

**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 CHINA¹

The following communication, dated 13 October 2006, is being circulated at the request of the Delegation of the United States.

Transparency

1. Transparency is one of the fundamental principles underlying the WTO Agreement. Without sufficient transparency, the ability of Members to assess China's compliance with its obligations under the Subsidies Agreement is compromised.
2. In April 2006, China submitted its first subsidies notification to the WTO since its accession in December 2001. While the United States appreciates the effort that it took to complete and translate this notification, the United States is concerned because the notification is incomplete, as it omits substantial subsidies that China maintains. China also notified several subsidies that appear to be prohibited, but without making any commitment to withdraw them, while China failed to notify other subsidies that appear to be prohibited.
3. In addition, China still has not responded in writing to questions that the United States submitted pursuant to Article 25.8 of the Subsidies Agreement in October 2004 (G/SCM/Q2/CHN/9).
4. In July 2006, the United States submitted extensive comments and questions regarding these matters. We look forward to receiving China's responses.

Industry Issues

Textiles

5. In WT/TPR/M/161/Add.2, page 77, China states, "The government has no policy whatsoever that provides direct subsidy to textile and apparel companies." The United States has specific information on sub-central government level subsidy programmes that appear to be export-contingent and only available to textile and apparel exporters. One example involves the subsidies provided by Ningbo City, as described in G/SCM/Q2/CHN/19. How does the central government monitor

¹ G/SCM/N/123/CHN

provincial and local government policies targeting textiles and apparel exporters to ensure compliance with China's WTO obligations? When does China intend to withdraw the Ningbo City programme?

6. In a 2004 China Daily article, Gao Fang, secretary-general of the China Cotton Association, referred to "excessive lending to the textile industry". The article also said, "It has been reported that the Chinese Government will loosen up credit lending controls to textile companies."

- (a) What guidance has the Chinese government provided to state-owned commercial banks with regard to loans to textiles and apparel companies? Please identify all relevant notices, directives, etc. providing guidance specific in this area.
- (b) What is the percentage of loans in the textiles and apparel sectors that are non-performing?

7. Earlier this year, the Ministry of Commerce ("MOFCOM") issued a notice on "Sell Well" brands and a notice on a programme entitled "Ten Thousand Miles March for Brand Building", which involves brand appraisal, brand promotion, brand marketing and brand protection for 45 types of products, including apparel products such as shirts and suits.

- (a) Please describe the benefits provided under this programme.
- (b) Please explain how the notices referenced above relate to China's programme to promote famous name brands.

8. Recently, the Ministry of Finance, the National Development and Reform Commission ("NDRC") and MOFCOM jointly issued the "Notice of Relevant Policies to Promote Chinese Textile Enterprises to Shift to New Ways of Growth and Support Them to Go Global". Among other purposes, this measure is designed to support technology innovation and development of core technologies and equipment in the textiles sector. This measure is also designed to provide funds to textiles companies that set up distribution channels in overseas markets.

- (a) Please describe the specific benefits planned under this measure. Are these benefits contingent upon export?
- (b) Given the substantial increases in exports of textiles and apparel products from Chinese textile enterprises in recent years, please explain why the Chinese government would issue a measure providing new funds encouraging exports by Chinese textiles companies.
- (c) Please explain how the issuance of this measure conforms with China's statement in WT/TPR/M/161/Add.2, page 77 that, "The government has no policy whatsoever that provides direct subsidy to textile and apparel companies."

Automobiles

9. On 18 August 2006, the *Financial Times* reported that, in order to become a bigger exporter of cars and parts, the Chinese government announced that eight cities have been designated as special zones for sales overseas of cars and components. Under the policy announced by MOFCOM Minister Bo Xilai, favoured companies would receive preferential loans and export tax rebates.

- (a) Please identify the eight cities that have been designated as special zones for overseas sales.

- (b) Please describe the incentives being offered to manufacturers/exporters of automobiles and components, and the eligibility criteria that must be met in order for companies to qualify for these incentives.
- (c) Please explain the relationship between the creation of the special zones for overseas sales of automobiles and auto components and Chinese government national development policies for the Chinese automobile industry.

Semiconductors

10. On 20 July 2006, the *China Daily* reported that the NDRC is developing a new aid policy for semiconductors. Among the key components of the plan are income tax reductions and exemptions. The plan also includes research loans and using research expenditures to offset taxes (in addition to the RMB 500 million fund previously established to help semiconductor companies' research). Other proposals include allowing tax reductions on imported equipment and setting up a specific fund for integrated circuit design.

- (a) What is the time frame for an announcement from the NDRC on this new aid policy for the Chinese semiconductor industry?
- (b) What types of incentives will be included in this new policy?

11. On 16 May 2006, the *International Herald Tribune* reported 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. The Semiconductor Manufacturing International Corp ("SMIC") will design, build and manage the plant.

- (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?

12. Please explain how the central, provincial and local governments have coordinated development plans for the semiconductor industry.

Agriculture

13. The NDRC issued a notice that became effective on 20 August 2006, announcing an exemption from the railway construction fund levy for all grains bound for overseas markets. Please explain how this support is consistent with China's WTO obligations, including those under Article 3 of the Subsidies Agreement and paragraph 12.1 of China's Protocol of Accession.

14. MOFCOM released its first agricultural export five-year plan on 24 August 2006. Six measures to support agriculture exports were included in the announcement, including expanding agricultural export support systems and increasing diplomatic representations.

- (a) Please describe the nature of the benefits to be provided under MOFCOM's agricultural export support plans.
- (b) Please explain how this support is consistent with China's WTO obligations, including those under Article 3 of the Subsidies Agreement and paragraph 12.1 of China's Protocol of Accession.

15. In connection with last year's transitional review before this Committee, the United States submitted questions to China regarding export support programmes in Jiangxi Province and Henan Province (G/SCM/Q2/CHN/14). To date, China has not responded to those questions. Please provide responses to those questions, explaining how these programmes are consistent with China's obligations under Article 3 of the Subsidies Agreement and paragraph 12.1 of China's Protocol of Accession.

Banking and Financial Sector

16. In the Working Party Report accompanying China's Protocol of Accession (WT/ACC/CHN/49, para. 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 . . .". In connection with last year's transitional review before this Committee, the United States sought information about the Chinese government's efforts to move 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) toward running on a more commercial basis. The United States commented that the Chinese government's attempts to improve corporate governance, loan classification standards and prudential rules and regulations were well-intentioned and welcome, but it also appeared that more fundamental reforms and stronger enforcement were still needed, particularly on the institutional side. Please provide an update on whether China is contemplating more fundamental banking reforms. If so, please describe those plans. If not, what are China's plans for meeting its objective that the Big Four banks should be run on a commercial basis and that bank lending be more consistent with commercial practices?

17. In previous transitional reviews before this Committee, the United States has submitted questions about China's policies towards the Big Four state-owned banks and non-performing loans (NPLs) as well as China's asset management companies. The United States appreciates the responses that China has previously provided. At this time, the United States seeks the following clarifications:

- (a) Please describe how loans are chosen to be 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 how the operation and functions of China's asset management companies are evolving, consistent with the objective that state-owned banks be run on a commercial basis.
- (c) The United States is familiar with the *Rules on Accounting Practices of Financial Asset Management Companies*, issued by the Ministry of Finance ("MOF") on 30 June 2000, and the *Rules on the Disposition of Assets by Financial Asset Management Companies*, issued by MOF on 8 November 2000). Please explain how it is determined which companies with NPLs are eligible for debt-to-equity conversions. Are there different rules for state-owned enterprises (SOEs) and private companies?

18. The United States understands that eligibility for long-term loans for fixed-assets and project financing from the Industrial and Commercial Bank of China, the China Construction Bank and the Bank of China must be consistent with state industrial policies. Is that correct? If so, please explain how these banks are able to issue loans in a market-oriented manner if they are required to take into account state industrial policies.

Export Credits

19. According to publicly available information, China Exim Bank offers loans at low interest rates to finance manufacturing projects that are able to generate favourable economic returns with secured repayment capacity and are tied to Chinese exports of mechanical and electronic products and complete sets of equipment, and may be considered as official development assistance. The Chinese companies implementing these projects should be medium-sized and large SOEs. The loans appear to be on advantageous terms and conditions. There also appears to be an absence of any risk/exposure fees to compensate for future potential losses and the operational cost of the programme.

- (a) Please describe the terms and conditions of these loans.
- (b) Please explain how this programme is consistent with the disciplines of the Subsidies Agreement.
- (c) Please clarify the definition of “official development assistance” that the China Exim Bank uses to classify this programme as official development assistance.

20. The China Exim Bank, in order to support the Chinese government’s “going global” strategy, provides loans on advantageous terms and conditions to selected state-owned enterprises in certain selected sectors to support their international strategies. Selected sectors include construction, electronics, mechanical, high and new technology products/capital goods, and telecommunications and power equipment. While the China Exim Bank typically charges a competitive interest rate (which the China Exim Bank defines as either a fixed rate based on the OECD Commercial Interest Reference Rate for the currency or a floating rate of Libor + spread), there appear to be provisions made for special cases in which a “preferential” interest rate is charged, longer than standard repayment terms are offered and/or certain fees are waived.

- (a) Please describe the terms and conditions of the loans provided under “preferential” circumstances and what criteria are used for determining preferential treatment.
- (b) Please explain how this programme is consistent with the disciplines of the Subsidies Agreement.

21. The China Development Bank has reportedly expanded its focus to support sectors that are considered to be essential to China’s long-term competitiveness and specifically for companies engaging in research and development, Chinese “brand name” companies and certain companies in their overseas expansion. In part, this support takes the form of export credits. Please describe the terms and conditions of this financing and explain how this programme is consistent with China’s obligations under the Subsidies Agreement.

State-Owned Enterprises

22. 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?

23. 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.

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

25. 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.

26. 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.

27. 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.

Price Controls

28. 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.

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

30. Has China implemented any new price controls or other regulatory measures affecting pricing with regard to any goods not listed in Annex 4?
