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**Committee on Subsidies and  
Countervailing Measures**

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## **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 23 October 2008, is being circulated at the request of the Delegation of the United States.

#### **Transparency**

1. Since joining the WTO in 2001, China has submitted only one subsidy notification under Article 25 of the WTO Agreement on Subsidies and Countervailing Measures ("Subsidies Agreement"). That notification was submitted in 2006 and did not include any subsidy programs administered by sub-central governments. As we have highlighted in prior submissions to this Committee, provincial and local authorities in China play an important role in implementing industrial policy, including with regard to subsidization, and therefore the absence of information on sub-central government subsidy programs is particularly troubling. Confirming the seriousness of this concern, the United States and other WTO Members on numerous occasions have identified information indicating possible subsidy programs in a wide range of sectors administered by provincial or local authorities in China and have asked China to provide information regarding these subsidies (see, for example, G/SCM/Q2/CHN/19, G/SCM/Q2/CHN/23 and G/SCM/Q2/CHN/33). In response, China has only stated that it continues to study the most effective and efficient way to collect the necessary information and has not provided any timeframe within which it expects to meet its WTO obligations. The United States again urges China to submit a full notification covering all subsidy programs administered at all levels of government.

- (a) In the continued absence of a notification covering sub-central government subsidy programs, can China explain the steps it is taking to compile the requisite information?
- (b) When does China expect to notify all of its subsidy programs at all levels of government in accordance with Article 25 of the Subsidies Agreement?

#### **Export-Contingent Subsidies**

2. A number of the questions previously raised by the United States and other WTO Members address what appear to be unreported subsidy programs at various levels of government that are contingent upon export performance. In addition, the United States continues to search for and obtain publicly available information indicating that authorities at various levels of government in China are

providing additional subsidies that appear to be contingent upon export performance. It is especially disturbing that some of these programs appear to have been formulated and adopted under the direction of the central government.

- (a) Is there any mechanism in place for reviewing new central government subsidy programs for WTO-consistency? Please explain.
- (b) What efforts has the central government made to review subsidy programs maintained or created by provincial and local authorities for WTO-consistency?

### **Industrial Policy Administration**

3. Please describe the relationship between the central government's industrial policies and subsidy programs, such as those contained in or called for by China's five-year plans, and the implementation of industrial policies and subsidy programs by the sub-central governments.

4. How are subsidy programs at the sub-central government level financed? Are there cost-sharing arrangements between or among different levels of government? If so, please explain.

### **State-Owned Enterprises**

5. China is currently consolidating state ownership of large or strategically important state-owned enterprises ("SOEs") under the State Assets Supervision and Administration Commission ("SASAC"). The 150 or so SOE holding companies under SASAC control thousands of companies and account for the vast bulk of profits in the SOE sector and span a wide range of industries, including power generation and distribution, oil and petrochemical, telecom, coal, civil aircraft, machinery, autos, information technology, construction, steel, metals and chemicals. Through this SASAC-administered consolidation process, China intends to regulate SOE investment and effectively limit it to core businesses, with SASAC determining what is core and non-core, on a company-by-company basis. A similar consolidation process is taking place at the provincial level. The manner in which SOE operations are financed, and in particular the manner in which SOE investments are financed, will likely raise increasing concerns on a number of fronts, given the size and importance of the SOEs under SASAC control, the government's heavy reliance on industrial policies and the government's explicit goal of preserving a leading role for SOEs in China's economy. For example, in paragraph 46 of the Working Party Report accompanying its WTO Protocol of Accession, China committed that SOEs would operate solely on a commercial basis and without being influenced by the government.

Please explain how SASAC's consolidation efforts, as well as the directives set forth in the *Interim Measures for the Supervision and Administration of the Investments by Central Enterprises*, Decree No. 2006-16, issued by SASAC in June 2006, and the *Circular on Transmitting and Issuing the Guiding Opinions of the State-Owned Assets Supervision and Administration Commission of the State Council on Promoting Adjustment of State-Owned Capital and Restructuring of State-Owned Enterprises*, issued by the General Office of the State Council in December 2006, are consistent with these commitments.

### **Land Administration**

6. Given the scarcity of land resources in China, the price of land-use rights and how they are allocated are important considerations from both a market access standpoint and a competition standpoint. They also implicate a more general concern with resource allocations and their effects on production and trade. It is therefore of some concern to the United States that the Chinese

government is recentralizing control over land administration, with the objective, in part, to ensure that land use-rights are allocated in accordance with state industrial development policies.

- (a) Could China describe the ongoing efforts to recentralize the government's control over land administration?
- (b) Please explain how the *Circular of the State Council on Strengthening Land Control*, Guo Fa [2006], No. 31, issued by the State Council in August 2006, is being implemented.
- (c) Please describe the recently established National Land Superintendency and its role and powers.
- (d) Please describe China's compulsory national land-use plan as well as the individual and collective roles of the National Land Superintendency, the Ministry of Land and Natural Resources, the Ministry of Finance and the National Development and Reform Commission in implementing the national land-use plan.

### **Fuel Subsidies – Price Controls**

7. In view of the significant financing cost and growing environmental impact concerns associated with energy overconsumption in China, please explain why China continues to subsidize fuel purchases to compensate for losses absorbed due to price controls.

### **Domestic Support and Subsidies for China's Agricultural Sector**

8. Article 4 of China's Enterprise Income Tax Law establishes a generally applicable enterprise income tax rate of 25 per cent. However, Article 86 of China's Enterprise Income Tax Law, which became effective on 1 January 2008, wholly exempts agricultural enterprises from the payment of enterprise income taxes with regard to certain agricultural activities and provision of services related to those activities.

- a. The United States requests information on what constitutes an enterprise for the purposes of China's Enterprise Income Tax Law.
- b. Recognizing that Article 86 of China's Enterprise Income Tax Law is new, what do you project the value of the enterprise income tax exemption to be in 2008, by category of agricultural enterprises listed in the Enterprise Income Tax law? Please provide any information that is available for this year if full year projections are not available.
- c. Similarly, what do you project the value of the enterprise income tax exemption to be in 2008 by commodity listed within the first category (e.g., grains, oilseeds, sugar, fruit and vegetables, cotton, etc.) and within the fifth category (e.g., pork, poultry, dairy, beef, etc.)? What percentage of agricultural production, by applicable categories in Article 86 of the Enterprise Income Tax Law, do you expect to be produced by enterprises instead of individual farmers or farmers' cooperatives?

- d. Under the seventh category, what constitutes "preliminary processing" of agricultural products? Please describe the scope of eligibility for agricultural processing companies in relationship to the commodities listed in the first or fifth category and any other commodities not specifically listed in those sections. What do you project the value of the enterprise income tax exemption to be in 2008 within the seventh category?

### **Discriminatory VAT exemptions**

9. In connection with last year's transitional review before the Committee on Agriculture (COA), the United States explained its understanding that many agricultural products are exempted from China's 13 per cent value-added tax (VAT) normally applicable to agricultural products. For example, it appears that 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 sales of agricultural inputs produced and sold in China, such as seed, pesticide, herbicide, agricultural machinery and certain fertilizers, are exempted from the VAT. However, when these same products are imported, it appears that they are assessed the VAT at the rate of 13 per cent. In response to US questions at the 2007 transitional review at the COA, China stated that the issue would be dealt with more appropriately in this Committee.

- (a) In its statement during last year's transitional review at the COA, China appeared to confirm that sales of agricultural commodities produced and sold by farmers in China, such as wheat, cotton and corn, are exempted from the VAT, while imports of these same products are assessed the VAT at 13 per cent. China appeared to argue that this practice is consistent with Article III of the General Agreement on Tariffs and Trade 1994 (GATT 1994) because downstream entities in China must pay the VAT in connection with transactions taking place after the initial transaction involving the farmer. However, China did not address how it justifies the more favorable VAT treatment accorded to the products in question when they are sold by a farmer in China versus the treatment accorded to imported products, which are always assessed the VAT. Please explain how China justifies this discriminatory treatment.
- (b) In its statement during last year's transitional review at the COA, China also did not explain how it justifies the VAT exemption for farmers in China under Article 3 of the Subsidies Agreement, which prohibits subsidies that are contingent on the use of domestic over imported goods. Please provide China's justification.
- (c) In its statement during last year's transitional review at the COA, China did not respond to questions posed by the United States regarding sales of agricultural inputs produced and sold in China, such as seed, pesticide, herbicide, agricultural machinery and certain fertilizers. The United States would ask that China respond to the following questions: Can China confirm that these agricultural inputs are exempted from the VAT, while imports of these same products 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 Subsidies Agreement.

### **Export VAT rebates**

10. In connection with last year's transitional review before the COA, the United States explained its understanding that a VAT rebate is available upon the export of some agricultural products, including ones for which payment of the VAT was imputed rather than actually paid at a prior stage because of an exemption (as explained in question 8 above). In its statement during last year's transitional review at the COA, China referenced the "*Interim Regulation of the P.R.C. on VAT*", but did not respond to the United States' question seeking an explanation regarding how China ensures that the export rebate is not excessive.

- (a) Please provide a citation to the "*Interim Regulation of the P.R.C. on VAT*".
- (b) Please identify and provide citation to any other measures that govern how China calculates the export rebate in this situation, including any measures that specifically address agricultural commodities such as wheat, cotton and corn or agricultural inputs such as seed, pesticide, herbicide, agricultural machinery and certain fertilizers.
- (c) Please explain how China ensures that the export rebate is not excessive.

11. Please explain how China applies the VAT to agricultural and food products imported into China for processing and then re-exported. Is the VAT charged on the imported agricultural or food product? Is the exported processed product eligible for a VAT rebate?

### **Other Issues**

12. In connection with last year's transitional review before this Committee and the Council for Trade in Goods, the United States requested information from China regarding important issues in a number of areas, including SOEs, the Northeast Revitalization Program and price controls (see questions 13-24 in G/SCM/Q2/CHN/33 and questions 6.1-6.8 and 7.1 in G/C/W/587), 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 asks that China provide responses and engage in a full and constructive discussion of these issues during this year's transitional review before this Committee.

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