

**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 fifth 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 26-27 October 2006.
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 the information in this respect on 23 October 2006, which has been circulated in document G/SCM/N/149.
3. Questions submitted in the context of the 2006 transitional review have been circulated in documents G/SCM/Q2/CHN/23 (United States) and G/SCM/Q2/CHN/24 (European Communities). The statements made in the context of this transitional review at the meeting of 26-27 October 2006 are reflected in the minutes of the meeting, the relevant paragraphs of which are annexed.

Excerpt from the minutes of the regular meeting of the Committee on Subsidies and Countervailing Measures held on 26-27 October 2006, (to be circulated as document G/SCM/M/58).

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

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

2. The Chairman 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 submission, received on 23 October 2006, had been circulated as document G/SCM/N/149. The United States and the European Communities had submitted written questions (G/SCM/Q2/CHN/23 and 24). Before proceeding to these questions, the Chairman opened the floor for any general comments.

3. The delegate of Canada stated that, in the context of the 2005 transitional review of China, Canada, jointly with the United States and Mexico, had submitted questions regarding China's steel policy (G/SCM/Q2/CHN/15). At that time, the delegate of China had provided partial, oral answers to some of the questions. He reiterated the request that answers to all questions be provided in writing and he recalled that the joint submission in document G/SCM/Q2/CHN/15 had highlighted some of Canada's concerns on China's steel policy announced in July 2005, which could have significant repercussions on the world steel market and on the Canadian steel industry. These concerns centred on the high degree of intervention of the Chinese Government in the direction and decision-making regarding the allocation of resources into and out of the steel industry. These concerns had been expressed in the context of the Working Party report accompanying China's Protocol of Accession in which China had agreed that the Government would not influence directly, or indirectly, commercial decisions on the part of state-owned or state-invested enterprises and had agreed that state-owned enterprises, including banks, should be run on a commercial basis. Canada's concerns were even more relevant today given the growing importance of China's steel production and capacity.

4. The delegate of the United States said that this was the fifth annual transitional review of China and that after this review the Committee would have completed more than one-half of the reviews required by China's Protocol of Accession. The United States continued to believe that the transitional review was a useful mechanism that helped to provide needed additional transparency with regard to China's trade regime and that also provided Members with a multilateral forum for conveying their concerns with China's WTO compliance efforts. As such, the transitional review mechanism was a useful supplement to bilateral discussions with China. In April 2006 China had

submitted its first subsidy notification since becoming a WTO Member in December 2001.¹ The submission of this document represented an important step for China as the notification obligation under the SCM Agreement was one of the more important transparency obligations of WTO Members. The United States welcomed the submission of this notification and looked forward to a full review of the notification after China had submitted its written responses to Members' questions. However, while the United States appreciated the efforts China had made with regard to its notification obligation, other important obligations remained of immediate concern to the United States. In this respect, the delegate mentioned the continued existence of prohibited subsidy programmes that China had specifically committed to eliminate upon accession to the WTO almost five years ago. A number of these Chinese programmes, some of which were reported in China's notification and some of which were not, provided subsidies contingent upon exportation or upon the use of domestic over imported goods. All of these programmes should be terminated without delay and without pre-conditions.

5. The delegate of Japan stated that, although Japan had not submitted questions in the context of this year's transitional review, Japan shared the concerns expressed by the United States and the European Communities in their written submissions. Japan appreciated the efforts that China had made in submitting its first subsidy notification, but there still remained uncertainty around China's subsidy regime. Therefore, Japan would like to continue to participate in the discussions on this issue in this Committee.

6. The Chairman then invited the delegation of the United States to introduce the questions in document G/SCM/Q2/CHN/23.

7. The delegate of the United States said that the questions posed by his delegation pertained to prohibited subsidy programmes that had been in existence for quite some time and to other possible prohibited subsidy programmes. In this connection, the United States had sought clarifications regarding disturbing information suggesting that China might be introducing new prohibited subsidies that targeted and extended financial support for the expansion of exports in certain industries, such as textiles, autos and auto parts, and agriculture. The United States was disappointed that China's subsidy notification did not cover certain types of subsidies. For example, there was no reporting of any subsidies that might have been provided through China's state-owned banks. He noted that this issue was covered in paragraphs 172 and 173 of China's Working Party report and that in paragraph 173 of that report China stated that "it was attempting to reduce the availability of certain types of subsidies, in particular by making government-owned banks operate on a commercial basis". China had also agreed at the time that it would work towards a full notification of its subsidies. Therefore, the United States had posed several questions relating to the banking and financial sector in China. For example, it had asked for an update regarding China's plans for banking reforms and specifically about China's plans for meeting its objective that the big four state-owned banks should be run on a commercial basis. It had also enquired about policies affecting the big four state-owned banks and sales of non-performing loans to China's asset management companies. In addition, the United States had asked China to explain whether its understanding was correct that eligibility for long-term loans was generally contingent upon consistency with state industrial policies and to explain how these banks were able to issue loans in a market-oriented manner if, in fact, they were required to take into account state industrial policies. In another part of its written submission, the United States had asked China to explain how its new bankruptcy law would, or would not, apply to state-owned enterprises if they were insolvent.

8. The delegate of the United States said that his delegation's written submission also addressed the important area of export credits, an issue that required more transparency. Specifically, the United States had asked a number of questions seeking information about the terms and conditions of export credit financing provided by China's Exim Bank and by the China Development Bank.

¹ G/SCM/N/123/CHN.

9. Finally, in reviewing China's subsidy notification, the United States had found no reporting of subsidies provided by provincial and local governments in China. Paragraph 173 of China's Accession Working Party report highlighted "subsidies provided by sub-national governments", as an area in which reporting was needed. He noted in this respect that at the special Committee meeting to review 2005 new and full subsidy notifications the delegate of China had indicated that China was in the process of preparing a notification with respect to those subsidies. The United States recognized that the compilation of all the information missing from China's subsidies notification would require significant time and effort, but this did not relieve China of its obligation to notify all of its subsidy programmes as required by Article 25 of the SCM Agreement and the commitments China had undertaken in its Protocol of Accession.

10. In summary, the United States welcomed the submission of China's first subsidy notification but remained troubled by China's continued use of what appeared to be prohibited subsidy programmes. As a major beneficiary of the multilateral trading system, China bore a responsibility, like other major trading powers, to ensure that its trade regime was consistent with the fundamental rules. If China failed to follow the fundamental rules of the trading system and failed to abide by its explicit accession commitments, China risked undermining the system itself and diminishing the economic and commercial benefits that China derived from it. The United States looked forward to China's responses to its written questions.

11. The delegate of China stated that he had listened very attentively to the statements made by other delegations and that he had already provided a detailed explanation of China's position on the issues raised by these delegations in his statement at the special Committee meeting to review the 2005 new and full subsidy notifications. China was determined to observe the obligations of the SCM Agreement but collecting information in a country as large as China posed enormous difficulties. China had made great efforts in this respect and had received assistance from the Secretariat to help Chinese officials to understand the SCM Agreement and determine which policies should be notified. Regarding the issues raised by the United States with respect to prohibited subsidies, China had explained in bilateral consultations with the United States why it considered that the policies referred to by the United States were not subsidies inconsistent with the SCM Agreement. His delegation would provide more details on this matter in its forthcoming responses to the questions posed by a number of delegations on China's subsidy notification. China was of the view that it had faithfully observed its obligations under the SCM Agreement. All subsidies identified in Annex 5(b) to China's Protocol of Accession had been eliminated. While there could be further discussions on whether or not certain subsidy programmes were WTO-inconsistent, doubts about China's determination to observe its WTO obligations were unfounded.

12. The delegate of China reiterated the position of his delegation that reform measures concerning the banking sector had nothing to do with the concept of subsidy as defined in the SCM Agreement. China had repeatedly stressed this point in discussions in this Committee in previous years and had provided a substantial amount of information on the banking sector and its reform which enabled Members to form an opinion as to whether or not China's state-owned commercial banks were operating on the basis of commercial considerations. With respect to the issue of transparency, China considered that its 2005 new and fully subsidy notification was complete, based on the information gathered on subsidies maintained at the central government level. He emphasized in this respect that the notification covered a particular time period and that determining whether a measure constituted a subsidy often posed technical difficulties.

13. Regarding the textiles sector, the delegate of China indicated that, as a consequence of the deepening of the reform of the financial sector in China, there were no longer government credit policies that would direct commercial banks to provide loans to certain sectors or enterprises. Policies of the Chinese Government that could have an effect on the credit decisions of these commercial banks regarding the textiles sector included the Decision of the State Council on the Reform of the

Investments Regime, Provisional Regulations on Promotion of Industrial Structure Adjustment, and Regulations on Guidance on the Direction of Foreign Investment. The Decision of the State Council on the Reform of the Investment Regime specifically provided that investment projects in the textiles sector should be decided by enterprises themselves in accordance with market considerations, with loans independently audited and examined by banks. Regarding the question posed by the United States in respect of the Notice of Relevant Policies to Promote Chinese Textile Enterprises to Shift to New Ways of Growth and Support Them to Go Global, the delegate of China explained that the Chinese Government would arrange a special fund to support technology innovation and research and development projects, including with respect to new fibre materials and products and water and energy saving techniques. This very recent programme was designed particularly for small and medium-size enterprises and was not contingent upon export. It aimed at accelerating the structural adjustment and technology upgrading of the textile sector, in view of the deteriorating trading environment and the unfair treatment faced by Chinese manufacturers. This was the first programme introduced specially for the textiles sector. Before the introduction of this programme, the Chinese Government had no policy whatsoever that provided direct subsidies specifically to the textiles sector. On the question of the United States regarding the Ten Thousand Miles March for Brand Building, he stated that this initiative was not limited to the textiles and clothing sector but applied to all industries across the board. This particular programme involved the organization of the participation of enterprises in regional, national and international exhibitions, brand publicity and promotion activities, and exchanges, training and workshops concerning brand promotion etc. Therefore, this programme did not involve subsidies as defined in the SCM Agreement.

14. Regarding the question of the United States concerning automobiles, the delegate of China stated that the Minister of Commerce of China (MOFCOM) and the National Development and Reform Commission (NDRC) had recently identified eight cities namely, Changchun, Tianjin, Taizhou, Shanghai, Wuhan, Xiamen, Wuhu and Chongqing where production of automobiles and components for export were mainly concentrated. However, the identification of these eight cities did not entail any specific measures to offer incentives.

15. In response to the question posed by the United States on China's measures with respect to semi-conductors, the delegate of China stated that China's 2005 new and full subsidy notification already contained the information regarding existing assistance provided to the semi-conductor sector. The Chinese Government was currently studying possible further policies related to this sector, which would be in accordance with WTO rules and the common practice of other countries. The Chinese Government had long ago abolished the practice of planning the development of individual enterprises. Thus there was no problem of coordination between central, provincial and local government, as implied by the question posed by the United States. As to the specific point mentioned in the question regarding Wuhan city, his authorities had not been able to obtain much detailed information on this issue as they had received the question at a very late stage but preliminary responses from relevant sources indicated that there was no subsidy involved in this project.

16. On the question of the United States regarding agriculture, the delegate of China stated that it was true that the NDRC had issued a notice announcing an exemption from the railway construction fund levy for all grains bound for overseas markets. However, it was important to note that another notice issued by NDRC in 2002 announced an exemption from the railway construction fund levy for all imported grains as well as for all grains for sale in the domestic market, effective 1 April 2002. In other words, the exemption from this railway construction fund levy of grains bound for the overseas market had been introduced after the exemption from this levy of imported grains as well as grains for the domestic market. As to the MOFCOM five-year plan for the export of agricultural products, the delegate of China explained that the six measures mentioned in the question of the United States were: tightening quality and food safety control; promoting brand publicity; strengthening training in the information services; promoting the establishment of agriculture associations; exploring support

measures, and finally intensifying diplomatic efforts for a sound trading environment. These were measures of a general guidance nature and did not involve specific benefits.

17. With respect to the issue of export credit, the delegate of China stated that the export credit business of the China Export and Import Bank was consistent with the exception provided in Item k of Annex I to the SCM Agreement. Detailed information on the export credit programmes of the China Export and Import Bank was available on its website. China had provided a long and detailed written response to the same questions posed in the framework of the first Trade Policy Review of China. While the details of these programmes were complicated, the export credit business of the China Export and Import Bank was consistent with the provisions of the SCM Agreement. With regard to the export credit business of the China Development Bank, after verification, his authorities could confirm that the export credit adopted by the Bank was a market-oriented business.

18. The delegate of China stated that the position of his Government with respect to VAT refund schemes was that such schemes did not involve subsidies because the refund rate was lower than the rate levied.

19. Finally, the delegate of China stated that it appeared that certain Members had strong doubts with regard to the subsidy programmes in China and that they considered that China's policies of a general guidance nature were subsidies. China could only provide subsidies if legislation existed involving the transfer of specific benefits. In this regard, consultations with various government agencies with regard to some of the questions posed to China, for example, on the steel development policy, revealed little evidence of the existence of subsidies. Thus he considered that Members should not exaggerate the situation regarding subsidies in China.

20. The delegate of the United States thanked the delegate of China for the detailed responses given to the questions of the United States. He noted that on textiles the delegate of China had explained that a fund had been arranged to finance new product and technology developments but that none of the funding was inconsistent with WTO rules and none of the funding was contingent on export performance. In this connection, he wondered why the Government of China found it necessary to subsidize or to provide these funds at all in an industry such as textiles, where China had a clear competitive advantage, and given that trade in textiles was expanding at a very high rate, including China's exports. He also asked how the fact that China's recent measures to cool down the economy, specifically to cool down bank lending, had entailed the use of administrative means or measures could be reconciled with the claim of the delegate of China that, as a result of reforms of the investment regime, there was no longer government involvement in the provision of credits by commercial banks.

21. With respect to the automobile sector, the delegate of the United States wondered how concentration of production of automobile and automobile parts could take place if no incentives were used. He wondered whether the delegate of China was suggesting that in China the market just happened to determine that production should be located in the eight cities designated by the Government.

22. Lastly, on banking, the delegate of the United States said that there were numerous sources including investment banks, NGOs, IGOs and academic studies that all noted problems in China's banking sector, particularly with respect to reforms on the institutional side. Since there was some confusion about the state of affairs in China's banking sector, he could perhaps read through some of these sources at the next meeting and have the delegate of China respond to them. All of these sources were publicly available. He asked whether China agreed with the United States that when a state-owned bank was providing a loan to an uncreditworthy company or was providing loans at below-market interest rates to specific groups of companies, for example, state-owned enterprises, that should be considered to be a subsidy. Secondly, the issue of non-performing loans had been

discussed quite thoroughly in much of the academic literature and his delegation understood that many of the non-performing loans had been purchased by asset management companies in China. One could perhaps argue that these were prudential measures that any government would take to provide for the stability of its financial system. However, the United States was also concerned about what the asset management companies were doing with the non-performing loans that they purchased. Some of the non-performing loans that were purchased by asset management companies had been converted into equity in the companies that had originally taken out the loans. He asked China if it could provide any more information on how such companies were chosen in terms of eligibility for such debt-equity conversions and on the terms on which such debt equity conversions were made.

23. With regard to the questions raised by the European Communities in document G/SCM/Q2/CHN/24, the delegate of China stated that he had already addressed the issue of VAT refund schemes and had explained the situation regarding subsidy programmes of local governments. The support provided by the Guangdong Provincial Government, mentioned in Question 4.2 of the European Communities, did not constitute an export subsidy because this programme was aimed at promoting the participation of small and medium-sized enterprises in the international market and was basically the same as the programme that existed at the level of the central government, which had been described in the notification recently submitted by China.

24. In response to the comments of the United States, the delegate of China stated that the Chinese textile sector was facing intense competition, particularly in low-end products. The Agreement on Textiles and Clothing required Members to make efforts toward structural adjustment, and China was actually making efforts in this regard. The measures adopted by China in this regard were not inappropriate, particularly in view of the difficulties faced by the Chinese manufacturers in the developed markets.

25. With regard to the questions raised by the United States on measures taken by China to cool down its economy, he stated that in this respect China did not employ straightforward administrative measures, but relied, instead, on a combination of macro-economic policy measures. With regard to automobiles, the delegate of China stated that MOFTOC and the NDRC had simply recognized the fact that as a result of years of competition production of automobiles in China had become concentrated in these eight cities. However, this did not mean that the Government was providing any incentives.

26. The delegate of China stated that China differed with the United States as to whether the issues relating to the banking sector should be discussed in this Committee but that the market response to the public listing of the state-owned banks showed that the direction of China's reform of the banking sector was sound.

27. The delegate of the European Communities noted that the delegate of China had pointed out with regard to the VAT refunds that these refunds were lower than the VAT paid. In this respect, and irrespective of legal assessment of this issue, the European Communities considered that such a policy was certainly not neutral to trade flows, because if the refund was lower than the duty paid, this clearly meant that the downstream industry using this product for which this low VAT refund was given, was favoured. The better access enjoyed by the downstream industry to certain products which were artificially kept in the country favoured the downstream industry also in terms of its consequent export performance. The European Communities shared the strong concerns that had been expressed by many European industries with respect to the potential, if not actual, trade-distorting effect of this practice. With regard to the response of the delegate of China to one of the sub-items in Question 4 of document G/SCM/Q2/CHN/24, he asked the delegate of China to identify the particular programme in the full subsidy notification of China to which he had referred. With regard to the other sub-items of this Question, he noted that these questions were very detailed and identified precisely who was providing, or perhaps providing, the assistance which looked like an export subsidy on the face of it.

While it might be difficult for a big country for China to lay its hands on each and every subsidy and notify this, at least with regard to these three items the European Communities would have very much appreciated it to get a more precise reply because it had given a clear indication where China's Government could have found, or can still find, more information with regard to these issues.

28. The delegate of China stated that he had taken note of the comments of the delegate of the European Communities and that the particular questions concerning these possible subsidies of the local government would be taken into consideration in the information gathering process with regard to subsidies provided at the level of local governments.

29. The Chairman stated that there were no guidelines for the report contained in the Protocol. Following the review at last year's fall meeting, the Chairperson, acting on her own responsibility, had prepared a brief, factual report, with references to the documents concerned, and attaching the portion of the minutes of the meeting which relate to the transition review. He proposed that the Committee agree to follow the same procedure. It was so decided.
