States understands that China has been phasing out protective prices for most grains. One exception is rice.

- (a) Please explain how a protective price for rice is set.
- (b) Please explain whether the protective price for rice will be phased-out. If so, when will this phase-out occur? If not, please explain how the protective price for rice is consistent with the WTO Agreement and, in particular, Article III of the General Agreement on Tariffs and Trade 1994.

18. According to the State Development and Reform Commission, "[t]o further reduce the farmers' burdens, the government will help stabilize the market prices of chemical fertilizers and the purchasing price of grain" in 2005.

- (a) Please explain how this policy is consistent with China's obligation to phase-out its protective prices.
 - (b) How does China intend to stabilize the market prices of chemical fertilizers and the purchasing price of grains?
 - (c) Please identify the specific grains that are being addressed by this policy.
-