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

Questions From the UNITED STATES to CHINA

The following communication, dated 3 November 2006, is being circulated at the request of the delegation of the United States.

The United States wishes to pose the following questions to China in connection with the 20 November 2006 meeting of the Council for Trade in Goods for the purposes of the transitional review mandated by China's Protocol of Accession. Several of these questions relate to matters that were raised by the United States and other Members during the transitional reviews held before the committees that report to the Council for Trade in Goods, but China did not respond to them. The United States notes that it may submit additional questions, depending on the outcomes of other upcoming transitional reviews before committees that report to the Council for Trade in Goods.

1. Transparency

1. In China's Protocol of Accession and accompanying Working Party Report, Members recognized the overriding importance of transparency through a host of provisions. Since China's accession, China has made notable improvements in the transparency of its trade regime, particularly through the many notifications that it has made to the WTO's councils and committees as well as through its use of numerous official journals, other publications and the Internet to publicize new or modified trade-related laws, regulations and other measures. Nevertheless, there remains much to be done to further improve transparency in China, as China itself has acknowledged. Transparency is a critically important area, both from a governmental perspective and from a business perspective.

2. In Section 2(C) of its Protocol of Accession, China specifically committed to establish or designate an official journal dedicated to the publication of all trade-related measures, including, *inter alia*, "all laws, regulations and other measures pertaining to or affecting trade in goods . . . ." The term "laws, regulations and other measures" is defined broadly as "laws, regulations and other measures of the central government as well as local regulations, rules and other measures issued or applied at the sub-national level."

3. During past transitional reviews, China has stated that its official journal was the *China Foreign Trade and Economic Cooperation Gazette*, now published by the Ministry of Commerce ("MOFCOM") and known as the MOFCOM Gazette. Until March 2006, however, only trade-related measures issued by MOFCOM, either on its own or jointly with other ministries or agencies, were published in the MOFCOM Gazette; trade-related measures issued by other ministries and agencies were not published in the MOFCOM Gazette. In March 2006, China's State Council issued a notice

directing all central, provincial and local government entities to begin sending copies of all of their trade-related measures to MOFCOM for immediate publication in its Gazette.

(a) Please provide an update on the progress being made by central, provincial and local government entities in fulfilling the State Council's directive to send measures pertaining to or affecting trade in goods to MOFCOM for publication in the MOFCOM Gazette. As part of that update, please identify the government entities that regularly send their goods measures to MOFCOM for publication in the MOFCOM Gazette. Please also describe the types of goods measures (e.g., laws, regulations, rules, measures, notices, decisions, etc.) regularly being sent to MOFCOM for publication in the MOFCOM Gazette.

(b) With regard to measures pertaining to or affecting trade in goods, please describe any progress that China has made during the past year in implementing the commitment that it made in Section 2(C) of its Protocol of Accession to provide a reasonable period for public comment on new or modified measures before implementing them, except in certain specified instances.

2. Trading Rights

4. In connection with the transitional review before the Committee on Market Access held on 4 October 2006, the United States noted that China, in its Protocol of Accession, had committed to eliminate its system of examination and approval of trading rights, i.e., the right to import goods (into China) and the right to export goods (from China), and make full trading rights automatically available for all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships, within three years of its accession, or by December 11, 2004, the same deadline for China to eliminate most restrictions in the area of distribution services. The only exceptions applied to products listed in Annexes 2A and 2B, such as grains, cotton and tobacco, for which China reserved the right to engage in state trading. In April 2004, the National People's Congress issued the revised *Foreign Trade Law*. Except with regard to products reserved for state trading, this law – consistent with China's WTO obligations – provided for trading rights to be automatically available through a registration process for all domestic and foreign entities and individuals, effective July 1, 2004. Despite the revised *Foreign Trade Law*, other Chinese measures reserve the right to import publications, including books, newspapers and magazines, audiovisual products and electronic publications, to certain state-owned enterprises. These measures include the *Administrative Regulations on Publishing*, issued by the State Council in December 2001, the *Catalogue for the Guidance of Foreign Investment Industries*, issued by the National Development and Reform Commission ("NDRC") and MOFCOM in November 2004, the *Decisions of the State Council Regarding Entrance of Non-Public Capitals into Cultural Industries*, issued by the State Council in April 2005, the *Several Opinions on Canvassing Foreign Investment into the Cultural Sector*, issued by the Ministry of Culture, the State Administration of Radio Film and Television, the General Administration of Press and Publications ("GAPP"), NDRC, and MOFCOM in July 2005, and the *Procedures for the Examination and Approval of Establishment of Publication Importation Entities*, issued by GAPP in December 2005. Other relevant measures include the *Administrative Regulations on Audio and Video Products*, issued by the State Council in December 2001, and the *Administrative Regulations on Electronic Publications*, issued by GAPP in December 1997. The United States had asked China to clarify certain matters relating to China's justification for the measures in question, but China did not do so at the Market Access Committee's transitional review. The United States therefore asks that China respond to the following questions during the upcoming transitional review before the Council for Trade in Goods:

(a) When China responded to questions on this issue from the United States at the November 2005 meeting of the Council for Trade in Goods, it explained − with regard to the importation of books, newspaper and magazines − that the Chinese government had the right to restrict the importation or exportation of products to protect public morals, public interest and national security. China cited Article XX of GATT 1994. Please explain the relevance of GATT Article XX to China's Protocol of Accession. In addition, please explain why China's import restriction is "necessary" within the meaning of Article XX.

(b) Does China contend that it has the right to restrict the importation of audiovisual products and electronic publications on the same basis as it restricts the importation of books, newspapers and magazines? Please explain.

3. Export Quotas

5. In connection with the transitional review before the Market Access Committee held on 4 October 2006, the United States noted that, since China's accession to the WTO, the United States and other Members had expressed concern about China's export restrictions on coke, a key steel input. The United States further noted that China is the world's largest producer of coke, with total production exceeding 208 million MT in 2005, a 14 percent increase over 2004. For 2006, China announced an export quota of 14.3 million MT, similar to the level to which China eventually raised the quota in 2004 and 2005, despite the fact that WTO rules establish a general prohibition against export restrictions, with only limited exceptions. The United States had asked China if it had any plans to eliminate its coke export quota system, but China did not respond at the Market Access Committee's transitional review. In subsequent bilateral discussions focused on China's steel industry, China stated that it had no plans to eliminate its coke export quota system. The United States continues to urge China to eliminate its coke export quota system without further delay.

6. Does China have any plans to eliminate the export quota that it maintains on fluorspar? If not, why not?

4. Export Duties

7. On 27 October 2006, the Customs Tariff Commission of China's State Council announced a 5 percent duty on exports of coke. It also announced export duties on certain other steel-making raw materials and semi-finished steel products, including 10 percent export duties on 30 types of primary steel products, including pig iron and billet, and 15 percent export duties on certain non-ferrous alloying metals. China does not appear to apply export duties to finished steel products.

(a) Please explain China's trade policy objectives for the imposition of export duties on these steel-making raw materials and semi-finished steel products.

(b) Please justify these export duties under WTO rules, including paragraph 11.3 of Part I of China's Protocol of Accession and Annex 6 thereto.

8. In its 27 October 2006 announcement, the Customs Tariff Commission also announced a 10 percent duty on exports of fluorspar.

(a) Please explain China's trade policy objectives for the imposition of the export duty on fluorspar.

(b) Please justify this export duty under WTO rules, including paragraph 11.3 of Part I of China's Protocol of Accession and Annex 6 thereto.

5. Value-Added Tax Rebates for Steel Exports

9. On 15 September 2006, China's Ministry of Finance, NDRC, MOFCOM, General Administration of Customs and State Administration of Taxation ("SAT") announced reductions in the value-added tax ("VAT") rebates applicable to exports of certain finished steel products, but not others.

(a) Please explain China's trade policy objectives for these reductions in VAT export rebates.

(b) Does China provide VAT export rebates for steel-making raw materials and semi-finished steel products? Please explain.

(c) Please explain how these VAT export rebate changes for finished steel products relate to the changes in the export duties on steel-making raw materials and semi-finished steel products announced by the Customs Tariff Commission on 27 October 2006.

6. Value-Added Tax Rebates for Domestic Equipment Purchases

10. On 24 July 2006, SAT and NDRC jointly issued the *Trial Measures for the Administration of Tax Rebate on Domestically Manufactured Equipment in Foreign-Invested Projects*. This measure provides for VAT rebates in connection with purchases of domestically manufactured equipment by foreign-invested enterprises engaged in transportation or residential project construction or the exploration and development of offshore petroleum. Domestically manufactured equipment refers to equipment produced in China that is classified as a fixed asset, as well as to accessories and parts listed in the equipment procurement contract. No VAT rebate is available in connection with purchases of imported equipment under this measure.

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

(b) Please explain how the difference in the treatment of imported versus domestic products under this measure is consistent with Article III of GATT 1994.

7. Investment

11. In connection with the transitional review before the TRIMs Committee held on 25 October 2006, the United States noted that, in June 2006, China publicly issued the *State Council Opinions on the Revitalization of the Industrial Machinery Manufacturing Industries* (the *State Council Opinions*). The *State Council Opinions* identify 16 types of equipment manufacturing as the focus of the new initiative, including, *inter alia*, large equipment for clean and efficient power generation, critical semiconductor manufacturing equipment, civilian aircraft and aircraft engines, pollution control equipment, textiles machinery and large excavators. Policy supports for the initiative include preferential import duties of parts and material needed for R&D (vs. finished machinery), encouragement for procuring domestically manufactured new major technical equipment, a dedicated fund to facilitate capital market financing for domestic firms, and strict review of imports. The *State Council Opinions* discuss new controls on foreign investment in these sectors, including new approval requirements when foreign entities seek majority ownership or control and the strengthening of the management of equipment and machinery imports, as well as a number of other initiatives designed to promote, develop and expand the market share of domestic companies in these sectors in China. At the TRIMs Committee's transitional review, China answered some of the United States' questions about the *State Council Opinions* but left others unanswered. The United States therefore asks that China respond to the following questions during the upcoming transitional review before the Council for Trade in Goods:

(a) Please describe the legal effect of the *State Council Opinions*.

(b) Please describe the extent to which China has begun to implement the *State Council Opinions*. What is the status of any proposed implementing regulations?

12. In connection with the transitional review before the TRIMs Committee held on 25 October 2006, the United States referenced new regulations on mergers and acquisitions (M&A regulations) that were jointly issued in August 2006 by MOFCOM, the State-owned Assets Supervision and Administration Commission, SAT, the State Administration of Industry and Commerce, the China Securities Regulatory Commission and the State Administration of Foreign Exchange. The regulations strengthen MOFCOM's supervisory role over foreign investment, in part by requiring MOFCOM's approval of M&A transactions that it believes impact state economic security or involve famous Chinese brands. The regulations also place MOFCOM in the role of determining if the domestic acquisition target has been appropriately valued. At the TRIMs Committee's transitional review, China answered some of the United States' questions about the M&A regulations but left others unanswered. The United States therefore asks that China respond to the following questions during the upcoming transitional review before the Council for Trade in Goods:

(a) When does China plan on issuing implementing rules for the M&A regulations? Will an opportunity be provided for public comment on a draft of these implementing rules?

(b) Article 12 of the M&A regulations calls for MOFCOM's approval of any deal involving a "major industry", having "impact on the state economic security" or concerning "famous trademarks or traditional Chinese brands". This language is very broad and appears to require MOFCOM approval on most foreign investment transactions. Please explain what the quoted terms mean. Does China intend to define these terms in the implementing rules?

(c) Article 14 of the M&A regulations requires that MOFCOM approve the valuation of any merger or acquisition. What qualifications and experience will be required of those who determine the appropriate valuation? On what basis will they determine the value?

(d) Article 30 of the M&A regulations requires an "acquisition consultant" be hired to complete a stock swap-based deal. Article 31 sets forth general guidelines as to who will be able to qualify as such a consultant. These guidelines include the requirements that the acquisition consultant have a "good reputation", no "significant" criminal record and the "capability to conduct" the investigation. Please explain what the quoted terms mean. Does China intend to define these terms or otherwise provide more specificity regarding the necessary qualifications for an acquisition consultant in the implementing rules?

(e) Chapter 5 of the M&A regulations requires MOFCOM approval for any M&A transaction that meets specific criteria or involves "very large market share" or "other important factors" that affect competition. Please explain what the quoted terms mean. Does China intend to define the quoted terms in the implementing rules? What are the other applicable criteria?

(f) Some provisions in Chapter 5 of the M&A regulations address competition policy concerns. Will these provisions remain in place after China issues its Anti-Monopoly Law? Please explain.

13. In connection with the transitional review before the Subsidies Committee held on 26 October 2006, the United States had noted a report in the *International Herald Tribune* on 16 May 2006 that the Wuhan city government will spend between $1.5 billion and $3.0 billion to build a semiconductor plant that will make 12-inch wafers. According to the report, the Semiconductor Manufacturing International Corp ("SMIC") will design, build and manage the plant. The United States sought specific information about this project but China did not provide it at the transitional review before the subsidies Committee. The United States therefore asks that China respond to the following questions during the upcoming transitional review before the Council for Trade in Goods:

(a) What is the specific ownership and investment role of the Wuhan government in this project?

(b) What are the specific terms and conditions of SMIC's participation in this project?

8. State-Owned Enterprises

14. In connection with the transitional review before the Subsidies Committee held on 26 October 2006, the United States had asked several questions related to state-owned enterprises ("SOEs"), but China did not respond to them. The United States therefore asks that China respond to the questions below on SOEs during the upcoming transitional review before the Council for Trade in Goods.

15. Does China plan to implement a formal privatization programme in the future where it sells majority ownership in large SOEs to private entities? If so, when does it expect to begin this programme?

16. China revised its Company Law, effective 1 January 2006. Please describe the changes that were made with regard to permissible levels of foreign investment, business registration requirements and shareholder protection with regard to SOEs. What measures has China issued, or does China plan to issue, to implement these changes? Please explain.

17. What plans does China have to further improve corporate governance and increase accountability in large SOEs?

18. How will the new Bankruptcy Law affect SOEs? Will SOEs be allowed to go bankrupt if they are insolvent? What criteria will be used to determine if a company can go bankrupt, and who will make the decision to allow bankruptcy of an SOE? Please also describe the rights and obligations of creditor-banks with regard to SOEs that have declared bankruptcy.

19. The United States understands that SOEs in China have been exempt from paying any dividends to the state since at least 1994. This exemption apparently remains in place even though a number of large SOEs in China are highly profitable, contributing to more than 6 percent of GDP in 2004 according to some estimates. Given the clear link established between the exemption of dividend payments and continued overinvestment by SOEs, as well as the documented link between dividend pay-outs and good corporate governance, please explain what steps, if any, are being taken by China to change this policy.

20. According to a World Bank report, northeast China has significant potential for growth but its growth has consistently been lower than that of China's southeastern provinces. This report notes that the northeast region would benefit from less government intervention and more emphasis on developing the private sector. Instead, the SOE sector, with government financial support, crowds out private sector development and hinders growth.

(a) Please explain the extent to which government plans for the revitalization of northeast China include maintaining ownership of SOEs in the region. What is the policy justification for maintaining ownership of SOEs in the region?

(b) Considering that the private sector has been an important engine of growth in China, please explain what measures the government is taking to encourage the growth of the private sector in China's northeast region as part of its revitalization plans.

9. Border Trade

21. In connection with transitional reviews in past years, the United States has expressed concern about imports from border areas that continue to benefit from preferential treatment in the form of reduced import duties and/or VAT pursuant to measures such as Bulletin No. 27 and Bulletin No. 39, issued by the General Administration of Customs on 1 May 2003 and 11 June 2003, respectively. In explaining its concerns, the United States has referenced China's WTO commitments, as set forth in Part XIV of Annex 5A to China's Protocol of Accession (where China stated that it would eliminate preferential import duties for border trade) and paragraph 2(A) of China's Protocol of Accession (where China extended its obligations under the WTO Agreement and the commitments that it made in its Protocol of Accession to border trade regions as part of its commitment to apply uniformly its trade regime). Has China eliminated preferential border area treatment for any products during the past year? Does China have any plans to review its preferential treatment of imports from border areas?