

# GENERAL AGREEMENT ON

# TARIFFS AND TRADE

RESTRICTED

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## WORKING PARTY ON CHINA'S STATUS AS A CONTRACTING PARTY

### Annotated Checklist of Issues

#### Note by the Secretariat

At its meeting on 18-19 April 1989 the Working Party requested the Secretariat to prepare an annotated checklist of issues to facilitate the drafting of a protocol on China's status as a contracting party. The present note has been prepared in response to that request. It contains a checklist compilation of the various issues raised during the Working Party's assessment of China's foreign trade regime.

The Working Party has not yet discussed all the issues that need to be dealt with in a protocol setting out China's rights and obligations as a contracting party. In many cases members of the Working Party raised issues without indicating whether they should be dealt with in the protocol and, if so, how. This checklist should therefore not be regarded as exhaustive or final.

The issues identified during the assessment phase broadly correspond to three categories of provisions that could be included in a protocol on the status of China as a contracting party. First, provisions that define the scope of application of the General Agreement in China. These provisions could define the territory, the governmental authorities, the domestic legislation and the external relations to which the General Agreement is to apply. Second, provisions that resolve issues relating to the application of specific provisions of the General Agreement by China. Third, provisions relating to the compatibility of the Chinese economic system with the principles underlying the General Agreement. The checklist has been organized with this categorization in mind.

1. SCOPE OF APPLICATION OF THE GENERAL AGREEMENT

1.1 Territorial Application (Article XXIV:1)

The question of the definition of the customs territory to which GATT rights and obligations would apply was raised by members of the Working Party.

1.2 Application by Local and Regional Governments and Authorities (Article XXIV:12)

Members of the Working Party stated that GATT disciplines should apply to all levels of government and that the imposition of trade barriers by the local governments, including tariff surcharges or other charges, should not be authorized by the central government. Members of the Working Party expressed the view that the draft protocol should contain a "federal clause" setting forth an undertaking by the central government to ensure observance of the GATT by regional and municipal governments.

China stated that its central government was empowered to annul or modify laws, regulations and administrative decisions of lower levels of government inconsistent with China's international obligations. MOFERT was charged with ensuring consistency of laws, regulations and decisions of such governments.

1.3 Application to Existing Legislation (Paragraph 1(b) of the Protocol of Provisional Application)

China stated that, upon the resumption of its membership, China would apply Part II of the General Agreement to the fullest extent not inconsistent with domestic legislation existing at the time of resumption. Members of the Working Party questioned the acceptability of this approach. The Working Party did not examine which legislation would be covered by the proposed reservation.

1.4 Application to Trade Relations between Nepal and Tibet  
(Article XXIV:3(a))

Members of the Working Party sought clarification from China as to whether it intended to obtain GATT authorization for its preferential regime for trade between Nepal and Tibet. China stated that all goods imported into China were subject to the unified tariff, with the exception of trade between Nepal and Tibet for which special tariff measures applied. China further stated that the simplified tariff structure for border trade between Nepal and Tibet was in accord with the General Agreement.

2. THE CONSISTENCY OF CHINA'S TRADE REGIME WITH THE PROVISIONS OF THE  
GENERAL AGREEMENT

2.1. Import and Export Restrictions (Article XI)

2.1.1 Foreign Trade Plan Targets

Members of the Working Party said that measures taken under the mandatory plan would have to be consistent with Article XI, and that appropriate provisions should be included in the draft protocol to ensure the implementation of that provision. To the extent mandatory planning was still in effect upon completion of the draft protocol, the Working Party would have to address the implications. Members doubted the compatibility with the General Agreement of mandatory maximum export targets contained in the plans. Members noted in addition that MOFERT's penalties for non-compliance with the foreign trade plans nullified the effectiveness of GATT.

China stated that its foreign trade plans were a form of macro-economic guidance in which the market mechanism played a major role. The role of mandatory plans had been greatly reduced and guidance plans did not

specify the content or volume of products to be exported. A minimum import target could not constitute an import restriction. Maximum export targets were specified for some products which were in short supply within China and minimum import quantities were specified for certain products where there was a particular need, such as in the construction industry.

#### 2.1.2 Authorization to Engage in Foreign Trade

Members of the Working Party considered that the various limitations placed on the right of enterprises and individuals to engage in foreign trade suggested serious inconsistencies with the GATT. There was concern that the thresholds placed on enterprises seeking to qualify for trading authorization could constitute a restriction on exportation in violation of Article XI.

#### 2.1.3 Import and Export Licensing

Members of the Working Party noted that the licensing of imports and exports for industry protective purposes was, as a general proposition, not consistent with the General Agreement. Members also noted that China used its licensing system to enforce de facto bans on imports of certain products. China's licensing system would have to be specifically justified under several GATT articles requiring notification and consultation. Members of the Working Party criticized the lack of transparency regarding the relationship between products covered by China's foreign trade plans and those requiring licenses. The extent to which such product categories overlapped was not clear. China would need to observe Articles X and XIII if it intended to maintain its licensing system. China should also notify its justifications for any quantitative restrictions it intended to maintain through its licensing system. Members stated that, because China's licensing system was intended as an instrument of industry protection, the issue needed to be specifically addressed in a draft protocol.

China stated that its licensing system was compatible with the GATT in that it ensured transparency and simplicity. China did not intend to abandon its licensing system.

Members urged China to consider joining the Agreement on Import Licensing. China stated that it was studying the acceptance of the Agreement on Import Licensing but that this was not an issue to be addressed in the draft protocol.

#### 2.1.4 Import Substitution Regulations

Members stated that with respect to certain products, importers in China had to receive certification prior to importation that there was no competing domestic product. The list of products subject to this certification requirement was expanding rapidly and the practice was less transparent than import licensing. The provinces were issuing separate regulations on import substitution. It was said that the policy of import substitution was a non-tariff measure with an effect equivalent to that of a quota, and was not consistent with the General Agreement. China should indicate to the Working Party how it intended to bring its import substitution policy into line with the GATT.

China stated that there were no mandatory regulations in China's import licensing system relating to import substitution but that industrial sectors within China encouraged the use of domestic products chiefly by developing domestic industry, reducing production costs and increasing quality.

#### 2.1.5 Import and Export Restrictions Made Effective Through State-Trading

It was the view of members of the Working Party that government control of foreign trade corporations (FTCs) through planning and price targets was not compatible with efforts to regulate China's trade through the GATT, particularly in the area of market access. The exclusive

handling of certain products by designated FTCs suggested that China intended to maintain quantitative restrictions on these products. China had to ensure that FTCs conducted their operations on a non-discriminatory basis and, in accordance with Article II:4, fully satisfied domestic demand for products exclusively handled by FTCs. Members also stated that the FTCs' operations should be notified to the GATT within the terms of Article XVII. China said that the mere fact that the FTCs were State-owned did not mean that they were State-trading enterprises within the meaning of the General Agreement.

#### 2.1.6 Invocation of Article XVIII

China stated that it was a low-income developing country in a primary stage of development. It benefited from treatment granted to low-income developing countries both in the International Monetary Fund and the World Bank, as well as from official development aid and GSP schemes of developed countries. China stated that it would undertake obligations in the GATT consistent with its level of economic development. It should therefore be entitled to the more favourable treatment granted to less-developed contracting parties under the General Agreement. Such treatment would include, inter alia, the right to maintain flexibility in its tariff structure, impose import restrictions for balance-of-payment purposes and protect infant industries in accordance with Article XVIII.

Members acknowledged that China's economy was not very advanced and that China continued to experience a foreign exchange shortage. However, the particular nature of China's economy should be considered and the draft protocol would have to address boundaries and disciplines for the developing country treatment which China was seeking in the GATT. It was said that if the Working Party could reach early agreement on the status of China as a developing country, this could greatly simplify the assessment of China's foreign trade regime in relation to the General Agreement.

Members stated that, to the extent China intended to rely on a balance-of-payments justification for its import restrictions, it would be obliged to enter into consultations and justify these restrictions under the appropriate article of the General Agreement. Members also stated that China should not simply invoke Article XVIII:B as a justification for maintaining the measures that members had identified as being inconsistent with the General Agreement. Such reliance on Article XVIII:B would create an imbalance ab initio in China's commitments to the contracting parties. Before accepting China's Article XVIII:B justification, the contracting parties would have to be convinced that the measures at issue met the requirements of that provision and were not taken for protective reasons.

2.2 Tariffs, Fees and Other Charges on Importation and Exportation  
(Articles II, VII and VIII)

2.2.1 Import Regulatory Tax

It was stated that the import regulatory tax would be viewed as an inconsistent additional charge if applied to items covered by a bound tariff; it should be incorporated into the tariff. China stated that the import regulatory tax was part of China's customs tariff and conformed to Article XVIII:2. The Chinese authorities did not intend to incorporate the tax into the tariff.

2.2.2 Customs Valuation

Members of the Working Party commented that some of the valuation methods used by China were arbitrary and allowed for valuation based on domestic costs, which served as additional protection. China asserted that its valuation methods conformed to Article VII.

Members also stated that China should accept the Customs Valuation Code. China said that it was considering the acceptance of the Customs Valuation Code but that this was not an issue to be addressed in the draft protocol.

### 2.2.3 Charges for Services Rendered

Members of the Working Party questioned whether the agency fee paid by production enterprises to FTCs for the importation or exportation of goods was equivalent to an ad valorem customs service charge. Members stated that such a charge would be inconsistent with Article VIII. China stated that the agency fee was not a charge imposed on importation but a commission to FTCs for services rendered.

## 2.3 Internal Taxes and Regulations (Article III)

### 2.3.1 Internal Taxes Levied on Products

Members of the Working Party called on China to ensure that its system of internal taxes conformed to Article III. Where the rates of the consolidated industrial and commercial tax applicable to imported goods were higher than the rates for the corresponding product tax or value-added tax applicable to domestic goods, China should reduce the consolidated industrial and commercial tax rates to the level of these other two taxes. China stated that the three taxes did not overlap and that China was now introducing a unified practice regarding the product tax and the value-added tax. The level of the consolidated industrial and commercial tax on certain products was slightly lower than the product tax and value-added tax.

### 2.3.2 Application of Price Controls to Imported Products

Members expressed concern about the impact of China's pricing policies on the pricing of imported products. In particular, there was concern that China adjusted the prices of imported products to match the guidance and State prices applied to sales of similar domestic products. China stated that its price system was administered without discrimination between domestic and imported products.

### 2.3.3 Local Content Requirements

Members of the Working Party stated that China's policies regarding local content were in contravention of Article III. Members had received frequent complaints from their exporters regarding China's local content requirements. China stated that its government did not impose any local content requirements. There were no rules requiring joint ventures to embody local content in their products. Joint ventures could freely import materials and labour so long as they had foreign exchange.

### 2.3.4 Technical Standards

Members of the Working Party noted with concern that China had introduced in 1989 major changes in its laws on standards and inspection. Contracting parties should be informed of these changes in China's laws. China stated that its new laws on technical standards and inspection had only recently been promulgated and that China would supply copies of these laws.

Members commented that China implemented its standards in a very rigid fashion and that this could serve as an impediment to trade. Selective exemptions from inspection could result in discriminatory treatment inconsistent with the General Agreement. China was urged to publish its criteria for establishing exemptions from inspection. Members were concerned that China applied different and higher standards to imported products than those applied to domestic products, particularly in the case of imported pesticides. Members also criticized the restrictive administration of China's animal and plant quarantine regulations. China stated that higher standards were sometimes applied to imported products where the exporting country or a third country had more stringent testing requirements.

Members also urged China to consider accepting the Agreement on Technical Barriers to Trade. China replied that it had not yet taken a final decision on accepting the Agreement on Technical Barriers to Trade, but that this was not an issue to be dealt with in the draft protocol.

#### 2.4 Production and Export Subsidies (Article XVI)

Members questioned whether production enterprises and FTCs were responsible for their own profits and losses. Members noted with concern that they were unaware of any declaration of bankruptcy by a State-owned firm in China. State support of enterprises operating at a loss constituted a subsidy. China stated that it was making efforts to reduce the losses of some enterprises through the negotiation of efficiency targets.

Members commented that China's present pricing system was in itself a form of indirect subsidization. Total subsidization in the Chinese economy amounted to approximately RMB 40 billion if one included this indirect form of subsidy. Members commented that the delay in implementation of price reforms and of the new bankruptcy laws would delay the phasing out of export subsidies. Members also noted that China had not provided a full listing of its export subsidies. In particular, China had not mentioned the provision of below-cost energy to export firms, the covering of export losses of FTCs, the subsidization of inputs in the agricultural sector and the ability of FTCs to sell RMB at higher rates than firms engaged in the domestic market.

Members stated that China's economic policies in the Special Economic Zones (SEZs) and Open Coastal Cities (OCCs) constituted a major source of subsidies and preferential production for export.

Members of the Working Party stated that China's foreign currency swap centres, providing foreign exchange, at twice the official RMB rate, artificially enhanced the enterprises' ability to export. China stated

that there was only one official rate of foreign exchange in China and that the rate of exchange in the swap centres was negotiated by buyers and sellers. China further stated that the volume of transactions in the swap centres was still small and that the swap centres had been established to contribute to the liberalization of the management of foreign exchange. As the balance-of-payments improved, foreign exchange would be further regulated by the market.

Members of the Working Party stated that China should notify its production and export subsidies to the GATT, as provided for in Article XVI. Members called for commitments by China to phase out its export subsidies. China stated that it intended to comply, after its resumption of membership in the GATT, with the provision of Article XVI when giving economic assistance to producers of export products.

Members called for a commitment by China to accept the Subsidies Code. China replied that it was studying the acceptance of the Subsidies Code but that it did not consider that this issue should be dealt with in the draft protocol.

#### 2.5 Exchange Controls Affecting Importation and Exportation (Article XV)

Members noted that there were two systems for allocating foreign exchange in China: a quota system for FTCs based upon the foreign exchange plan and the foreign exchange retention system. Exporters to China considered the foreign exchange controls to be the greatest barrier to exports. China should commit itself not to use exchange controls for the purpose of restricting or taxing imports and subsidizing exports.

China stated that it suffered from a long-term shortage in foreign exchange. It was essential for China to use its limited foreign exchange for the developing sectors most in need. China maintained that such a policy would contribute to the diversification of the Chinese economy and the expansion of foreign trade.

China considered that its exchange control system was consistent with Article XIV of the IMF's Articles of Agreement, and with Article XV of the General Agreement.

2.6 Most-Favoured-Nation Treatment and Non-Discrimination  
(Articles I, XIII and XVII)

2.6.1 Plan Targets

It was said that China's import plans were inconsistent with the most-favoured-nation principle to the extent they specified countries of origin. All such specifications should be removed prior to China joining the GATT. China stated that its import plans did not specify countries of origin.

2.6.2 Bilateral Trade and Payments Relations

Members of the Working Party doubted the conformity with the General Agreement of China's bilateral trade agreements that provided for annual protocols of exchange of goods with indicative lists of commodities to be exchanged. Obligatory purchases listed in these bilateral protocols were not consistent with Article I. Equal opportunity to compete had to be extended to all contracting parties. Members also stated that a strict most-favoured-nation test should be applied to the agreements that provided for mandatory exchanges of goods. The view was also expressed that China's barter trade agreements were by definition discriminatory. China considered that its trade and payments agreement conformed to the principle of Article I but that it would review them upon resumption of its membership rights in light of relevant GATT provisions.

Members criticized China's duty-free trade with certain countries, in particular the USSR, as inconsistent with Article I. China replied that China's tariff system was unified, with no preferential rates for products or regions, and that its trade with the USSR was not duty-free.

### 2.6.3 Goods Originating in or Destined for Hong Kong

It was stated that all trade relations between China and Hong Kong would have to be governed by the General Agreement after China resumed contracting party status. It was also stated that China's quota and licensing restrictions applicable to goods originating from or destined for Hong Kong should be brought into conformity with the General Agreement.

### 2.7 Publication and Administration of Trade Regulations (Article X)

Members of the Working Party said that the lack of publication of China's mandatory and guidance plans was inconsistent with Article X:1. China stated that it considered plan targets as business secrets not requiring publication under Article X:1.

Members also stated that more transparency was required in China's licensing system, particularly in the criteria employed in granting or rejecting license applications. Members requested that China provide the contracting parties with tariff line information for the 53 product categories subject to import licensing so that the contracting parties could more effectively monitor China's licensing system. Members also noted that Article X:3(a) required the independent administration of the tariff system. It was stated that China should list official publication points for each type of law or regulation relevant to foreign trade.

It was further stated that China was not in compliance with Article X:2, which required advanced publication of regulations. China should state that no law or regulation would be enforced until published and should undertake to publish all unpublished or internal laws and regulations. Members also noted that there was a lack of information as to which enterprises in China had access to foreign exchange. China was requested to improve the level of such information. In addition, members

noted that exporters had experienced differing requirements at different points of entry in China, and called on China to rectify this situation in anticipation of GATT participation in accordance with the provisions of Article X:3(a).

China stated that its laws and regulations were all published in a timely manner. China would undertake to fulfil its Article X obligations upon resumption of its membership.

3. THE COMPATIBILITY OF THE CHINESE ECONOMIC SYSTEM WITH THE PRINCIPLES UNDERLYING THE GENERAL AGREEMENT

3.1 Uniform Administration of the Trade Regime

Members noted with concern that different economic systems coexisted in China. Considerable differences in China's trade regime existed as between the SEZs and the OCCs and the rest of China. There were also variations among the various SEZs and OCCs. In particular, differences relating to market access and tax treatment were noted. Enterprises in the SEZs and OCCs were relieved of many of the import restrictions imposed in the rest of China. Members of the Working Party stated that the differing trade regimes applicable in SEZs and OCCs threatened the uniform application of GATT in China. The implications of the two-track system in China for the application of GATT had to be clarified.

China stated that the SEZs and OCCs had been established for the purpose of attracting foreign investment and providing secure opportunities to foreign firms to enter China's market. They enabled China to experiment with regulatory regimes that could serve as models for the rest of China.

Members of the Working Party expressed the concern that China's tariff was not playing a central role in China's foreign trade regime in view of the overlapping operation of many other trade restricting measures,

including mandatory and guidance planning, limitations on the type and scope of operation of entities engaged in foreign trade, policy guidance from MOFERT, irrational elements of the price system, foreign exchange limitations, restrictive import and export licensing, and import substitution policies. Members called on China to simplify its system of trade control.

China stated that its tariff system complemented other trade measures, as was the case in the systems of many contracting parties. Its trade regime was on the whole not less transparent and more complex than those of other contracting parties.

Members called for provisions in the draft protocol to provide for a periodic review of the "regulation gap" between the SEZs and OCCs and the rest of China. Noting great variations in the speed and scope of China's reforms in various parts of China, the complexity of China's trade regime and the lack of information on trade regulations and trade flows, members stated that the draft protocol should provide for a monitoring system to ensure a uniform administration of the trade regime by China. China did not consider that a special review mechanism applicable only to China was justified.

### 3.2 Transparency of the Trade Regime

Members of the Working Party called on China to provide more trade statistics and other trade data in order to provide contracting parties with more complete information about China's foreign trade regime. Members also stated that China should make efforts to improve the availability of statistical information on the product coverage and geographical coverage of its trade regime. Members criticized the lack of information on trade flows between the SEZs and OCCs and the rest of China. Members also commented on the scarcity of information on China's subsidy programs. Reliable statistical information was an important element in ensuring the transparency of China's trade regime. In this regard, China was asked to undertake more effective publication of its tariff modifications and to provide more statistics on the amount of trade and value of duties collected at each tariff level.

Members said that China should provide more information not only on its laws and regulations but also on all important administrative decisions relating to its trade regime. In addition, contracting parties needed more information on the respective competences and administrative decisions of lower governments. There was a need for more clarification of the laws, regulations and administrative decisions applicable to China's foreign trade at all levels of government.

Members requested China to provide lists by tariff item of products subject to plan restrictions in order to assist the contracting parties in monitoring the progress of reforms in China's trade regime. Members stated that China should publish all annual foreign trade plans.

Members of the Working Party stressed the importance of transparency as the yardstick for participation in the GATT. Members stated that the contracting parties would have to develop a working understanding with China on what it would do to improve the transparency of its trade regime. An undertaking on transparency should be included in the draft protocol.

China stated that trade statistics were collected by both Customs and the State Bureau of Statistics. These could be provided to the contracting parties. If members of the Working Party believed that China's statistical or regulatory information was insufficient, this was a technical question that could be addressed.

### 3.3 Economic Planning, Autonomy of Enterprises and Domestic Price Controls

Members noted with concern that China's execution of foreign trade was still largely directed by the State. In particular, the State exercised an important role in determining the content of mandatory and

guidance planning, setting prices, controlling the right to engage in foreign trade and individual acts of importation and exportation, restricting access to foreign exchange and regulating the autonomy of enterprises. Members also noted the role of the State in determining the availability and price of inputs, in providing mechanisms for balancing profits and losses among trading firms, and in limiting competition among trading entities. Such involvement by the State was not seen as compatible with the provisions of the GATT, which presupposed the existence of autonomous enterprises competing in a market. Members also noted that the reduction in day-to-day intervention by governmental organs did not equate to the implementation of a true market economy in China. The State was still the ultimate decision-maker and there still existed considerable distortions unrelated to the market.

Members stated that the current system was characterized by the pervasive role of the central government in State, guidance and market-regulated pricing. Even so-called "market" prices were determined in the context of overall State regulation. It was further stated that China should undertake to provide more information on its pricing and on progress in its price reforms. Specifically, China should provide information on what portions of its import and export markets were covered by State, guidance and market pricing, respectively. Members of the Working Party considered that China's reform of its price system was critical to its ability to effectively participate in the GATT as a contracting party. Members expressed concern that China's economic policies, especially those relating to pricing decisions, could result in the export by China of large quantities of goods at non-market prices that would have a detrimental impact on markets of the contracting parties. The subsidization of export industries and the lack of any mechanism that could ensure the profitable pricing of exports were cited as sources of potential market distortion.

China stated that its price reform program would continue and prices would be increasingly in accordance with supply and demand. The perception that China practised tight control over import and export prices was

incorrect. There was a need for macro-economic control over the total volume of demand to control inflation. China noted that the pace of the price reform could be slower in certain periods as there was a need to consolidate the economic reforms and prevent the overheating of the economy. China also stated that it did not intend to reject the planning element as it moved towards a planned commodity economy. China would systematically integrate the advantages of a planned economy with the vitality of a market economy.

Members of the Working Party recognized that price reform was a matter of long-term adjustment but expressed concern at the lack of a definite time-frame for the implementation of price reform. In the absence of a rational pricing system, members concluded, China could not effectively respect many GATT disciplines.

In the context of respect for GATT disciplines, it was also stated that additional reforms would need to be undertaken by China. China was called upon to continue its price reforms, reduce the scope and specificity of its mandatory and guidance planning, withdraw State involvement from the financing of enterprise loans, simplify and reduce the incidence of non-tariff measures, and extend full trading and economic rights to private enterprises. Members further stated that the draft protocol should contain a mechanism for periodic review of China's progress in its reforms. It was also stated that the draft protocol should contain a commitment by China to continue the reforms and to undertake a timetable for their completion.

Members further stated that there was a need for a special safeguard provision to avoid the potential danger of serious distortions in trade and to ensure a balance of rights and obligations pending further reforms in China's foreign trade regime and economy. This safeguard provision would be a transitional mechanism. It would be subject to progress in China's reforms and allow for the progressive development of China's GATT rights

and obligations. Other members of the Working Party questioned the need for a special safeguard mechanism, noting that the Working Party should first consider the applicability of several articles of the General Agreement, e.g. Articles VI, XIX, XXII and XXIII. Members stressed that the interim safeguard measure would have to be carefully drafted so that it did not become a mechanism for implementing protectionist policies.

China stated that its economic regime was basically compatible with GATT principles and that it could apply GATT disciplines effectively. A special safeguards clause was therefore not warranted. China expected to be treated as an equal trading partner, with the right of most-favoured-nation treatment, upon resumption of its membership rights.