WORLD TRADE ORGANIZATION

G/C/W/587
5 November 2007

(07-4795)

Council for Trade in Goods Original: English

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 2 November 2007, 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 23 November 2007 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. Export Restrictions

1.1 The United States remains concerned about China's export quotas (and related export licensing requirements) on numerous raw materials. For example, China maintains export quotas on (i) antimony, (ii) coke, (iii) fluorspar, (iv) indium, (v) magnesium carbonate, (vi) molybdenum, (vii) rare earths, (viii) silicon, (ix) talc, (x) tin, (xi) tungsten and (xii) zinc, despite the fact that China is the world's leading producer of each of these raw materials (except for molybdenum, for which China is the world's second leading producer), and despite the fact that China maintains no comparable restrictions on domestic sales of these raw materials. China's export quotas on these raw materials significantly disadvantage U.S. and other foreign producers, which use these raw materials to make a wide range of downstream products, such as steel, chemicals, ceramics, semiconductor chips, refrigerants, medical imagery, aircraft, refined petroleum products, fiber optic cables and catalytic converters, among numerous others. The export quotas create disadvantages for foreign producers by artificially increasing China's export prices for these raw materials, which also drives up the world prices. At the same time, the export quotas artificially lower China's domestic prices for these raw materials due to domestic oversupply, enabling China's domestic downstream producers to produce lower-priced products from these raw materials and thereby creating significant advantages for China's domestic downstream producers when competing against foreign downstream producers both in the China market and in export markets.

(a) For each of the 12 raw materials identified above, please separately explain how China justifies its use of the export quotas under Article XI of the General Agreement on Tariffs and Trade 1994 and identify any measures relevant to China's justification.

(b) Please separately describe China’s plans for eliminating the export quotas on each of the 12 raw materials identified above. If China does not have any such plans, please explain why it does not.

(c) The United States understands that China has not notified to the WTO any of the export quotas on the 12 raw materials identified above, despite China’s commitment in paragraph 8.1(b) of Part I of China’s Protocol of Accession to notify all export quotas “listed separately by HS tariff line and with the quantities associated with the restriction... and the justification for maintaining the restriction or its scheduled date of termination.” Is the United States’ understanding correct? If so, please indicate when China will submit the required notifications.

1.2 For many of the raw materials on which China maintains export quotas, China also imposes export duties. For example, China imposes export duties of 15 percent on coke, 15 percent on fluorspar, 15 percent on indium, 5 percent on magnesium carbonate, 15 percent on molybdenum, 15 percent on rare earths and 15 percent on silicon. However, in Section 11.3 of Part I of its Protocol of Accession, China committed not to impose export duties on any goods not appearing on the list of goods subject to export duty in Annex 6 of its Protocol of Accession. Coke, fluorspar, indium, magnesium carbonate, molybdenum, rare earths and silicon do not appear on the Annex 6 list. Please explain how China justifies its imposition of export duties on these raw materials in light of the commitment that China made in Section 11.3 of Part I of its Protocol of Accession.

2. VAT on Agricultural Goods

2.1 The United States understands that many agricultural products are exempted from China's 13 per cent value-added tax (VAT) normally applicable to agricultural products when sold domestically. For example, it appears that domestic sales of agricultural commodities produced and sold by farmers in China, such as wheat, cotton and corn, are exempted from the VAT. In addition, it appears that domestic sales of agricultural inputs produced in China, such as seed, pesticide, herbicide, agricultural machinery and certain fertilizers, are exempted from the VAT. However, when imports of these same products are sold in China, it appears that they are assessed the VAT at the rate of 13 per cent.

(a) In connection with this year’s transitional review before the Committee on Agriculture, China confirmed that domestic sales of agricultural commodities produced and sold by farmers in China, such as wheat, cotton and corn, are exempted from the VAT. However, China did not address the United States’ further questions about the discriminatory treatment of imports of these same products when sold in China. China instead focused on rebates of the VAT when the domestically produced agricultural commodities were later exported. The United States notes that it is not asking about rebates of the VAT upon export, but rather only about the VAT treatment of two types of sales taking place in China, i.e., domestic sales of agricultural commodities produced in China versus domestic sales of imports of these same products. With that distinction in mind, can China confirm that imports of agricultural commodities such as wheat, cotton and corn when sold in China are assessed the VAT at 13 per cent? If so, can China identify the applicable measures? Can China also explain how it justifies these VAT exemptions under its WTO obligations, including Article III of the General Agreement on Tariffs and Trade 1994 (GATT 1994) and Article 3 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement)?

(b) Can China confirm that domestic sales of agricultural inputs produced in China, such as seed, pesticide, herbicide, agricultural machinery and certain fertilizers, are exempted from the VAT, while imports of these same products when sold in China are assessed the VAT at 13 per cent? If so, please identify the applicable measures. Please also explain how China justifies these VAT exemptions under its WTO obligations, including Article III of the GATT 1994 and Article 3 of the SCM Agreement. The United States notes, as above, that it is not asking about rebates of the VAT upon export, but rather only about the VAT treatment of two types of sales taking place in China, i.e., domestic sales of agricultural inputs produced in China versus domestic sales of imports of these same products.

3. Textiles

3.1 The United States has identified a number of programs under which China appears to provide export-contingent subsidies to Chinese textile sector companies. For example, according to Xiang Zheng Fa (2007) No. 1, the Ningbo Xiangshan County Foreign Trade and Economic Cooperation Bureau offered a new subsidy, effective beginning 1 January 2007. A stated goal of this program is to "accelerate exports", and it specifies various awards, which are contingent upon export. Textile companies receive "additional awards" of RMB 0.02 for each US dollar above the previous year's actual exports for "non-quota" textile sector goods exported to "quota areas" (e.g., the United States and the European Union). In addition, certain textile sector companies that export to "quota areas" are eligible for an "award" of up to RMB 20,000 for a portion of the cost to purchase export quota rights.

(a) Please describe the specific benefits that are available to textile and apparel companies under this program. Are these benefits contingent upon export performance?

(b) Please describe what steps the central government is taking to prevent and discourage provincial and sub-regional governments from establishing WTO-prohibited subsidy programs targeting the textile and apparel industry.

3.2 Information available to the United States indicates that the *Management Measures for the Xiamen City Key Exporting Enterprises Support Fund*, issued by the Xiamen City Trade Development Bureau and the Xiamen City Financial Administration Bureau on 5 July 2006, provides grants to exporting enterprises where the level of benefits is determined by the enterprise's level of exports. This measure stipulates that "Xiamen Exporting Backbone Companies" are eligible for grants of up to RMB 600,000 depending on certain criteria, including: (1) the level of exports, (2) export growth, (3) ranking among the city's top exporters, (4) the enterprise's export plan for 2006-2010, and (5) Xiamen export content. Enterprises from 18 listed sectors, including the textiles and apparel sectors, are given preferential treatment under this measure. One of the stated goals of this measure is to encourage enterprises to expand exports of key products defined in the relevant 11th Five-Year Plans. The measure also provides a one-time award of RMB 500,000 to enterprises with exported products of at least $100,000,000 per year and MOFCOM assessment as a "Famous Export Brand." Enterprises that export at lower levels receive lesser awards. Other provisions in this measure addressing "Xiamen Famous Export Brands" provide grants of up to RMB 500,000 to eligible enterprises exporting over $3,000,000. Finally, one other provision states that enterprises with "big export development potential" are eligible for support of RMB 1,000,000.

(a) Please describe the specific benefits that are available to textile and apparel enterprises under this measure. Are these benefits contingent upon export performance?

(b) Please describe the relationship between central government policies and programs, such as those contained in relevant Five-Year Plans, and the export-contingent benefits that sub-national governments provide to enterprises.

(c) What is the funding source for the benefits available under the measure described above?

(d) Please describe the relationship, if any, between the Xiamen City Key Exporting Enterprises Support Fund and the Textile Support Fund the Chinese representative described in G/SCM/119 No. 14?

4. Technology – Software and Integrated Circuits

4.1 In 2000, the State Council issued the *Notice of the State Council on Issuing Relevant Policies on Encouraging the Development of Software and IC Industry* (Guo Fa (2000) No. 18), which sets out a plan to encourage and promote China's software and integrated circuit (IC) industries. Information available to the United States indicates that China has introduced a number of programs in order to implement the policies set forth in the *Notice of the State Council on Issuing Relevant Policies on Encouraging the Development of Software and IC Industry*.

4.2 The United States understands that pursuant to the policies set forth in the *Notice of the State Council on Issuing Relevant Policies on Encouraging the Development of Software and IC Industry,* the *Outline of Software Industry Revitalization Movement (2002-2005)* (Guo Fa 2002 No. 47) was issued on 24 July 2002. It is also the United States' understanding that the *Outline of Software Industry Revitalization Movement* details goals for export growth targets through the implementation of policies, including the establishment of several software export bases. The *Outline of Software Industry Revitalization Movement* further seeks the establishment of a number of funds, including the Electronic Information Industry Development Fund, the 863 Fund, the State Science and Technology Fund, the Industry Technology Research and Development Fund, and the Scientific Medium and Large-Sized Creation Fund. In June 2006, an official from China's Ministry of Commerce (MOFCOM) stated that China would establish 15 software export bases pursuant to the 11th Five-Year Program (2006-2010). (See "China to Establish 15 Software Export Bases in 2006-2010," Asia Pulse, 22 June 2006.) On 1 December 2006, MOFCOM designated the cities of Guangzhou, Nanjing, Hangzhou, Chengdu and Jinan as "National Software Export Bases." (See "Report on Chinese Subsidies for Period Ending December 8, 2006," available at www.mofcom.gov.cn/aarticle/difang/yunnan/200611/20061103649443.html.) The MOFCOM official indicated that MOFCOM will provide more support to the national software export bases in the form of interest rebates, R&D funding, personnel training, export credit loans and credit insurance.

(a) What specific incentives are offered to software manufacturers/exporters under the Outline of Software Industry Revitalization Movement and the various funds and programs identified above?

(b) Are any of the offered incentives contingent upon export performance?

4.3 In a notice issued on 1 August 2007, and posted on the website of the National Development and Reform Commission ("NDRC"), the NDRC, the Ministry of Information Industry, the General Customs Administration and the State Administration of Taxation released its list of 94 semiconductor manufacturers, chip packaging and testing enterprises and silicon material producers that have been designated as "state-encouraged" integrated circuit enterprises. (See www.ndrc.gov.cn/zcfbtz/2007tongzhi/t20070814_153464.htm.) It is the United States' understanding that this designation was based on the certification rules from state-encouraged IC enterprises issued in 2005. According to the 1 August 2007 notice, the 2005 rules were issued to implement the *Notice of the State Council on Issuing Relevant Policies on Encouraging the Development of Software Industry and IC Industry* (Guo Fa (2000) No.18) policies to encourage the software and IC industries.

(a) What specific incentives are offered to the "state-encouraged" integrated circuit enterprises?

(b) Are any of the offered incentives contingent upon export performance?

5. Banking and Financial Sector

5.1 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 past transitional reviews before this Committee, the United States has 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 has 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. For example, the United States notes that Article 34 of the Commercial Bank Law states that commercial banks shall conduct their lending business in accordance with national and social-development needs and under the guidance of the industrial policies of the State. Please explain how Article 34 is consistent with the objective of the Big Four banks operating on a commercial basis.

5.2 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.

6. State-Owned Enterprises

6.1 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 state-owned enterprises (SOEs). What measures has China issued, or does China plan to issue, to implement these changes? Please explain.

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

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

6.4 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.

6.5 The United States understands that SOEs in China have been exempt from paying any dividends to the state since at least 1994, 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.

(a) Does this exemption remain in place, or has it been modified? Please explain.

(b) 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, what steps, if any, are being taken by China to change this policy?

6.6 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 non-performing loans (NPLs) are eligible for debt-to-equity conversions. Are there different rules for SOEs and private companies?

6.7 The United States understands that the government is using debt-for-equity swaps to keep certain SOEs out of bankruptcy and specifically chose 580 SOEs and converted their debt claims into asset management company-held equity stakes. Is this understanding correct? If not, please explain.

6.8 The United States also understands that the SOEs that participated in a debt-for-equity swap will be required to repurchase their asset management company-held equity stakes within ten years. Please describe the terms and conditions under which these equity stakes will be repurchased.

7. Northeast Revitalization Program

7.1 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. Moreover, a 21 August 2007 report in the China Daily notes that a "blueprint for the Northeast revitalization program… was formally released at a press conference held by the State Council Information Office yesterday." (See "Northeast's Revival Tied to Private Investment," China Daily, 21 August 2007.) In an effort to attract private investment, the blueprint notes that private capital will be granted "the same tax exemptions, land use and loan policies as the State firms being restructured."

(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) What specific types of incentives, e.g., tax exemptions, land use and loan policies, are provided to SOEs and private firms investing in the northeast, as provided for in the blueprint for the revitalization plan?

8. Disclosures

8.1 During past transitional reviews before the Anti-Dumping Committee, the United States has reported on complaints from interested parties in Chinese anti-dumping proceedings about a lack of transparency with respect to the factual information before China's Ministry of Commerce (MOFCOM) and a lack of adequate explanation by MOFCOM of its interpretation of those facts. For example, respondents have complained that the disclosures of anti-dumping margin calculations in preliminary and final determinations have not contained sufficient information needed to replicate certain calculations and identify the specific adjustments that were made. In connection with this year's transitional review before the Anti-Dumping Committee, the United States asked China to describe the specific steps that MOFCOM had taken since last year's transitional review meeting before the Anti-Dumping Committee to ensure that disclosures provide greater transparency. In response, China asserted that its disclosures were consistent with the Anti-Dumping Agreement. Does China's response mean that MOFCOM has not taken any specific steps since last year's transitional review meeting before the Anti-Dumping Committee to ensure that its disclosures provide greater transparency? If that is the case, does MOFCOM have any future plans for improvements? Please explain.

9. Transparency

9.1 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.

9.2 In Section 2(C) of Part I 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."

9.3 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 Part I 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.

____