

# WORLD TRADE ORGANIZATION

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## 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<sup>1</sup>

#### Report of the Chairperson

1. Pursuant to Paragraph 18 of the Protocol of Accession of the People's Republic of China, the Committee on Trade-Related Investment Measures carried out the ninth and final annual review under China's Transitional Review Mechanism (TRM) at its meeting on 3 October 2011.
2. In a communication dated 23 September 2011, China submitted information on Annex 1A of its Protocol of Accession in connection with this review. This submission was distributed in document G/TRIMS/W/90 dated 23 September 2011.
3. A written communication regarding China's Transitional Review was submitted in advance of the review by Japan. This communication was circulated in document G/TRIMS/W/85 dated 21 September 2011.
4. Annex 1 to this report reproduces the relevant sections of the Minutes of the TRIMs Committee's meeting held on 3 October 2011 in which Members' substantive discussions regarding China's ninth and final Transitional Review are reflected.

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

Annex 1

Relevant Sections of the Minutes  
of the meeting held on 3 October 2011

(G/TRIMS/M/31)

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

1. The Chairperson recalled that under Paragraph 18 of China's Protocol of Accession (WT/L/432) 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 of Accession, and to report to the Council for Trade in Goods (CTG) on the results of its review. The eighth annual review of China had taken place on 16 October 2009, and the relevant report had been submitted to the CTG as document G/L/899.

2. With respect to this year's review, the ninth and final, the Chairperson said that in order to discharge its reporting obligations in a timely manner, the TRIMs Committee needed to undertake the review and submit its report in advance of the next meeting of the CTG which was scheduled for 7 November 2011. Pursuant to paragraph 18 of China's Protocol of Accession, the CTG would in turn report to the General Council by December 2011.

3. The Chairperson said that the Committee had received a communication from China concerning information required under Annex 1A of its Protocol of Accession, which had been circulated as document G/TRIMS/W/90. She added that the Committee had also received a communication from Japan in connection with this review. This communication was circulated in document G/TRIMS/W/85.

4. The Chairperson proposed that, in keeping with previous practice, the Committee would conduct the review in the following manner: she would first give the floor to the delegation of Japan that had submitted a communication in connection with the review, and to any other delegation that wished to comment on this item. She would then invite the delegation of China to answer the questions posed and provide any other information it might wish to share with the Committee.

5. The Committee so agreed.

6. The representative of Japan welcomed generally China's efforts to simplify the verification processes for investment projects in recent years, including efforts on decentralization, liberalization, and enhancement of transparency. However, there were still difficulties for foreign SMEs to follow the implementation of the verification processes, since a unified response could not be expected among different local governments. In this sense, further transparency and predictability for foreign investors would be appreciated. He added that restrictions on foreign capital participation remained in many sectors. For instance, commitments had been made to open up certain sectors under the Law on Management of Foreign Investment in the Commercial Sectors, but the implementing regulations were not enforced yet. He indicated that China would be required to enforce related regulations to fulfil its commitments. He submitted that although China had committed itself to fully comply with the relevant provisions under the TRIMs Agreement as well as its Accession Protocol, in particular paragraph 7.3 of Part I, performance requirements on local content or technology transfer still remain as impediments.

7. On China's consistency with its commitments under paragraph 7.3 of the Protocol, the representative of Japan noted that Japan was concerned that the Government of China was still imposing a kind of technology transfer requirements on investments in the new-energy vehicles production. He requested China to provide its view in this regard. He indicated that it would be appropriate for China to refrain from intervening in the market in order to enhance the visibility and creditability of the Chinese market.

8. The representative of the United States recalled that the TRM was created largely because China was admitted to the WTO Membership before it had revised all of its trade-related laws and regulations to become WTO-compatible, and because China was allowed a variety of transition periods before it took on certain WTO obligations. The annual TRM meetings, therefore, provided Members with opportunities to review with China, in a multilateral setting, the efforts that China had taken to implement specific commitments made in its Protocol of Accession as well as China's efforts to comply with the obligations that it had taken on under the many agreements that made up the WTO Agreement.

9. The representative of the United States indicated that looking back on past transitional reviews, the focus of these reviews had changed over time. For the first five years of China's WTO Membership, the transitional reviews focused predominantly on the scheduled phase-in of key commitments that China had made in its Protocol of Accession. However, once that phase-in-period ended, and China could no longer be considered a new WTO Member, the focus of the TRM shifted. At that point, the transitional reviews focused more on China's adherence to the range of WTO rules that obligate all Members. She added that during the initial phase-in period, China implemented a set of sweeping commitments, including reducing tariffs, eliminating non-tariff barriers that denied national treatment and market access for goods and services imported from other WTO Members, and making legal improvements in intellectual property protections and in transparency. These actions deepened China's integration into the international trading system, facilitating and strengthening China's rule of law and economic reform. Trade and investment also expanded dramatically between China and its many trading partners.

10. The representative of the United States stated that even though China had taken many impressive steps to reform its economy since joining the WTO ten years ago, the overall picture remained complex, given a troubling trend in China toward increased state intervention in the Chinese economy in recent years. Frequently, trade frictions with China could be traced to China's pursuit of industrial policies that rely on excessive, trade-distorting government intervention intended to promote or protect China's domestic industries and state-owned enterprises. This government intervention reflected that China's rapid transition from a centrally planned economy to a free-market economy governed by rule of law remained incomplete.

11. On developments relating to investment measures in particular, the representative of the United States recalled that, as a result of its accession negotiations, China had not only taken on the obligations of the TRIMs Agreement, but also made additional commitments that Members had sought in order to discipline China's use of a variety of investment restrictions. For example, China agreed to eliminate export performance, local content and foreign exchange balancing requirements from its laws, regulations and other measures, and not to enforce the terms of any contracts imposing these requirements. In addition, China agreed that it would no longer condition importation or investment approvals on these requirements or on requirements such as technology transfer and offsets.

12. Furthermore, the representative of the United States submitted that before and after its accession, China revised many laws and regulations on foreign-invested enterprises to eliminate WTO-inconsistent requirements relating to export performance, local content, foreign exchange balancing and technology transfer. However, some of the revised laws and regulations have continued

to "encourage" technology transfer or the use of local content, without formally requiring it. Moreover, even when laws and regulations had not expressly encouraged it, enterprises from the United States and other Members had continually reported that some Chinese government officials, who retained a high degree of discretion when reviewing investment applications, still considered factors such as technology transfer and local content when deciding whether to approve an investment. She added that one sector that had been particularly hit with investment restrictions and related problematic policies designed to shield Chinese enterprises from foreign competition throughout China's ten years of WTO Membership was the auto sector. Unfortunately, these policies had included guidelines which appeared to conflict with China's WTO obligations.

13. In addition, even though China had committed to revise its industrial policy for the auto sector to make it compatible with WTO rules, the revised policy that China issued in 2004 included provisions discouraging the importation of auto parts and encouraging the use of domestic technology. It also required new automobile and automobile engine plants to include substantial investment in research and development facilities, despite its commitment not to condition the right of investment on the conduct of research and development. One of the measures that emanated from China's revised auto policy was a 2005 regulation that unfairly discriminated against imported auto parts and discouraged automobile manufacturers in China from using imported auto parts in the assembly of vehicles. In 2006, after bilateral dialogue failed to convince China to withdraw its regulation, the United States, the European Union and Canada initiated a WTO case challenging China's regulation as inconsistent with several WTO provisions, including Article III of the GATT 1994 and Article 2 of the TRIMs Agreement, as well as the commitment in China's accession agreement to eliminate all local content requirements relating to importation. A WTO panel and the WTO Appellate Body had both ruled in favour of the United States and the other complaining parties and China repealed its regulation in 2009.

14. The representative of the United States also explained that China had, more recently, taken a series of problematic actions related to the so-called "new energy vehicles" or NEVs. For example, regulations issued by the National Development and Reform Commission in 2007 and the Ministry of Industry and Information Technology in 2009 required that the foreign manufacturers' NEV investments in China be subject to project approval. Through this approval process, foreign manufacturers may be required to transfer sensitive technologies to their joint ventures with Chinese partners - the only investment mechanism through which foreign manufacturers may build vehicles in China - in order for any new NEV manufacturing facilities and new NEV models to be approved, given the regulations' requirement that the manufacturing entity in China should "hold" and demonstrate "mastery" of certain core NEV technologies. The regulations also required the manufacturers to set up research and development units in China. These aspects of China's regulations had raised serious concerns in the United States and other Members in light of the commitment that China made not to condition investment on the transfer of technology or the conduct of research and development.

15. Moreover, based on statements made by Chinese government officials and reports from various non-governmental sources, it appeared that China had begun to implement, or may soon implement, a number of other troubling policies relating to NEVs, either through the exercise of discretionary authority by Chinese regulatory agencies or the issuance of new regulations. In particular, China appeared to be imposing new requirements to sell NEVs in China only under Chinese brands, even though China committed to eliminate restrictions on the types of cars foreign enterprises produce or sell in China. Revisions to China's Foreign Investment Catalogue currently under consideration, would limit foreign manufacturers to no more than 50 per cent of a joint venture to manufacture NEV parts, even though parts manufacturers (unlike manufacturers of whole vehicles) previously had been able to operate in China through wholly foreign-owned enterprises. China appeared to have begun, or might soon begin, making substantial subsidies available in connection with the purchase of domestically produced NEVs, but not imported NEVs, raising national treatment

concerns under Article III of the GATT 1994. China also appeared to be considering incentives that would allow purchasers of domestically produced NEVs to complete automobile registration in municipalities like Beijing and Shanghai more quickly and easily.

16. The representative of the United States also stated that the steel sector was another sector which had been impacted by troubling investment restrictions since China acceded to the WTO. For example, the industrial policy for the steel sector that China issued in 2005 required that foreign investors possess proprietary technology or intellectual property in the processing of steel. Given that foreign investors were not allowed to have a controlling share in steel enterprises in China, this requirement would seem to constitute a *de facto* technology transfer requirement, in conflict with China's commitment not to condition investment on the transfer of technology. This policy also appeared to discriminate against foreign equipment and technology imports. Like other measures, this policy encouraged the use of local content by calling for a variety of government financial support for steel projects utilizing newly developed domestic equipment. It also called for the use of domestically produced steel-manufacturing equipment and domestic technologies whenever domestic suppliers exist, apparently in contravention of the commitment that China made not to condition the right of investment or importation on whether competing domestic suppliers existed.

17. In a number of other sectors, the United States and other Members had become increasingly concerned over the last few years about new restrictions on investment being proposed and implemented by China. Often, these restrictions were accompanied by other problematic industrial policies, such as the increased use of subsidies, preferences for using domestic rather than imported goods, and the development of China-specific standards. Many of these investment restrictions could be traced to a five-year plan, issued in 2006, which sought to restrict foreign enterprises' acquisition of "dragon head" enterprises, prevent the "emergence or expansion of foreign capital monopolies", protect national economic security, particularly "industry security", and prevent "abuse of intellectual property". China's investment restrictions – including the restrictions that China placed on foreign acquisitions of Chinese companies, which went beyond genuine national security concerns – had run counter to the market-oriented principles that were the basis for much of China's economic success over the past few decades. Indeed, these types of investment restrictions were more likely to retard the growth and development of the Chinese economy than to accomplish the state planners' ultimate objective of creating internationally competitive domestic enterprises.

18. Finally, the representative of the United States mentioned that in the area of investment, like many other areas, it appeared that China had made progress but had not yet implemented all of the cross-cutting transparency commitments that it made when it acceded to the WTO, and that serious concerns remained, even after ten years of the WTO Membership.

19. First, with regard to China's commitment to publish all laws, regulations and other measures pertaining to or affecting trade in goods or services (as set forth in paragraph 331 of China's Working Party Report), China had complied with this commitment in many respects. However, it still did not appear that China had published measures that provided "internal guidance".

20. Second, with regard to China's commitment to publish measures for comment before implementing them (as set forth in paragraph 2 (C) 2 of Part I of China's Protocol of Accession), China had made improvements, but it appeared that China had still not institutionalized a notice-and-comment mechanism for all Chinese agencies. To date, while the State Council had been regularly publishing proposed regulations for public comment, it appeared that Chinese agencies had had more difficulty publishing proposed departmental rules and other proposed measures. The United States noted that, in case of the NEVs discussed previously, while proposed revisions to China's Foreign Investment Catalogue were published for public comment, other proposed measures had not been made public, even though it appeared that Chinese government officials might already be implementing some of them.

21. Third, with regard to China's commitment to make available all laws, regulations and other measures pertaining to or affecting trade in goods or services in one or more WTO languages (as set forth in paragraph 334 of China's Working Party Report), it appeared that China had made no progress in implementing this important commitment.

22. Going forward, the representative of the United States urged China to reconsider its heavy reliance on investment restrictions as a tool of industrial policy. She also urged China to review its existing investment restrictions, particularly in the auto and steel sectors, in light of its WTO commitments and make appropriate revisions where necessary. She concluded by indicating that the United States would continue to engage with China, both in the Committee and bilaterally, until these outstanding issues were satisfactorily resolved.

23. The representative of Mexico indicated that there was no doubt that the accession of China had marked an important step for the multilateral trading system. The importance of China in the multilateral trading system had required great monitoring of its commitments within the framework of its accession to the WTO. He noted that China made important progress in terms of FDI, the elimination of certain requirements such as export performance and local content requirements, but noted that there were many concerns which interested foreign companies had with regard to performance requirements and the recruiting of local staff, among other things. He was of the view that this was not in line with paragraph 203 of the Report of the Working Party on the Accession of China which stated that the allocation, permission or rights of importation and investment would not be conditional upon performance requirements set by national or sub-national authorities, or subject to secondary conditions covering, for example, the conduct of research, the provision of offsets or other forms of industrial compensation including specified types or volumes of business opportunities, the use of local inputs or the transfer of technology. He also recalled that paragraph 49 of China's Protocol of Accession stated that China would not impose any requirements pertaining to the transfer of technology which were not compatible with the TRIMs Agreement. He finally submitted that this had given rise to concerns within the private sector in Mexico and urged China to review these measures in line with the commitments it took upon its accession to the WTO.

24. The representative of the European Union indicated that after ten years of its accession to the WTO, China has moved from being an emerging economy to a global economic power. Its WTO Membership had certainly not been alien to its impressive transformation; as a corollary, it was also expected that China's domestic policies and measures would fully abide by WTO rules and be duly designed and implemented in line with the commitments made in the run up to its accession. He noted that this TRM had provided the WTO Members with the opportunity to review the implementation of these commitments. He added that, like many other Members, the European Union had made active use of this TRM throughout the process – be it orally or via written submissions – and thanked China for its cooperation. He also thanked China for submitting, though belatedly, the information prior to this meeting<sup>2</sup> in accordance with Article 18.1 and Annex 1A of China's Accession Protocol.

25. The representative of the European Union had welcomed China's overall efforts to enhance transparency as far as the investment approval process and publication and consultation on new legislative initiatives which impact investment were concerned. However, he submitted that the European Union had also noted that investment approval in China remained a very difficult process and that there were no clear "one-stop" shops pertaining to these approval procedures and that further streamlining would be appreciated. In 2011, the Chinese government published a draft revision of the Catalogue for the Guidance of Foreign Investment Industries, which listed the sectors in which foreign direct investment was either encouraged, restricted or prohibited and would eventually update the 2007 version of the Catalogue. The European Union had also welcomed the opportunity to comment in the public consultation and has submitted comments to China, but would like to receive

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<sup>2</sup> G/TRIMS/W/90.

some update on the next steps in this process. He also regretted that in its draft version, the revised Catalogue did not substantively remove restrictions for sectors and had even added some sectors, such as postal and courier services to the list of prohibited sectors.

26. The representative of the European Union noted that China continued to maintain an investment environment where all foreign investments appear to be subject to some form of government approval. The European Union welcomed the steps undertaken in the past to facilitate the approval process by increasing the threshold under which sub-central authorities could approve foreign investments. However, the Chinese investment environment continued to include many restrictions on foreign investment, including complete bans on foreign investment in certain sectors, reflecting the government's continued role as a very active manager of the economy. He emphasized that in the future more restrictions should be lifted. In this context, the European Union had been concerned about the new national security screening mechanism for foreign investment through mergers and acquisitions of domestic Chinese enterprises. While national security concerns were of course important, he stressed that national security had to remain a narrowly defined concept and should not be used beyond what would be proportionate. In particular, the European Union was concerned about the retroactive applicability of this screening mechanism, which seemed to allow China to even force disinvestments with no timeframe for already established foreign enterprises. He urged China to implement such measures ensuring transparency and predictability. Furthermore, while the European Union recognized that China had revised many laws and regulations on foreign-invested enterprises to eliminate WTO-inconsistent requirements relating to export performance, local content, foreign exchange balancing and technology transfer (as required by China's Protocol of Accession, part I, paragraph 7.3, and China's Working Party Report, paragraph 203), he believed that this process had not been finalized and encouraged China to ensure these requirements were fully removed.

27. The representative of the European Union added that it regrettably appeared that the Chinese Government continued to pressure foreign companies to transfer technology, use local content or set up research facilities in China. These requirements were still contained in certain joint-venture operations. In particular, he expressed concern about this in the area of new energy vehicles production. He referred to his delegation's earlier statements in this respect in this Committee, and to documents G/TRIMS/W/60 (14 October 2008) and G/TRIMS/W/69 (5 October 2009), and indicated that the European Union would remain concerned with the joint-venture requirements and the "2+2" regulation that was severely limiting foreign investment opportunities in the automobiles and auto-components sector. In a sector which had now become the world's largest, protection of infant industry was an argument that could no longer hold. Therefore, the European Union would once again encourage China to completely eliminate these requirements in all cases with a view to really pursue the consolidation of the automobile industry.

28. Another example where the European Union remained concerned about restrictive conditions for foreign investors was the wind power sector. The representative of the European Union submitted that while localization requirements might have been removed, serious limitations persisted, that would effectively hinder foreign investors from participating in this market, for instance by requiring that wind turbine generators be produced domestically. Foreign developers could only participate in offshore wind projects via Chinese-controlled joint ventures. Another additional worrisome development was the issuance of measures aiming at the exclusion of foreign-invested enterprises from the implementation of *Clean Development Mechanism* projects.

29. Finally, the representative of the European Union stated that his delegation would monitor all those important issues. He believed that, within its remit, this Committee would continue to provide an appropriate forum for spurring Members to ensure that their trade regimes were fully in conformity with the rules of the multilateral trading system, to the benefit of the whole WTO Membership.

30. The representative of China started by responding to the question posed by Japan concerning the *Rules on the Access of New-Energy Vehicle Manufacturers and Products*. He also referred to the statements made by the United States and the European Union in which the relevant policies of the Chinese government were mentioned. He explained that with respect to the specific rules on the new energy vehicles and following consultations with the relevant Chinese authorities, it became apparent that Members had probably misunderstood some of the Chinese measures or policies. He clarified that the rules themselves did not impose TRIMs inconsistent compulsory technology transfer requirements as understood by China's trading partners. He explained that what was specified in the rules was that the manufacturers, both foreign and domestic, should indeed have their own key technology in the area of new energy vehicle manufacturing, but that did not mean that the technology owned by foreign investors should be transferred. The Chinese authorities were of the view that since this sector was relatively new and still at an early stage of technology development and industrialization, such requirement would be necessary at this stage to guarantee the safety and quality of the products and to demonstrate the effectiveness of the product's performance as a new energy vehicle.

31. The representative of China also referred to China's efforts in the past ten years with regard to the implementation of China's TRIMs-related commitments. He explained that as reflected in all the nine submissions provided by China to the Committee pursuant to Annex 1 (A) of China's Protocol of Accession, China had seriously fulfilled its commitments with respect to the TRIMs Agreement. Furthermore, China had also been engaged in discussions and consultations with Members in an open and candid spirit on issues concerning China's TRIMs with the aim that the implementation of these measures would be consistent with the requirements of the TRIMs Agreement. Such exchanges had by no means been limited only to this item of the Committee meeting's agenda.

32. The representative of China indicated that China would continue to take rights and obligations in the WTO seriously, including those under the TRIMs Agreement. He had taken note of the concerns and views expressed by some other Members in their previous statements and it was not surprising that Members had either misunderstandings or concerns on some of China's policies, particularly in the industrial policy area. On that particular issue, he stated that China as a sovereign state had the right to design its regimes including that concerning foreign investment. He also stated that China, in the welfare of its own people and to achieve economic progress and development, certainly had the right to design its own policies and measures which it believed to be important and adequate. However, in this course, China and other WTO Members shared a common ground of WTO rules and principles including those of the TRIMs Agreement. He expressed China's readiness to continue its discussions with Members based on these common rules and principles.

33. The representative of China assured the Committee that China would continue to further expand its opening up to foreign investment, and the latest move of China in this respect was reflected in the latest submission made by China to the Committee as contained in document G/TRIMS/W/90, that is, as noted by the European Union, China was revising its Catalogue for the Guidance of Foreign Investment Industries, and in this revision China would open up some sectors further to foreign investment. He concluded that China's exchange with Members on TRIMs-related issues would certainly continue in view of China's further opening and that the end of this transitional review would not mean the end of China's communication with other Members. China would continue to participate in the activities of this Committee in an open and cooperative spirit.

34. The Chairperson said that with regard to the Committee's reporting obligation to the CTG, she understood that Members would wish the Committee to follow the same procedure that had been adopted in previous years, i.e. the Chairperson would submit a brief, factual report, which would include references to the submissions made in connection with this year's Review and would contain in the Annex the relevant parts of the Minutes of this meeting. She indicated that she had taken the liberty of asking the Secretariat to prepare a draft outline of her report for Members' consideration.

This had been circulated as document G/TRIMS/W/84. If Members agreed to this outline, and once the relevant section of the Minutes had been attached to it, she would forward the report to the CTG.

35. The Committee took note of the statements made under this item and agreed on the proposed procedure to discharge its reporting obligations concerning China's TRM.

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