

Committee on Trade-Related Investment Measures

**TRANSITIONAL REVIEW MECHANISM PURSUANT TO PARAGRAPH 18 OF THE
PROTOCOL OF ACCESSION OF THE PEOPLE'S REPUBLIC OF CHINA TO THE
WORLD TRADE ORGANIZATION**

REPORT OF THE CHAIRMAN

1. Pursuant to Paragraph 18 of the Protocol of Accession of the People's Republic of China, the Committee held the third annual review under China's Transitional Review Mechanism (TRM) at its meeting on 26 October 2004.
 2. Written comments and questions in connection with China's TRM were submitted in advance of the review by the European Communities and the United States. These submissions were distributed in documents G/TRIMS/W/36, and G/TRIMS/W/35 and 37, respectively.
 3. In a communication dated 25 October 2004, China submitted information on Annex 1A of its Protocol of Accession in the context of the TRM. This submission was circulated as document G/TRIMS/W/40, dated 26 October 2004.
 4. Reproduced as Annex 1 to this document are the relevant sections of the Minutes of the TRIMs Committee meeting held on 26 October 2004 in which the substantive discussions on China's TRM are reflected.
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Annex 1

Relevant Sections of the Minutes
of the meeting held on 26 October 2004

(G/TRIMS/M/19)

C. TRANSITIONAL REVIEW MECHANISM PURSUANT TO PARAGRAPH 18 OF THE PROTOCOL OF
ACCESSION OF THE PEOPLE'S REPUBLIC OF CHINA TO THE WORLD TRADE ORGANIZATION

12. The Chairman recalled that under Paragraph 18 of China's Protocol of Accession, the TRIMs Committee was required to review annually, over a period of eight years after China's accession, the implementation by China of the TRIMs Agreement and the related provisions of the Protocol and to report to the Council for Trade in Goods (CTG) on the results of its review. The second annual review had taken place in October 2003 and the corresponding report had been forwarded to the CTG as document G/L/648. With regard to this year's review, he said that in order to carry out its task in a timely manner the TRIMs Committee would need to undertake the review and submit its report in advance of the meeting of the CTG scheduled for 25 November 2004. The Council for Trade in Goods would, in turn, report to the General Council by the end of the year. He then said that the Committee had received communications from the European Communities and the United States which contained comments and questions submitted in connection with China's Transitional Review Mechanism (TRM). These submissions had been circulated in documents G/TRIMS/W/36, and G/TRIMS/W/35 and 37, respectively. Information submitted by China on Annex 1A of its Protocol of Accession had been circulated in document G/TRIMS/W/40.

13. He then proposed to conduct the review as follows: he would first give the floor to the delegations that had addressed written questions to China, and to any other delegation that wished to comment on this item. He would then offer the floor to the delegation of China to respond and provide any other comments they might wish to make. With regard to the Committee's reporting obligation to the Council for Trade in Goods, he said that it was his understanding that Members would wish the Committee to follow the same procedure it had adopted for the previous year's review. In other words, he would draft a brief, factual report to which the relevant parts of the Minutes of the present meeting would be attached. The report would be circulated to all Members before it was submitted to the Council for Trade in Goods.

14. The Committee agreed on the proposed procedure to discharge its reporting obligations.

15. The representative of the European Communities recalled that his delegation had submitted two questions in connection with China's current TRM relating to TRIMs. One of the questions that had previously been raised by his delegation and to which China had responded, related to the amendment of clauses contained in various contractual arrangements that were incompatible with the TRIMs Agreement. In his delegation's submission (G/TRIMS/W/36), attention was drawn to the explicit undertaking that China had assumed upon joining the WTO in terms of such contractual arrangements. Quoting the relevant paragraph of China's Accession Protocol, he said that China had undertaken "...not to enforce provisions of contracts imposing such requirements." In light of the answer that had been provided to the European Communities, his delegation felt the need to reinforce and put the question once again to China and looked forward to receiving additional information on that matter. The second question related to the New Automobile Policy adopted by China this summer. As laid out in document G/TRIMS/W/36, the question called upon China to specify and clarify to the Committee and the CTG the relevant features of the New Automobile Policy, and in particular as regards two questions. One was which government ministry or agency was responsible

for export processing zones in China and which regulations foresaw the abolition of otherwise applicable joint venture restrictions provided the investment was located in an export processing zone. The other question called upon China to provide further details about the characteristics of the export processing zones, including the possibility of importing goods processed in the zones into the mainland, and also whether there were circumstances under which such importation could take place on a duty-free basis. His delegation looked forward to hearing China's responses to those questions.

16. The representative of the United States said that his delegation believed that the TRM could be a useful exercise for both China and other WTO Members. It allowed China and other WTO Members to exchange information, review implementation progress and clarify points of agreement and disagreement. He thanked China for its submission on Annex 1A information and looked forward to China's explanation of the document. He first referred to the questions his delegation had submitted in connection with China's auto policy. His delegation noted that with regard to new automobile production plans and new automobile engine manufacturing plans, Article 47 of China's New Automobile Policy required an investment in research and development (R&D) facilities. His delegation also noted that in China's Protocol of Accession and in commitments in its Working Party Report, China had agreed that the right of investment would not be conditioned on, among other things, the conduct of research and development in China. His delegation sought some clarification from China as to the meaning of this provision and how it would be applied. His delegation also noted that in Annex II to the New Automobile Policy, among the documents required to be filed with the approval authorities was any technology transfer agreement. In China's Protocol of Accession and in commitments in its Working Party Report, China had agreed not to condition the right of investment on the transfer of technology. His delegation looked for an explanation from China as to the meaning of this provision of the New Automobile Policy. The other questions submitted by his delegation dealt with the Catalogue for Foreign Investment, which China had issued in March 2002. In this regard, his delegation sought information about China's plans for issuing a new or revised catalogue, and specifically whether China had any plans to remove biotechnology seed development and production from the prohibited investment category.

17. The representative of Chinese Taipei said that a communication from his delegation would be forthcoming. His delegation also had a number of questions regarding China's Automobile Industry Development Policy (hereafter the Policy), published in May 2004, and would appreciate if China could provide further clarification in this regard. The first question related to Article 36 of the Policy, which stated that China was to abolish the existing approval management method for the sales right of passenger cars, and that it would draft the implementation rules for management of brand marketing for automobile products. He asked if China could provide information on the status of its drafting of the implementation rules for management of brand marketing for automobile products and also provide details of the main content of these rules. The second question related to Article 39 of the Policy, which stated that "Transferring the right of sales links to another impersonal entity is regarded as a major change in the feasibility study report in the original investment project, and should be approved by the Ministry of Commerce and reported to the original project examining and approving unit for approval." In his delegation's view, transferring the right of sales from a motor vehicle production enterprise to another impersonal entity was generally regarded as normal business practice and should be respected. However, China regarded this transfer as a major change in the original investment project and required it to be approved by the relevant authorities. His delegation asked if China could confirm that these requirements would not hinder or interfere with the autonomy of business enterprises to transfer the right of sales and the right of marketing. Moreover, he asked if, in light of normal international business practice, China could consider removing these requirements.

18. He said that his third question related to Article 47 of the Policy, which set out strict requirements for new investment projects. This aspect had been referred to by previous speakers, so he did not need to mention the details of these requirements. His delegation asked if China could explain how the requirements relating to total investment and after-tax profits did not amount to

investment barriers for new investors. The fourth question related to paragraph 203 of the Report of the Working Party on China's Accession, under which China had committed to eliminate local content requirements. However, Articles 55, 56, and 57 of the Policy gave a strict definition and scope of complete vehicle features. He asked if China could confirm that these stipulations did not aim at increasing the rate of localization of automobile products, and that they would not constitute new trade barriers on vehicle imports. His delegation's last question concerned Article 58 of the Policy, according to which the State had designated four coastal ports and two land ports as well as the Xinjiang Alataw Pass, to be the ports handling imports of complete vehicles. Therefore, imported complete vehicles must enter China via these ports. His delegation was interested in knowing the reasons why China had designated these particular ports for the handling of imports of complete vehicles and whether China planned to designate more ports in the future.

19. The representative of China said that, prior to this meeting, China had submitted information required by Annex 1A of the Protocol of Accession to the TRIMs Committee. Before passing the floor to her colleague to respond to the written specific questions from the Members, she would like to provide some illustrative information on the issues of concern to some Members. Firstly, immediately upon accession, China had amended the Industrial Guideline Catalogue for Foreign Investment in a comprehensive manner according to the WTO rules and China's commitments. The existing Catalogue had a distinctive feature. It expanded the degree of opening up and took encouraging foreign investment as a general policy. The industries falling under the "encouraged" category had increased from 186 to 262, and the number of "restricted" industries had been reduced to 75 from 112. China had also further loosened equity limits on foreign investment. For example, the requirement of majority equity holding by the Chinese side in the public dock facilities of ports had been relinquished. Furthermore, some previous prohibitions for foreign investment in areas like telecom, supply of gas and water had been lifted. Secondly, on 1 June 2004, China had promulgated the Policy on the Development of Auto Industry. In drafting the Policy, the Chinese Government had broadly solicited the opinions and comments from both domestic enterprises as well as foreign investors through the internet and various symposiums. The Policy had only been finalized after repeated revisions based on the inputs from these industries. The new policy had two major improvements over the old Policy on Auto Industry. It had removed provisions inconsistent with WTO rules. The requirements on foreign exchange balance, local content and export performance had been abolished. It had also greatly deregulated administrative approvals. The policy had based the auto industry administration more on the laws and technology standards, and less on the government authorities, aiming to guide the healthy development of the industry. This new policy had met the requirements of the development of China's auto industry, as well as the specific commitments China had made upon accession. She added that 2004 was the third year of China's WTO membership. In the past years, China's faithful and complete implementation of its obligations with regard to the TRIMs had created a favourable environment and a level playing field for foreign investors. In the year of 2003, with an inflow of foreign direct investment of US\$ 53.5 billion, China had become one of the most attractive destinations of global FDI. Her delegation believed that the affirmation from investors was the best testimony to China's liberal investment regime and its successful implementation of commitments on TRIMs. She then passed the floor to her colleague.

20. Before replying to the specific questions raised by Members, the representative of China said that written questions should be submitted to China at least ten days before the meeting in which the TRM would take place. This would enable China to have adequate time to mobilize domestic resources to prepare for the responses. He said that his delegation had never received written questions from Chinese Taipei. He then proceeded to provide oral responses to the questions raised by Members. First of all, he reiterated that China had fully abided by its TRIMs commitments and obligations upon its accession, and that it had abolished the requirements on foreign exchange balance, trade balance, local content and export performance. However, with regard to all the existing commercial contracts on joint venture operation and technology transfer, since they had been signed by the relevant parties in consideration of their own business interests, the parties involved should

negotiate about the amendment of those contracts themselves on the basis of fairness, justice and equality. The contracts should not be regarded as invalid automatically or be annulled through or by government actions or interference. Regarding the *Industrial Guideline Catalogue for Foreign Investment*, he said that as all Members knew, the catalogue currently in effect had been publicized and implemented after amendment in March 2002. With the rapid development of China's national economy and society since then, and in order to meet the needs of further opening up, China would amend its *Industrial Guideline Catalogue for Foreign Investment* from time to time as appropriate. At present, the competent authorities were working on the amendment, and the new version would be issued and implemented soon after its approval by the State Council. The aim of establishing and implementing the *Industrial Guideline Catalogue for Foreign Investment* was to further the guidance on foreign investment and to direct it to closely follow up the rapid development of China's national economy and society. Consistent with *The Regulation on Foreign Investment guidance*, foreign investment projects that endangered the national security or imperil social and public interests should be prohibited. Upon its accession to the WTO, China had made no promise to open up the ten presently prohibited types of projects to foreign investment. Among those, in the fields of "agriculture, forestry and fishery", there were three types of projects prohibited to foreign investment, with "production and development of genetically modified plants seeds" included as one of them. However, bio-technology seed development and production was not included among the three.

21. He then referred to the new *Policy on Development of Automobile Industry*. He said that this policy stipulated that "...Projects, set up by foreign or domestic automobile manufacturers within export processing zones (EPZ) on the production of automobiles and engines oriented for export, will not be restricted by the provisions of this Policy, but should be submitted to the State Council for examination and approval." His delegation believed that the practice of establishing export processing zones and applying different administrative methods to the enterprises within the zones was the common practice adopted by most Members and it should not be regarded as requirements on export performance. He added that, according to *Interim Measures on Custom Administration on the Export Processing Zones*, the automobile manufacturers inside the zones would not be included in the public registry for domestic manufacturers and products. Automobiles and engines produced in the zone were intended for export only. As for goods transported out of the zones, they were subject to the same customs procedures applicable to imported goods, as well as to the tariff on finished products. For goods under import licensing, a valid import licence needed to be submitted to the customs. All the articles in the *Policy on Development of Automobile Industry* applied to enterprises that invested in the automobile industry in China. Article 3 - or "paragraph 3 of the new policy" as a Member had put it in its written question - generally outlined China's goals, strategy and direction in automobile industry development, without touching upon any detailed measures or restrictions on the volume. Annex 2 of the Policy stipulated that, when setting up an automobile enterprise project, the enterprises involved should put relevant documents on record. Article 4 of Annex 2 set out that the contract on foreign technology transfer should be put on record. The reason why China required "foreign technology transfer and contract on technical cooperation" was to prevent illegal assembling, to protect intellectual property and to ease up the procedures for product testing and accreditation, but not to force foreign parties to transfer their technologies. Therefore, this practice did not constitute a restriction on investment, nor a violation of the Protocol of Accession or the Working Party's Report. He went on to say that Article 47 of the Policy required the newly-established enterprises to set up their own Research and Development institutions. The reason for this requirement was to equip the enterprises with basic technical ability in order to ensure that the newly-established enterprises be able to conduct technical reconstruction and research and development on their own products, and that they could meet the increasing technical and legal requirements on safety, environmental protection and energy saving, as well as customer demand in China. This article did not stipulate specific and mandatory requirements on product R&D performance. Finally, he said that in China the customs were responsible for the regulations on supervision of EPZ. Reference could be made to the *Interim Measures on Custom Administration on the Export Processing Zones* for details. The investment

projects on automobiles and engines within the EPZ were operated in accordance with the stipulations in this Policy.

22. The representative of the United States said that his delegation appreciated China's responses, but wanted to seek further clarification on some of them. He had understood the Chinese delegate to say that, with regard to Article 47 of the New Automobile Policy, the provision dealing with R&D was not mandatory. He asked China if his understanding was correct. Regarding the Catalogue for foreign investment, he had understood from China's responses that biotechnology seed development and production was not included in the prohibited category. He also wanted to clarify that this interpretation was correct. Lastly, he said that his authorities in the capital would review the responses and the information on Annex 1A that had been received from China at the meeting and that, if necessary, his delegation would raise any follow-up comments or questions in the Council for Trade in Goods.

23. The representative of the European Communities thanked the Chinese delegation for having provided some answers to the questions that his delegation had put in its document submitted on 13 September 2004. He wanted to ask for clarification on two points, which he would take back to Brussels for further discussions, including with the automobile industry and experts. The first question related to the issue of enforcement of contracts. He had understood from China's response that such contracts which might contain TRIMs-incompatible clauses should be the subject of renegotiation or amendment among the parties to the contracts rather than to any government intervention. Leaving aside that argument, he asked if China could clarify what exactly was meant by the following sentence from the Protocol of Accession: "...Moreover, China will not enforce provisions of contracts imposing such requirements...". He asked China whether that sentence could be read to mean that, for instance, if a foreign investor refused to meet the requirement by a domestic party to use local components and he was taken to court, the Chinese authorities would ensure that the relevant provisions of such a contract were not "enforced" in accordance with the Accession Protocol. The second question related to paragraph 13 in document G/TRIMS/W/36. He asked China to what extent actual export performance was a condition or requirement in order to be granted the relevant approval to invest in the EPZs. He acknowledged that China had provided useful information about the EPZs, however he would be grateful if China could provide a very specific answer to his question.

24. The representative of Chinese Taipei thanked the delegation of China for its remarks and said that he understood that China had not fully responded to the questions posed by his delegation given that these had come too late. He looked forward to their responses at an appropriate time.

25. The representative of China said that his delegation required a lot of time and resources to prepare its responses under the TRM. He thanked Members' appreciation for China's efforts and contribution in this regard. He added that under the TRM process, once this item of the agenda was completed at the present meeting, the questions orally made or raised should be put to China in some other appropriate situation. Once the TRM was completed in the Committee it was over. He was happy to answer some of the follow-up questions raised by Members; in some other cases he would need to take the questions back home for further discussion in order to provide the appropriate responses. Regarding the question on the EPZs, he advised the delegate of the European Communities to refer to the *Interim Measures on Custom Administration on the Export Processing Zones*. He added that once back in the capital, his delegation would get more information from the customs and would get back to the European Community with the responses, in some other situation. On the question regarding biotechnology seed development and production, his delegation could confirm that there were only three types of projects in the fields of agriculture, forestry and fishery that were prohibited to foreign investment, and that production and the development of genetically modified plant seeds was one of them. As far as he knew, biotechnology seed development and production was not included among the three. Referring to Article 47 of the Chinese auto parts

industry policy, he said that this provision did not stipulate specific or mandatory requirements on product research and development performance.

26. The Chairman commended the delegation of China for its efforts in preparing for the review and in replying to the questions that had been submitted. He also thanked all other delegations for their active participation in the exercise. The Committee took note of the statements made.

27. The Committee approved *ad referendum* the Report of the Chairman to the Council for Trade in Goods¹, and agreed that the Report, to which would be attached as an annex the relevant sections of the Minutes of the present meeting, be submitted to the Council for Trade in Goods.

¹ A draft Report of the Chairman was distributed to Members at the meeting for their consideration.