

**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 6 October 2009, is being circulated at the request of the Delegation of the United States.

**Transparency**

1. China's continued failure to notify any subsidies administered by sub-central governments, as required by Article 25 of the WTO Agreement on Subsidies and Countervailing Measures ("Subsidies Agreement"), leaves a fundamental gap in China's obligation to fulfil its transparency commitments in the area of subsidies. China's only subsidy notification since joining the WTO in 2001 was submitted in 2006 and it did not include a single subsidy program administered by sub-central governments. In prior submissions to this Committee, the United States has explained that it considers subsidies administered by provincial and local authorities in China to be a significant problem in light of the important role these authorities play in implementing industrial policy, including with regard to subsidization. Some sources, for example, indicate that local governments are responsible for nearly 20 per cent of China's investment, much of which is misdirected into sectors with excess capacity, such as steel. (See, for example, C. Fred Bergsten, Charles Freeman, Nicholas Lardy and Derek J. Mitchell, *China's Rise*, p. 82). The continued absence of any information on sub-central government subsidy programs is thus particularly troubling. Confirming the seriousness of this concern, the United States and other WTO Members on numerous occasions have identified information indicating local and provincial subsidy programs provided to a wide range of industrial sectors and to exporters. Notwithstanding repeated requests to provide information regarding these subsidies, China has only stated that it continues to work towards providing a notification, but has not provided any timeframe within which it expects to meet its WTO obligations. (See, for example, G/SCM/Q2/CHN/19, G/SCM/Q2/CHN/23, G/SCM/Q2/CHN/33, and G/SCM/Q2/CHN/41). Even more troubling are China's most recent statements on this issue at the last Transitional Review Mechanism, which seemed to imply that China's only obligation was to work progressively towards a subsidy notification. (See G/SCM/125). China is obligated under Article 25 of the Subsidies Agreement to submit a *complete* notification covering subsidy programs administered at all levels of government. China has now had eight years to meet this obligation and has failed to do so.

- (a) Please describe the steps China has taken in the last year to meet its obligation to compile and submit the requisite information on subsidies, including those administered by central *and* sub-central levels of government?

- (b) What is the schedule going forward for China to submit its notification at all levels of government in accordance with Article 25 of the Subsidies Agreement?

### **Export-Contingent Subsidies**

2. On numerous occasions before this Committee the United States and other WTO Members have asked China about what appear to be unreported subsidy programs at various levels of government that are contingent upon export performance. Some of these programs appear to have been formulated and adopted under the direction of the central government.

- (a) Could China please explain if there are any mechanisms in place for systematically reviewing new central government subsidy programs specifically for consistency with the Subsidies Agreement? Please explain.
- (b) Similarly, what efforts has the central government taken to systematically review new subsidy programs maintained or created by provincial and local authorities specifically for consistency with the Subsidies Agreement?

### **Industrial Policy Administration**

3. China makes extensive use of industrial policies at both the central- and local-government level. The United States seeks to understand more clearly the relationship between (a) China's national five-year plans and specific government industrial policy or sector-specific measures, such as the *Order of the National Development and Reform Commission: Interim Measures Governing National Hi-Tech Industry Development Projects*" No. 43, issued 28 February 2006, and (b) how industrial policy in China is implemented, with respect to central and local government coordination and enforcement, particularly regarding subsidy programs.

- (a) Please explain the relationship between China's national five-year plans and sub-central five year plans as well as specific government industrial policies and sector-specific measures, particularly in the case of subsidy programs. How do the central government and the local governments interact and coordinate to implement and enforce the various five-year plans and industrial policies in China? To what extent are local governments able to develop and implement subsidy programs outside of national five-year plans and industrial policies?
- (b) During the 2008 transitional review before this Committee, China indicated that its subsidy programs and industrial policies are not necessarily linked, suggesting that not all industrial policies have associated subsidy programs and not all subsidy programs are related to industrial policies. (See G/SCM/125). Please explain the implementation of five-year plans and industrial policies which include subsidy programs. Please also explain how subsidy programs outside of five-year plans and industrial policy measures are developed and implemented.
- (c) In the case of subsidy programs administered at the sub-central government level, how are such programs financed? To what extent does central government funding support sub-central government initiatives? To what extent are there cost-sharing arrangements between or among different levels of government? How are such arrangements administered?
- (d) During the 2008 transitional review before this Committee, China indicated that the Government of China was in the process of devoting more resources to the review of

local government subsidy programs. Please describe how this is being done and the findings of these reviews to date.

- (e) Please identify and provide citations to all of the current provincial five-year plans and the current provincial programs and policies for all sectors that the central government has deemed a basic, pillar, strategic or key industry (e.g., telecommunications, civil aviation, machinery, autos, steel, base metals, chemical, etc.) in accordance with Annex 1A(i) of China's Working Party Report and Article 18.1 of China's Protocol of Accession.

### State-Owned Enterprises

4. China continues its efforts to streamline state ownership of large or strategically important state-owned enterprises ("SOEs") at the central, provincial and local levels of government. SOEs 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. Article 7 of the *2004 Constitution* describes the role of the state-owned sector as the "leading force in the national economy". (See also Article 1 of *Notice of the State-owned Assets Supervision and Administration Commission of the State Council on the Relevant Issues concerning the Implementation of the Law of the People's Republic of China on the State-Owned Assets of Enterprises*, Decree No. 194, issued by SASAC on 12 November 2008). At the last transitional review before this Committee, China reaffirmed its commitment that state owned enterprises' decisions were based solely on commercial considerations and that its SOE reform efforts were in accordance with market economy principles. (See G/SCM/125). China, however, did not address the fundamental issue of how state-owned enterprises can operate on a purely commercial basis when state-owned enterprises must make investment decisions in accordance with government industrial policy. If China's ownership and management decisions are not based on commercial considerations, subsidy issues may arise. This is particularly worrisome given the size and importance of the SOEs, the government's heavy reliance on industrial policies, the government's explicit goal of preserving a leading role for SOEs in China's economy, and a recent law that enforces conformity with state industrial policies. As part of its Protocol of Accession, China committed that SOEs would operate solely on a commercial basis and without being influenced by the government. (See paragraph 46 of China's Working Party Report).

- (a) Please clarify how Article 7 of the *Law of the People's Republic of China on the State-Owned Assets of Enterprises*, adopted 28 October 2008 (replacing the *Interim Measures for the Supervision and Administration of the Investments by Central Enterprises*, Decree No. 2006-16, issued by SASAC in June 2006), which specifies that the "state shall take measures to promote the centralization of state-owned capital ... and strengthen the control, force and influence of the state-owned economy" for "important industries and key fields", is consistent with China's WTO commitments and China's previously articulated efforts to reform SOEs in accordance with market economy principles. (See G/SCM/125).
- (b) Please clarify how Article 36 of the *Law of the People's Republic of China on the State-Owned Assets of Enterprises*, which mandates that investment by state-owned enterprises shall conform with national industrial policies, is consistent with China's WTO commitments. Please explain how this mandate is enforced, by whom, and if SASAC has any role. If SASAC does have a role, please explain it.

## Land Administration

5. Given the scarcity of land resources in China, the price of land-use rights and how they are allocated are important considerations in terms of subsidy, market access and competition issues. Land-use rights in China also implicate a more general concern with regard to resource allocation and their effect on production and trade. Some sources indicate that free or considerably underpriced land is a common subsidy local authorities in China offer investors in favored projects. (See *China's Rise*, p. 82). At last year's transitional review before this Committee, China indicated that the market will play the fundamental role in the allocation of resources and noted that industrial land is *only* provided through public bidding procedures. (See G/SCM/125). However, 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. (See *Decision of the State Council on Promulgating and Implementing the Temporary Provisions on Promoting Industrial Structure Adjustment* Guo Fa [2005] No. 40, issued in November 2005; *Ministry of Land and NDRC Jointly Issued Notification on Issuance and Implementation of Catalogue of Restricted and Prohibited Land Uses (2006 version) and Catalogue of Restricted and Prohibited Land Use (2006 version)*, Guo Tu Zi Fa [2006] No. 296, issued on 12 December 2006).

- (a) Please clarify how China's land recentralization in accordance with state industrial development policies is consistent with allowing the market to allocate land-use and determine the price of industrial land.
- (b) Please confirm whether, in fact, *all* industrial land in China is *only* provided through public auction. If public bidding is *de facto* the only mechanism available, why does China need to recentralize and strengthen land control to ensure that the market plays a fundamental role in land allocation and pricing?
- (c) 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.
- (d) Please describe China's compulsory national land-use plan, which is used to control rural-urban land allocation and ensure that land-use is consistent with industrial policies (See *Decision of the State Council on Promulgating and Implementing the Temporary Provisions on Promoting Industrial Structure Adjustment* [2005] No. 40, issued November 2005). Please explain the individual and collective roles of the National Land Superintendency, the Ministry of Land and Natural Resources, the Ministry of Finance as well as the National Development and Reform Commission in implementing the national land-use plan.

## Aerospace/Civil Aircraft

6. China's presence in the aerospace industry has increased significantly over the past several years. Publicly available information indicates that the Chinese government has dedicated significant resources to the development of domestically designed and produced civil aircraft. For example:

- Developing a large passenger airplane was listed as a priority project in China's *11<sup>th</sup> Five-Year Plan (2006-2010)*.
- The State Council has approved the "Large Aircraft Project" as one of 16 Key Science & Technology Special Projects ("Key S&T Projects"), as established by the "National Medium- and Long-Term Science and Technology Development Plan

(2006-2020)". One State Council document indicates that once the State Council approves a key S&T project, special funding becomes available from policy banks, such as the National Development Bank, China Export & Import Bank (EX-IM Bank) and China Agriculture Banks. (See *Notification of a Number of Supporting Policies for Implementing the National Medium- and Long-Term Science and Technology Development Plan (2006-2020)*, Guo Fa [2006] No. 6, 7 February 2006 ("State Council Notice No. 6"))).

- In May 2009, Premier Wen Jiabao announced that the central government would arrange funding in the amount of RMB 32.8 billion for 2009 and RMB 30 billion for 2010 to support the implementation of 11 of these Key S&T Projects, including the large aircraft program. (See *Executive Meeting of the State Council Makes Arrangements to Speed up the Implementation of Important National Science and Technology Projects*, State Council General Office, 13 May 2009, accessed at [http://www.gov.cn/idhd/2009-05/13/content\\_1313484.htm](http://www.gov.cn/idhd/2009-05/13/content_1313484.htm)).
- State Council Notice No. 6 also provides that the government shall encourage commercial financial institutions to provide active support, in the form of loans and credits, for high-technology and new technology projects designated by the State and provinces. This apparently complements or supplements the investment subsidies and loan interest subsidies that NDRC offers for hi-technology industry development projects, which include those in civil aviation. (See *Order of the National Development and Reform Commission*, No. 43, issued 28 February 2006).
- Perhaps pursuant to State Council Notice No. 6 and the February 2006 NDRC order, the General Administration of Civil Aviation of China (CAAC) announced in December of 2007, at the 17th National Congress of the Communist Party of China, that the government would provide RMB 1 billion (US\$133 million) in subsidies for the development of regional aviation, about RMB 400 million of which would be used to subsidize small and medium-sized airline companies.
- In addition, in 2008, the State approved the creation of Commercial Aircraft Corporation of China Ltd. (COMAC), a state-owned enterprise responsible for developing China's first large commercial aircraft. In 2009, COMCAC received US\$2 billion in government funding for the development of the ARJ21-700 regional jet. Further, the Industrial and Commercial Bank of China (ICBC) has stated that part of its mandate is to help indigenous passenger aircraft programs like the ARJ21, in particular by providing helping airlines in other countries to lease the aircraft. Similar support is likely to be provided for the narrow body C919.
- Moreover, also in 2009, the state-owned China Aviation Industry Corporation (AVIC) secured a pledge of up to RMB 176 billion (US\$25.7 billion) in domestic bank loans, including loans from state-owned commercial banks, which will be used to finance the development of helicopters, engines, cargo planes and the building of passenger aircraft.

7. Given these explicit government policies focused on the aerospace/civil aircraft industry, we request that China provide further details on these policies and the nature and scope of the government support they provide to this sector.

- (a) Please identify all of the national and provincial level documents directed to the implementation of industrial policy related to the development of China's aerospace industry.
- (b) Please provide information on government funds provided to specific aerospace projects such as the ARJ21 and the C919.
- (c) Please provide information on the terms and conditions under which the Government of China, including China's EX-IM Bank and state-owned commercial banks such as ICBC, provide investment subsidies loan interest rate subsidies and loan financing for commercial aircraft projects.

### **Subsidies to the Textiles Sector**

8. Publicly available information indicates that numerous provincial and local authorities in China have developed textile-specific plans for the period 2009-2011, as directed by the central government's "Plan for Adjustment and Revival of Textile Industry". Several of these provincial and local planning documents appear to contain provisions contemplating significant support for the textile sector, and some raise concerns, given WTO subsidies rules.

9. A July 2009 Wuxi City plan states that "foreign exchange from fibre per ton shall be increased by 20 per cent as compared with 2008" and "the ratio of domestic fabric in the clothing for export shall reach 90 per cent and above". (See *Adjustment and Promotion Action Plan for the Textile and Clothing Industry (2009-2011)*, Wu Zheng Fa 2009 (No. 140) ("Wuxi Plan")). In addition, the Wuxi Plan states: "For the major technologies, projects and enterprises which are included in the three-year adjustment & improvement plan, the lands and capital shall be firstly supplied". A list of projects specifying funds to individual companies includes, for example, over RMB 411 million earmarked for one company specifically for "high-grade apparel for foreign trade".

- (a) Could China please explain in what ways Wuxi City is seeking to increase "foreign exchange from fibre" and promoting "domestic fabric in clothing for export"? Please explain how these policies are consistent with China's obligation under Article 3 of the Subsidies Agreement.
- (b) Please explain the criteria for providing support for the purpose of "apparel for foreign trade". Is this support contingent upon exportation?

10. A 2009 Hunan Province plan states: "We will offer certain subsidies and rewards for products exported by ramie processing companies". (See *Implementation Plan for Reviving Hunan's Textile Industry (2009-2011)*, Xiang Zheng Fa 2009 (No. 19)).

- (a) What "subsidies and rewards" are available to exporting companies in Hunan Province?
- (b) Please explain how this plan is consistent with China's obligation under Article 3 of the Subsidies Agreement.

11. In Jiangsu Province, the provincial authorities have outlined policy measures to be implemented with regard to the textile industry. (See *Notice of the People's Government of Jiangsu Province About Releasing the Guidelines for Adjusting and Reviving Jiangsu's Textile Industry*, Su Zheng Fa 2009 (No. 84)). The first of these policy measures is entitled, "Increasing Credit Support". It states: "We will carry out the state credit policy for the textile industry, encourage financial institutions to increase credit support for textile companies, and provide current capital for companies

with good fundamentals but temporary difficulties, and offer more fixed asset loans for major technological reform projects that are in line with industrial policies". Further, it states: "We will encourage guaranteeing institutions to provide credit backing and financing service for textile companies".

- (a) Please provide examples of how this policy is being implemented at the provincial and local levels in Jiangsu Province.
- (b) Please explain what is meant by China's "state credit policy for the textile industry". Please also describe the manner in which guidance is provided to financial institutions to increase credit support for the textile industry.
- (c) What criteria are used to determine which companies qualify as "companies with good fundamentals but temporary difficulties"? Which authorities determine what criteria are to be used in identifying these companies?
- (d) Please identify and describe the industrial policies pursuant to which fixed asset loans for major technological reform projects can be offered under this policy.

12. A Hangzhou City plan states that the city will "offer aid or awards in the form of special funds" to the textile sector, and states that the government will "optimize fiscal and financial credit support". (See *Three-year Action Plan for Adjusting and Reviving Hangzhou's Textile and Clothing Industry (2009-2011)*, Hang Zheng Ban Han 2009 (No. 236)). The plan also states: "We will increase the input into special fiscal funds for textile companies and the 'development fund for Hangzhou's silk and women's clothing industry', and increase fiscal support to companies".

- (a) Please describe the fiscal and financial credit support available specifically to textile and apparel sector companies in Hangzhou City.
- (b) What "aid or awards" are available to Hangzhou City textile sector companies? What criteria must be met to qualify for "aid or awards"?

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

13. Please describe the current government price controls on oil products and electricity and how the government compensates companies for losses incurred due to these price controls.

14. What is the current status of China's energy price reform efforts, particularly with respect to fuel prices?

### **Recent Industry Support Plans**

15. Aspects of China's recent ten industry support plans raise potential concerns, given the rules of the Subsidies Agreement. Specifically, (1) the auto plan discusses support for auto and auto parts "export bases"; (2) the shipbuilding plan provides special credit lines for the purchase of domestic ships; and (3) the machinery plan, *inter alia*, establishes a risk compensation mechanism to encourage the first use of domestically-produced machinery. Please explain how these provisions are consistent with China's obligation under Article 3 of the Subsidies Agreement.

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