

**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 eighth 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 held on 20 October 2009.
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 5 October 2009, which has been circulated in document G/SCM/N/198.
3. Questions submitted in the context of the 2009 transitional review have been circulated in documents G/SCM/W/548 (United States) and G/SCM/W/550 (European Communities). The Statements made in the context of this transitional review at the meeting of 20 October 2009 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 20 October 2009, to be circulated as document G/SCM/M/71

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."

2. 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.

3. The Chairman indicated that the Protocol contained no procedures 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 the 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". The notification by China provided for in Annex 1A had been circulated in document G/SCM/N/198, dated 5 October 2009. The United States and the European Communities had submitted questions in the context of this transition review, which had been circulated in documents G/SCM/W/548 and G/SCM/W/550, respectively.

4. The delegate of the United States noted that the principal purpose of the transitional review mechanism was to examine China's compliance with its WTO obligations. One of these obligations was to provide a timely and complete subsidy notification. After nearly five years as a WTO Member, China had submitted its first subsidy notification in 2006, covering the period 2001- 2004. While this was a positive step, the notification was largely incomplete as it failed to include a single sub-central government measure.

5. The delegate of the United States indicated that, as the United States had highlighted in prior submissions to the Committee, provincial and local authorities in China played a very important role in implementing industrial policy, including subsidy policy. Recent academic literature, for example, indicated that local governments were responsible for nearly 20 per cent of China's investment, much of which was misdirected into sectors with excess capacity, such as steel. Therefore, the notification of sub-central government measures by China was imperative. The timeliness of China's subsidy notifications was also of obvious concern. China lagging behind for four years in providing its subsidy notifications was particularly troubling because some of China's subsidy programmes expired after two years. Given this fact, the delays in China's subsidy notifications effectively denied Members' ability to analyze and meaningfully question China's subsidy programmes.

6. In light of these very significant issues, the United States had been surprised when, last year, China had firmly rejected any implication that it had failed to fulfil its transparency commitments in the area of subsidies and failed to provide any specific timetable for bringing itself into compliance. In accordance with Annex 1A(i) of China's Working Party Report and Article 18.1 of China's Protocol

of Accession, China was obligated to provide annual economic development plans, five-year programmes, and any industrial or sectoral programmes or policies promulgated by central and sub-central government entities. While China had provided some limited information with respect to its national five-year plans, it appeared as though it had not provided any information with respect to the industrial policies and programmes of sub-central government entities. The delegate of the United States therefore requested that China identify and provide citations to all of the current provincial five-year plans and current provincial programmes and policies at least for all sectors that the central government had deemed as basic, pillar, strategic or key industry (e.g., telecommunications, civil aviation, machinery, autos, steel, base metals, chemical, etc.).

7. The delegate of the United States continued that another of the obligations China had assumed upon joining the WTO was not to provide any prohibited subsidies. The United States and other WTO Members had raised numerous questions over the years with respect to what had appeared to be unreported subsidy programmes at various levels of government that were contingent upon export performance or the use of domestic over imported goods. The United States continued to find these types of measures. As an example, the delegate of the United States quoted a statement from Hunan Province's 2009-2011 plan indicating that subsidies for products exported by ramie processing companies would be provided.

8. The delegate of the United States added that in the context of subsidies provided for the use of domestic goods, China's recent plan for machinery established a risk compensation mechanism to encourage the first use of domestically-produced machinery. It was particularly troubling, as the end of the period for the transitional review mechanism was approaching, to see China taking what seemed to be steps backward rather than forward, by implementing what appeared to be new prohibited subsidy programmes at nearly all levels of government. This was not tenable, the delegate of the United States added, stressing that China needed to meet its obligations to provide a timely and complete subsidy notification covering all levels of government, and to terminate without delay any prohibited subsidies in place.

9. A third obligation undertaken by China upon joining the WTO was that it would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, as set forth in paragraph 46 of the Working Party on China's Accession. The delegate noted that the approximately 150 SOE holding companies owned by the State Assets Supervision and Administration Commission ("SASAC") controlled thousands of companies across a wide range of industries and accounted for most of the profits in the SOE sector. Further, as had been noted in the last transitional review exercise, the General Office of the State Council established a mechanism by which profits from SOEs would fund the re-organization of state-owned enterprises, consistent with national industrial policies and planning. China had not, in last year's trade review mechanism, addressed the fundamental issue of how state-owned enterprises could operate on a purely commercial basis when they had to make investment decisions in accordance with government industrial policy. If China's ownership and management decisions were not based on commercial considerations, subsidy issues could arise. Given this, the delegate of the United States asked China how it intended to proceed with its plans for restructuring the SOE sector and at the same time meet its WTO obligation to operate its SOEs solely on a commercial basis, without government influence.

10. Finally, the delegate of the United States noted that China was obligated to notify to the Committee the application of any price controls and the reason for their use. In the context of the significant rise in international oil prices the last year, it had been widely reported and acknowledged by the Chinese Government that the price of oil products had been held down by the government and that Chinese refineries received significant subsidies to cover their losses. The delegate of the United States requested that China describe the current government price controls on oil products, how the government compensated companies for losses incurred due to these price controls, and the current status of China's energy price reform efforts, particularly with respect to fuel prices.

11. The delegate of the European Communities expressed appreciation for the transitional review mechanism as a useful supplement for additional transparency about China's trade regime and in particular about its subsidies policy in addition to bilateral discussions and China's subsidy notification. The delegate of the European Communities added that China had submitted a subsidy notification in 2006 covering the period 2001 to 2004 and that in the last transitional review mechanism, the delegate of China had stated that China was working to update this notification which would cover years 2005-2008. While the European Communities appreciated the efforts undertaken by China to submit a complete and timely subsidy notification, China had yet to submit its notification to the Committee, one year after the last transitional review mechanism exercise. Two notifications were missing, one for the period 2005-2006 and the second for the period 2007-2008. The delegate of the European Communities noted that it was also unclear whether China's next subsidy notification would cover subsidies at the sub-federal level. Subsidies provided by sub-national governments was an area specifically highlighted by Members in paragraph 173 of the Working Party Report on China's accession to the WTO. The European Communities was therefore concerned by the fact that China might again provide an incomplete subsidy notification. The delegate of the European Communities noted that the EC trade defence investigating authorities continued to uncover subsidy schemes, in particular in the steel sector. The existence of these subsidies had been confirmed by a number of independent studies and by the rapid growth of China's steel exports in recent years.

12. China's continued failure to submit a complete subsidy notification in due time left WTO Members with only one of two options: to tolerate China's disregard for the legitimate interests of its trading partners regarding transparency and notification requirements; or to resort to formal dispute settlement proceedings – a path – one could assume – both sides would prefer to avoid. Moreover, China appeared to use a practice whereby it restricted the export of certain raw materials which in turn depressed the prices of those raw materials when used in the downstream manufacturing industry. This practice could effectively amount to a subsidization of inputs for certain downstream products, and was often coupled with various incentives for exports of the downstream product.

13. In light of this, the European Communities was looking forward to receiving replies to the questions submitted ahead of the Committee meeting.

14. The delegate of Japan noted that Japan had not submitted written questions but wished to make certain remarks with regard to transparency. Japan was concerned about China not having made the required 2007 and 2009 new and full subsidy notifications. In light of the sound and fair function of the surveillance mechanism under the SCM Committee, Japan urged China to submit these two notifications as required under Article 25 of the SCM Agreement.

15. The delegate of Canada thanked the delegations of the United States and the European Communities for their detailed communications and the delegation of Japan for the comments it provided. Canada agreed that the subsidy notification process was an important transparency exercise and hoped that China would make every effort to submit its new and full notifications in a timely manner. Canada shared the United States' concerns about China's industrial policies and their linkages with respect to subsidisation. On numerous occasions, Canada had sought clarifications regarding China's iron and steel policy. Canada's 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 its steel industry, including subsidisation. Canada therefore shared the United States' interest in learning more about the relationship between China's national five-year plans and specific government policies. The delegate of Canada noted the efforts of China's Ministry of Industry and Information to reduce and/or eliminate steel-making capacity in China and requested that China provide any available information on any possible role that subsidization would or could play in this endeavour. Canada looked forward to China's answers on the leading role of state-owned enterprises in advancing industrial policies.

16. The delegate of China took note of the comments made by previous speakers and of the written questions raised by the delegations of the United States and the European Communities. China had elaborated its positions on many of these questions as reflected in the minutes of the Committee meetings at which previous reviews had been held. In addition, the delegate of China wished to make the following points in the transitional review by the Committee this year in response to questions put forward by other delegations and to comments made by previous speakers.

17. On the issue of transparency, the delegate of China informed the Committee that a draft of China's second subsidy notification was ready for examination and that work to submit the notification was at the final stage. This second notification was to cover the period 2005-2008. Upon the submission of this second notification, the clarity of the measures of the Chinese central government which might constitute subsidies as defined in the SCM Agreement would be greatly enhanced. China would make all efforts in the coming few months to finalize the second notification and was particularly pleased that its transparency obligation under the SCM Agreement for this four year period could finally be fulfilled. The delegate noted that preparation of the second notification had been more complex than anticipated due to changes in recent years resulting from major reforms in China's income tax and value-added tax regimes.

18. China would continue to work towards incorporating subsidies at the local level into future notifications. The delegate of China at this time had difficulties in providing a specific time schedule for the submission of a notification that contained sub-central measures, but noted that China's progress in submitting the first and second notifications had enhanced its confidence and would enable China to concentrate better its future efforts in fulfilling this difficult task.

19. With respect to mechanisms to review subsidy programmes for consistency with the SCM Agreement, the delegate of China informed the Committee that the Central Government of China or the State Council had inter-ministerial consultation procedures to ensure WTO consistency when new policies and measures were formulated, including those that may be related to the SCM Agreement. Other information on such mechanisms could be found in paragraph 74 of document G/SCM/M/66, which recorded the transitional review undertaken last year in the Committee. The Chinese delegation had, in that review, provided detailed replies on this question. The delegate further informed the Committee that regulations, rules and other administrative measures of both the central and local governments were reviewed at intervals and that those abolished or no longer applicable would be published collectively.

20. With respect to industry policy administration, the delegate of China first provided explanations on China's national five-year plans. The national five-year plans were blueprints of the overall social and economic development of the nation to be achieved in every five years period. The plans were approved by the National People's Congress and implemented by the State Council or the Central Government. Likewise, local five-year plans of an administrative region at or above county level were approved by the corresponding local people's congresses. The national and local five-year plans were not necessarily inter-related as the goals and tasks set could differ in view of the different situations and development levels of different localities. However, the general guiding principles of the plans would usually be consistent. Achievement of the goals and tasks set in these five-year plans relied primarily on the fundamental role of the market and the five-year plans contained no specific subsidy programmes. In response to a question asked by the United States, the delegate of China indicated that the provincial five-year plans were available on the official websites of the relevant provincial governments.

21. The delegate of China explained that industrial policies were general guidelines for development of certain industries in order to achieve development goals envisaged in the five-year plans. Industrial policies aimed at promoting structural adjustment and industrial upgrading so that the sectors concerned could develop in a steady, healthy and sustainable manner. Industrial policies

were usually formulated at the national level, and shared common features, notably the high priority given to resources and energy conservation, to the reduction of emissions, and the importance placed on the strengthening of China's capacity for independent innovation. The delegate of China noted that local governments could draft their own industrial development plans, but that these plans had to be in line with the industrial policies at the national level. As general guidelines, industrial policies contained no specific subsidy programmes. Industrial policies were implemented through administrative measures, for example access conditions for investment in various sectors. Subsidy programmes were found in administrative measures and might or might not be related to industrial policies. General policy statements such as the industrial policies were not to be mistaken for subsidy programmes; for a subsidy programme to exist, there would have to be an administrative measure specifying at least the financial contribution and its utilization.

22. The delegate of China then turned to the question of state-owned enterprises. In China's view, the observance of industrial policies by state-owned enterprises did not preclude such enterprises from operating on a commercial basis. China also saw no inconsistency between the Law of the People's Republic of China on the State-Owned Assets of Enterprises (adopted on 28 October 2008) and its WTO obligations. Article 6 of the Law clearly stated that the State as an investor or shareholder would observe the principles of separation of government from enterprise, separation of its public administration functions from those of an investor or shareholder and non-interference in the independent management and operation of enterprises. As to Article 7, it reflected the areas that the State as an investor was interested in and there was no indication in that provision that the State would not behave according to market economy principles.

23. Regarding land administration, the delegate of China indicated that in China's view, it was only natural that projects not in accordance with industrial policies - in particular projects wasting energy and resources, polluting the environment, or expanding production capacity already in excess - were not supplied with land. The delegate of China did not see a contradiction between this and the supply of land on commercial conditions to projects consistent with industrial policy. The delegate of China noted that the provision of free or underpriced land used to be a kind of subsidy offered by local authorities to investors, largely foreign investors, in the early years of China's opening up, but indicated that this had no longer been the case. China had made it clear in the last review that a basic principle adhered to by China in its economic reforms was to introduce market forces and have them play a fundamental role in the allocation of resources, including land. The delegate added that presently, land for industrial purposes in China could only be provided through public bidding procedures.

24. In response to questions regarding civil aircraft, the delegate of China clarified that China had not formulated an industrial policy on the development of the aerospace industry. That said, "large aircraft" was one of the "16 national science and technology major projects", the implementation of which was the responsibility of the Ministry of Science and Technology. These 16 projects would have a budget of around RMB 32.8 billion in 2009 and around RMB 30 billion in 2010. The relevance of this to the SCM Agreement remained to be clarified. At this stage, China did not consider it appropriate for the Committee to address the issue of a Member's funding of science and technology development. As to the relationship between banks and the Commercial Aircraft Corporation of China Ltd, to his knowledge, only the Industrial and Commercial Bank of China Ltd had signed a letter of intention with the company. Whether the Bank would provide loans to the company in the end and, if so, on what terms and conditions, remained to be determined by the Bank based on its judgement of benefits and risks of the project. The delegate of China also noted the reference made by the delegation of the United States to a subsidy programme of the Civil Aviation Administration of China (CAAC) concerning the development of regional aviation. This programme, which concerned trade in services, was initiated last year for general services purposes, and was provided to airlines for their launch and operation of regional flights. It was unrelated to the large aircraft project.

25. With respect to the textiles sector and recent industry support plan, the delegate of China indicated that after the outbreak of the financial crisis, China had put forward (in February and March 2009) adjustment and reinvigoration plans for 10 industries, including textiles. The ten plans were general policy guidelines and were implemented through specific implementing measures, including for example, raising export VAT rebate rate, lowering the purchase tax on certain vehicles, expansion of existing trade promotion schemes, and various projects to promote consumption. China had notified these implementing measures to the WTO TPRB's financial crisis monitoring mechanism as they were staged. The delegate of China also noted that some local governments drafted their own plans for certain sectors. In the course of tackling the financial crisis, China attached great importance to the consistency of the measures with its WTO obligations. Issues raised in the questions addressed to China, such as those on alleged prohibited subsidies, were basically general policy statements as found in relevant plans. They involved no confirmed subsidy programmes with specified amount of financial contribution and its utilization.

26. Lastly, turning to fuel prices, the delegate of China indicated that the price of crude oil in China was interconnected with the international market and subject to negotiations between buyers and sellers. On processed oil, the price was now a government guidance price, where the benchmark price was set by the government based on prices on the international market, plus consideration of other relevant factors such as taxes, production costs, profits at an appropriate level etc. Retailers also had a margin within which they could decide retailing prices. Steps had been taken in December 2008 to reform the mechanism to set the benchmark price. After the reform, the benchmark price would be adjusted more frequently provided that prices in the international market went beyond a certain level within a certain time period.

27. The delegate of the United States thanked the delegate of China for the answers provided, some of which were particularly helpful. While expressing satisfaction at China's indication that its notification would soon be submitted to the Committee, the delegate of the United States considered that it was particularly disturbing that China would not be notifying subsidies at the sub-central level in that notification, given that the United States had raised the issue in the Committee for several years and that notifying these is critically important. The United States had had significant experience examining Chinese sub-central measures and had found numerous measures that appeared to be inconsistent with China's obligations under the SCM Agreement. For these reasons, the delegate of the United States noted that it was disturbing that the central government was still unable to provide a timetable on when sub-central subsidy measures would be notified.

28. With regard to the five-year plans, the delegate of United States noted with interest the indication by the delegate of China that all five-year plans at all levels of government were available on the internet. The United States had been unable to find most provincial-level five-year plans, not to mention plans at more local levels and expressed interest in obtaining the websites from China.

29. The United States had, in its transitional review mechanism submission and in its earlier intervention, cited to very specific plans that were currently in place and that clearly appeared to provide subsidies. While the United States accepted China's point that the five year plans were not exclusively about subsidy programmes, it noted that it was also clear to the United States that the five-year plans - especially at the sub-central levels – did in fact provide subsidies that needed to be notified to the SCM Committee.

30. Finally, the delegate of the United States referred to China's comments with respect to government science and technology programmes not being an appropriate subject for the SCM Committee's consideration. The question posed by the United States concerned the aerospace industry. The delegate of the United States noted that there was a current dispute pending in the dispute settlement system that in a very significant measure related to science and technology funding.

In the view of the United States, science and technology funding programmes constituted potential actionable subsidies and hence were an appropriate subject for the SCM Committee.

31. The delegate of the European Commission expressed appreciation at China's efforts to include subsidies at sub-central level in the next notifications but regretted that China would not do so in its coming subsidy notification. The European Communities was especially concerned about subsidies in the steel sector and requested China to do its utmost to include subsidies to this sector at the sub-federal level in the next notification. The inclusion of subsidies at sub-federal level being part of China's obligations under the WTO Agreement, it was unacceptable that China had not been able to do so in its notifications, eight years after its accession to the WTO. The delegate of the European Communities also noted that the delegate of China had not commented on the European Communities' last question concerning the practice (identified as part of EC trade defence investigations) which restricted the export of certain raw materials and which could confer a subsidy on the downstream product. The delegate of the European Communities asked China to indicate whether it would respond to this question orally or in writing.

32. The delegate of China took note of the follow-up comments made by previous speakers with respect to China's subsidy notifications and in particular their concerns with the lack of information provided concerning programmes at the sub-central level. He referred to China's positions in the reviews of previous years and noted that China had already explained the tremendous capacity constraints it had in this regard. China was aware of the requirement to include sub-central subsidies in its notifications and its future efforts would concentrate on that aspect. Responding to comments of other Members – in particular the United States – concerning the existence of large amounts of subsidy programmes at sub-central level, the delegate of China clarified that it was natural that China and its governments at different levels would have in place plans of different levels, all stating guiding principles. That said, in order to confirm the existence of a subsidy programme as defined by the SCM Agreement and also for the purpose of preparing China's subsidy notifications, very specific provisions and measures specifying the financial contribution and its utilization were required. Five years plans or industrial policies reflecting general policy statements should not be seen as subsidy programmes. With respect to the provincial websites on which the plans could be found, the delegate of China once again indicated that these websites were easily accessible and referred other Members to the official websites of the relevant provincial governments.

33. The delegate of China also wished to clarify his earlier statement with respect to the aircraft sector: whether funding with respect to science and technology development should be regarded as relevant to the SCM Agreement and if so, to what extent it was relevant, remained to be clarified. Given this, China was of the view that this was not an appropriate subject for the SCM Committee to consider. China had an interest in the dispute mentioned by the United States in its intervention, and would follow its outcome. With respect to the question posed by the European Communities concerning export administration measures, China did not have a very clear position at this stage. In China's view, export administration measures were not an issue directly relevant to the SCM Agreement. Whether such measures might constitute subsidies to downstream industries was an issue to be further studied.

34. The delegate of the United States reiterated that the US delegation had not been able to identify all the relevant websites of provincial governments containing their five year plans even after conducting Chinese language research. The United States had been able to identify the websites for some of the relevant provinces, but not for most of them. In addition, locating plans below the provincial levels was extremely difficult. The delegate of the United States reminded China of its obligation, under its Protocol of Accession to provide these plans. The delegate of the United States suggested that the United States and China work informally through their Geneva representatives to obtain the website information.

35. The delegate of the European Communities thanked China for its comments.
36. The delegate of China considered that there was no need for future cooperation concerning the websites. The 32 provincial level regions in China's mainland all had their own official government websites, which were not difficult to locate. No further information was provided with respect to plans below the provincial level.
37. With regard to the Committee's report on the transitional review, the Chairman noted that there were no guidelines for the report in the Protocol. Following the review at the previous year's fall meeting, the Chairperson, acting on his 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 related to the transition review. He proposed that the Committee agree to follow the same procedure. It was so decided.
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