

**COMMUNICATION FROM THE EUROPEAN COMMUNITIES**

The following communication, dated 2 October 2009, is being circulated at the request of the Delegation of the European Communities.

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**TRANSITIONAL REVIEW MECHANISM PURSUANT TO PARAGRAPH 18  
OF THE PROTOCOL ON THE ACCESSION OF THE PEOPLE'S  
REPUBLIC OF CHINA<sup>1</sup> ("CHINA")**

1. The EC is transmitting these comments and questions in advance of the meeting of the Committee on Trade-Related Investment Measures (TRIMs) on 16 October 2009, in order for the Chinese authorities to reply and to complete any information that may be incomplete. The questions build upon the previous meetings of the Committee on TRIMs on 14 October 2002, 3 October 2003, 25 October 2004, 10 October 2005, 25 of October 2006, 1 November 2007, and 23 October 2008 as well as previous questions from the European Communities as contained in documents G/TRIMS/W/21, G/TRIMS/W/31, G/TRIMS/W/36, G/TRIMS/W/41, G/TRIMS/W/50, G/TRIMS/W/55, and G/TRIMS/W/60.

2. In connection with its accession to the WTO, China has committed itself to comply fully with the TRIMs Agreement by abolishing legislation and other measures constituting illegal TRIMs upon joining the WTO and through "providing relevant information, including information contained in Annex 1A, to each subsidiary body in advance of the review". In particular, paragraph 7.3 of the Accession Protocol for China reads:

*"China shall, upon accession, comply with the TRIMs Agreement, without recourse to the provisions of Article 5 of the TRIMs Agreement. China shall eliminate and cease to enforce trade and foreign exchange balancing requirements, local content and export or performance requirements made effective through laws, regulations or other measures. Moreover, China will not enforce provisions of contracts imposing such requirements. Without prejudice to the relevant provisions of this Protocol, China shall ensure that the distribution of import licences, quotas, tariff-rate quotas, or any other means of approval for importation, the right of importation or investment by national and sub-national authorities, is not conditioned on: whether competing domestic suppliers of such products exist; or performance requirements of any kind, such as local content, offsets, the transfer of technology, export performance or the conduct of research and development in China."*

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<sup>1</sup> WT/L/432.

3. At this point in time, the EC's comments and questions are focused on the following priority items:

#### **I. LOCAL CONTENT REQUIREMENTS**

4. China has in previous transitional reviews argued that it has honoured its accession commitments as concerns the elimination of local content requirements, and that its trade policies and measures are uniformly implemented. In addition, China has referred to a number review mechanisms that citizens and enterprises have at their disposal should problems in this respect appear. The EC has taken note of these explanations, but remains concerned of reports from industry that local content requirements continue to be applied in China across several sectors, especially at the local level.

(a) Could China indicate what measures it foresees in order to rectify this situation of authorities imposing local content requirements which allegedly are not in line with national legislation?

(b) Could China provide an assessment of how often the various review mechanisms that are available for industry have resulted in locally applied local content requirements to be rectified?

#### **II. STEEL INDUSTRY DEVELOPMENT POLICY**

5. In connection with previous transitional reviews before this Committee, the EC has raised questions regarding China's industrial policy for steel. In particular, the EC has sought clarifications on Articles 23, 17 and 18 of the "Steel Industry Development Policy". While China has given answers to some of our questions, we feel that certain matters require further clarification.

6. Article 23 of the NDRC Steel Industry Development Policy states that "[i]n principle, when investing in the Chinese steel industry, foreign investors will not hold a controlling stake". In particular, it is established that "[a] minimum owned capital of at least 40 per cent of the total capital needed". The EC has argued that this limitation was counterproductive and would hinder a sound development of the steel industry and investment flows in the sector. China has replied that this restriction in foreign ownership was not related to the mandate of this Committee. The EC, however, understands that China could provide further information on the economic and legal basis for applying such restrictions, which clearly impose artificial limits to investment decisions in the steel sector. In addition, the EC urges China to lift this foreign ownership limit so that investment decisions could be based on sound, objective foundations.

7. In addition, Article 23 sets out that "enterprises must demonstrate they have the necessary funding, modern technology and management capacity, as well as demonstrate they have necessary, stable, and reliable healthy sales network, sufficient water and ore resources, coal, and electric power resources". During previous transitional reviews, China has asserted that these requirements applied for both domestic and foreign companies, and that its delegation has not been informed by its competent authority of any additional requirements or tests applicable only to foreign investors. However, the EC has received frequent reports from industry indicating that requirements are not applied in a similar fashion to domestic and foreign companies.

8. In this regard, the EC would be grateful if China could respond to the following questions in detail:

(a) On what basis does China establish that a company, foreign or domestic, has the necessary funding, modern technology and management capacity, a stable and

reliable healthy sales network, sufficient water and ore resources, coal, and electric power resources? What are the criteria used so as to define these requirements?

- (b) Could China confirm that the criteria used to define requirements pursuant to Article 23 are in all cases identical for both foreign and domestic companies? If criteria were different, could China elaborate on the reasoning for applying different requirements?
- (c) Could China verify whether any additional tests are set for foreign non-steel investors, which do not apply to domestic non-steel investors?
- (d) On what basis does China intend to establish whether a non steel company, domestic or foreign, has a *high level of public trust*?

9. The EC notes that Article 17 envisages a ban on outdated techniques and equipments. For this purpose, a list of outdated production capacity, techniques and products has been or will be established. In addition, Article 18 of the NDRC Steel Industry Development Policy reads: "Policies for imported technologies and equipments: use of national equipment and technologies is encouraged, and import is to be reduced. The equipments and technologies that must be imported because they cannot be made in China or cannot meet the requirements must be advanced and practical. The manufacturing of the equipments which are largely needed in the future will be localized. Use of outdated and second-hand steel production equipments eliminated either at home or overseas is prohibited". In the 2008 transitional review China noted that Article 18 is "a reflection of the general guidance nature of the industrial policy and is not directly applicable itself".

10. In light of China's commitments in paragraph 7.3 of China's Protocol Accession, the EC would be grateful if China replied to the following questions in detail:

- (a) Could China explain what are the practical consequences of the "general guidance" contained in the requirements of Article 18?
- (b) What measures does China intend to take in order to further encourage the use of national equipment and technologies and to localize the manufacturing of the equipments which are largely needed in the future?
- (c) Could China confirm whether it intends to impose a condition on the importation of equipments and technologies, namely that they cannot be made in China or cannot meet the requirements?

### **III. TRIMS INCOMPATIBLE CLAUSES IN CONTRACTUAL ARRANGEMENTS**

11. During previous transitional reviews, the EC has addressed concerns regarding the procedures to amend contracts that contained TRIMs incompatible clauses. China has noted that "the investors may decide by themselves whether to change the terms" of a contract, and if so was decided, "they may file the application to relevant authorities to change their articles of association or contract of enterprise accordingly". In addition, China has stressed that this application would be "processed timely and in a manner consistent with the TRIMs agreement".

12. In relation to this statement, the EC would like to pose the following questions, which it does not consider China has previously answered in a comprehensive and fully satisfactory manner:

- (a) What mechanisms does China intend to use in order to ensure that the "approval for investment by national and sub-national authorities" is not conditioned on performance requirements of any kind?
- (b) How does China ensure that the "approval for investment by national and sub-national authorities" is not conditioned on local content requirements of any kind?
- (c) In particular can China confirm that national and sub-national authorities are not bound by performance requirements stipulated in the industrial policies issued by the NDRC?
- (d) Overall, how does China monitor the application process so as to ensure its compliance with the TRIMs Agreement?

#### **IV. JOINT VENTURE OWNERSHIP LIMITATIONS**

13. In connection with prior transitional reviews before this Committee, the EC has signalled its concerns over the continued use of restrictions on foreign investors in several sectors of the Chinese economy. Foreign joint venture partners are not allowed majority ownership *inter alia* in the automobile, petrochemical, chemical, energy and environmental sectors. We have elaborated on our specific concerns in these sectors in our previous submissions mentioned in paragraph 1, and China has noted that it has similar views to those of the EC as concerns opening these sectors for foreign investment, but that it would need "a bit more time" to do so.

14. During previous transitional reviews before this Committee, the EC has argued that such stringent regulations with a view to protecting a preliminary stage of development in those sectors are no longer relevant, given the outstanding performance of the already mature Chinese industry. China has responded that it has "the legitimate right to independently judge on the level of maturity of specific industries and to decide on the speed of investment liberalization". In addition, China has claimed that it does not think there is a question of consistency with WTO obligations.

- (a) What progress has China achieved in opening these sectors for foreign investment since the last transitional review in 2008?
- (b) Could China elaborate on the timeframes it foresees for further investment liberalization in these sectors, notably in light of Minister Chen Deming's September speech at the Xiamen fair that recalls China's plan to gradually reduce the restrictions of the equity caps for foreign investment.

#### **V. REGULATIONS FOR THE IMPLEMENTATION OF THE LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON SINO-FOREIGN EQUITY JOINT VENTURE**

15. In previous transitional reviews, the EC has addressed certain particularities of the regulations for the implementation of the Law of the PRC on Sino-foreign equity JVs, and in particular, regarding provisions pursuant to Article 41, which stipulate that "[t]he technology to be introduced to the joint venture shall be appropriate and advanced and enable the venture's products to display conspicuous social economic results domestically or to be competitive on the international market". In response to EC's concerns regarding compatibility of these requirements with China's Accession Protocol, China has stressed that Article 41 aims at ensuring that technology is "appropriate and advanced", though it is not a performance requirement as such.

16. However, we would like to highlight that Article 43 requires that "[t]he technology transfer agreements concluded by a joint venture shall be submitted to the examination and approval

authorities for approval". In addition, the remainder of Article 43 imposes several requirements on those technology transfer agreements. We note that China has in previous transitional reviews stressed that Article 43 contains no compulsory requirement for foreign investors to include a technology transfer agreement in the contract, and that inclusion of such agreements are at the discretion of the foreign investors and their Chinese partners. However, our concern remains that in many instances Chinese authorities continue to consider technology transfer agreements a *de facto* requirement in joint venture contracts.

- (a) Could China indicate whether the provisions of Articles 41 and 43 are related to both domestic and foreign enterprises?
  - (b) What measures does China intend to take in order to ensure that technology transfer agreements are not imposed on foreign investors engaging in joint ventures, as provided by Article 43, and remain exclusively on a voluntary basis?
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