

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

Questions from the UNITED STATES to CHINA

The following communication, dated 8 October 2007, is being circulated at the request of the Delegation of the United States.

Transparency

1. The United States appreciates China's recent responses to detailed questions posed by the United States regarding China's first subsidies notification to the WTO. Although the United States recognizes the difficulties China has identified in collecting this information from various levels of government, the United States is concerned by China's continued failure to notify *any* sub-national subsidies, leaving a significant gap in China's accounting of the full range of its subsidy programs. The difficulties China has identified in notifying subsidies administered by sub-national authorities are not unique to China. Moreover, China has been a WTO Member since 2001 and therefore, has had a significant period of time to educate sub-national authorities. Numerous WTO Members, including the United States, have identified a wide range of subsidy programs – some of which appear to be prohibited --administered by local or provincial authorities in China. At a minimum, China could have addressed these specific questions.

2. Could China please explain when it expects these programs to be notified in accordance with Article 25 of the WTO Agreement on Subsidies and Countervailing Measures ("Subsidies Agreement") and when it expects to respond fully to questions posed by the United States and other Members regarding these subsidies?

3. In connection with last year's transitional review before this Committee, the United States notes that it requested information from China regarding important issues in a number of areas, including the banking and financial sector, state-owned enterprises (SOEs), the Northeast Revitalization Program and price controls, but received incomplete responses or, in some cases, no response at all. These issues are of continued importance to the United States. The United States sets out the outstanding questions and follow-up questions below and looks forward to China's responses and a full and constructive discussion of these issues in the upcoming meeting of this Committee.

Textiles

4. Notwithstanding statements by China that it has eliminated prohibited export-contingent programs targeting the textile sector, the United States remains concerned that such programs may

continue to exist. The United States identified a number of these programs and submitted numerous questions about them in G/SCM/Q2/CHN/23. The United States continues to look forward to China's responses to those specific questions.

5. The United States has identified a number of additional 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?
- 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.

6. 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?
- 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?

Technology – Software and Integrated Circuits

7. 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*.

8. 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?

9. 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?

Banking and Financial Sector

10. 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.

- a. 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?
- b. 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.

11. 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.

12. Please explain why state-owned commercial banks continue to lend primarily to SOEs and why only a small percentage of lending is provided to private businesses.

State-Owned Enterprises

13. 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.

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

15. 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?

16. 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.

17. 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, what steps, if any, are being taken by China to change this policy?

18. 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?

19. 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.

20. 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.

21. The United States notes that China's asset management companies were originally intended to be in existence for ten years. Is it still the China's intention to liquidate or otherwise terminate the operations of the asset management companies after ten years?

Northeast Revitalization Program

22. 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?

Price Controls

23. 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.

24. 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?
