

TARIFFS AND TRADE

WORKING PARTY ON CHINA'S STATUS AS A CONTRACTING PARTY

Introduction and General Statements

Note by the Secretariat

1. Introduction

1.1 On 10 July 1986 China submitted to the CONTRACTING PARTIES a request to resume its status as a contracting party (L/6017) and on 13 February 1987 a Memorandum on China's Foreign Trade Regime (L/6125). At its meeting on 4 March 1987 the Council established a Working Party on China's status as a contracting party and invited all contracting parties to submit questions concerning China's foreign trade regime (C/M/207 and GATT/AIR/2392). At its meeting on 14 May 1987 the Council determined the Working Party's terms of reference. It asked the Working Party in particular to

"examine the foreign trade regime of the People's Republic of China, develop a draft Protocol setting out the respective rights and obligations, provide a forum for the negotiation of a schedule, address as appropriate other issues concerning the People's Republic of China and the GATT, including procedures for decision-making by the CONTRACTING PARTIES, and make recommendations to the Council" (C/M/209).¹

1.2 The Working Party met on 22 October 1987, 23-24 February 1988 [to be completed] under the chairmanship of H.E. Mr. Pierre-Louis Girard.

1.3 The Working Party had the following documents before it:

- Memorandum on China's Foreign Trade Regime (L/6125);

¹The full terms of reference and the membership of the Working Party are set out in Document L/6191/[Rev.1].

- Questions and Replies concerning the Memorandum on China's Foreign Trade Regime (L/6270)

[To be completed]

2. General Statements

2.1 The representative of China said that the Chinese Government attached great importance to China's participation in the multilateral trading system and therefore formally applied for the resumption of its status as a contracting party in 1986. He expressed the conviction that the resumption of China's status as a contracting party would contribute to the strengthening of the multilateral trading system. He recalled that profound changes had taken place in China's economic structure over the past nine years. The previous economic system, based on pure public ownership, had given way to an economic system with public ownership as the predominant factor supplemented by different types of ownership, such as collective, individual, private ownership, joint Chinese-foreign ownership and full foreign ownership. The forms of public ownership had also changed: the separation of ownership from managerial authority was being introduced, ensuring the autonomous management of enterprises. Diversified forms of management and a contract responsibility system were being developed. By 1987, over 60 per cent of the large and medium-sized state-owned commercial enterprises had adopted the contract responsibility system while 80 per cent of the small-sized ones had been transformed either into enterprises with collective ownership and management or into enterprises with individual management on the basis of a lease. The relations between the State and the enterprises and between the owners and managers of enterprises with regard to their respective responsibilities, rights and interests were established in the form of contracts.

2.2 China had preliminarily established and would further develop and improve the market mechanism. By 1986 the system of state-set prices had been replaced by a combination of state guidance prices and market

regulated prices for 63 per cent of the agricultural and sideline products, 53 per cent of the consumer goods and 40 per cent of the capital goods. The highly-centralized planning system had been turned into a system with both mandatory and guidance planning. The scope of mandatory planning had been gradually reduced while that of market regulation had continuously expanded. In the rural economy the production contract responsibility system was practised and agricultural production was now basically regulated by market forces. China had changed the past practice of direct state administration over economic activities and laid the foundation of a macro-economic control system based on indirect supervision of activities of enterprises through regulatory and administrative means. So far more than 200 economic laws and regulations had been promulgated to ensure the proper functioning of this system. In China a new system was taking shape in which the State regulated the market and the market guided enterprises. Monetary policy measures began to play a vital role in regulating total supply and demand. For example, of the country's total investment in production and construction, the proportion of State budgetary resources had been reduced from 76.6 per cent in 1978 to 31.6 per cent in 1986 while the proportion of bank credits had increased from 23.4 per cent to 68.4 per cent during the same period.

2.3 Since the beginning of the open policy, China expanded its cooperation with other countries in the economic, financial and technological fields and also other areas. China currently maintained trade relations with 179 countries and regions throughout the world. The total value of its imports and exports had gone up from US\$ 20.64 billion in 1978 to US\$83.78 billion in 1987 of which US\$39.92 billion were exports and US\$43.86 billion imports. However, the total value of China's imports and exports still accounted for less than 1.6 per cent of total world trade. China had set up four special economic zones, fourteen open coastal cities and three open triangular areas, and recently decided to turn the Hainan Province into the largest special economic zone. Since the adoption of the open policy, over 10,000 enterprises from more than 40 countries and regions had invested in China and had brought new vitality into China's economy.

2.4 However, in spite of the economic achievements since the founding of new China, including those resulting from the nine years of economic reform and opening measures, China had not yet been able to shake off poverty and backwardness totally. China remained a low-income developing country with a vast territory and a large population and its per capita GNP still ranked among the lowest in the world. Of the total population of over one billion, 800 million people lived in rural areas where most still used hand tools to make a living. Modern industries coexisted with industries that were several decades or even a century behind modern industrial standards. The general scientific and technological level remained low and nearly one quarter of the population was still illiterate or semi-literate. The commodity economy and the domestic market were as yet under-developed and the subsistence economy constituted a considerable proportion of the whole. In short, China had remained in the early stages of economic development.

2.5 The representative of China emphasized that further measures would be taken to achieve a phased opening to the outside world, first in the special economic zones and the coastal cities and then in the hinterland. The Hainan Island would become the largest special economic zone. The Pearl River Delta in Guangdong Province and the triangular area of Southern Fujian Province would be made experimenting areas for an all-round opening to the outside world with a gradual liberalization of all prices and a better environment for foreign investors. Together with the changes in managerial mechanisms of enterprises, a comprehensive set of reforms was being instituted in the systems of foreign trade, planning, investment, finance and monetary affairs with a view to gradually establishing the basic framework for a planned commodity economy. Economic reforms would focus on the following aspects in the next few years:

- (a) The different forms of managerial responsibility would be further developed so as to achieve the separation of ownership from managerial authority in the state-owned enterprises. The

share-holding system in enterprises would be further implemented on a trial basis. The different forms of economic responsibility within the enterprises would be improved and the relations between owners, management and producers rationalized.

- (b) Horizontal economic ties would be promoted with a view to breaking the geographical and sectoral limitations and groups or associations of enterprises would be formed so as to meet the requirements of economy of scale and specialization.
- (c) A competitive and open market system would be further developed for consumer goods and means of production, such as capital goods, funds, labour, technology, information and real estate. At the same time, the pricing system would be energetically and steadily transformed into one in which the State set the prices for a few vital products and services and the rest was subject to market prices.
- (d) The macro-economic control system based on indirect supervision of economic activities would be improved. The chief function of planning would be to formulate industrial policies and facilitate their implementation through the comprehensive application of economic levers. The monetary system would be reformed to give greater emphasis to monetary means to raise and circulate funds. The fiscal system would be reformed by introducing new tax categories and tax rates that were fair and reasonable, encouraged competition and reflected industrial policies. The economic legislation would be consolidated and improved.
- (e) Different types of ownership with public ownership as the predominant factor would be developed. Public, cooperative, individual and private sectors of the economy in both urban and rural areas were encouraged to expand. The proportions of the

different types of ownership were allowed to vary in different economic fields and different localities. Further steps would be taken to improve the investment environment for Chinese-foreign equity joint ventures, contractual joint ventures and wholly foreign-owned enterprises.

- (f) Different forms of distribution would be adopted with distribution according to the principle "to each according to his work" remaining predominant. Access to credit interests, dividends from shareholding and income of owners of private enterprises were recognized as long as they were acquired legally. Enterprises and individuals were encouraged to acquire wealth through good management and honest work while regulatory measures were used to prevent a polarization in the possession of wealth and to bring about social equity while raising efficiency.

2.6 The representative of China further stated that the reform of China's foreign trade system, as an important part of its overall economic reform, would be speeded up this year. Significant advances had been made in decentralizing the management of foreign trade in the past few years. The number of enterprises entitled to engage in foreign trade had increased from 18 to more than 1,000. As administrative intervention had declined, there had been a gradual shift to the use of macro-economic and fiscal measures to regulate imports and exports, such as exchange rate policies and customs duties. The contract responsibility system, which had proven to be effective in the process of agricultural, industrial and commercial reforms, would be gradually introduced for foreign trade enterprises during 1988. These enterprises would be given full management authority and made responsible for their profits or losses; as a consequence better co-ordination between production and foreign trade would be achieved. Moreover, the agency system, under which foreign trade corporations could act as agents for other enterprises, would be extended.

2.7 The representative of China added that the economic restructuring was such an arduous task that its accomplishment required considerable courage. Therefore, the Government, while persevering in its reform efforts, had to be prepared to face the possibility of some temporary difficulties and the need for transitional measures. However, the objective of China's reform, clear and irreversible, was to establish a planned commodity economy of Chinese style combining planning with the market. All contracting parties should recognize the drastic changes during the past nine years and the dynamic nature of China's economic and trade reforms. These reforms would eventually bring China's economic and trade structure in line with the GATT system. China's participation in the multilateral trading system would benefit not only China's own economic development but would also expand world trade and strengthen the multilateral trading system.

2.8 The representative of China concluded his statement by expressing the expectations that China, after its resumption of contracting party status, will enjoy most-favoured-nation treatment and the special and differential treatment accorded to developing countries under the GATT and that trade barriers against China will be reduced to help accelerate the process of economic and trade reforms and expand trade between China and other contracting parties. He reaffirmed China's willingness to enter into substantive negotiations with contracting parties on the resumption of its GATT membership on the basis of tariff concessions.

2.9 Members of the Working Party that made general statements welcomed China's decision to reform its economy, to open its economy to the outside world and to assume membership in the GATT. They considered that China's reforms would help it make use of its vast economic potential and that China's integration into the world economic system offered great opportunities both for China and the rest of the world. Several members said that the first task of the Working Party was to examine carefully

China's economic system in the light of GATT principles. The results of that examination would determine the issues which would have to be addressed in the negotiations leading to the protocol setting out China's commitments under GATT. They emphasized that the GATT was not just an organization but a treaty with substantive trade policy rules. China's request raised therefore not merely institutional issues but above all the question of how to achieve a balance in the rights and obligations between China on the one hand and the contracting parties on the other.

2.10 One member of the Working Party recalled that, when China announced its decision to seek contracting party status in the GATT in July 1986, his Government had welcomed this event as further proof that China was committed to a course of broad economic and trade reform and to an opening of its economy to participation in the international economic system. He expressed the belief that China's further integration into the international trading system on the basis of the reforms that it had announced and partially implemented would have positive results for all and would aid China's efforts to modernize its economy and accelerate its economic development. He further said that he saw the work of the Working Party as forming the basis of the ultimate objective, i.e. the negotiation of the terms of China's association with the General Agreement. Each contracting party had, or would have by the end of the work of the Working Party, an idea of the assurances, commitments or statements that it believed should be included in the protocol that would sum up the various negotiations that had taken place with China. The elements of this protocol could not be expected to appear without a point of reference in the deliberations of this Working Party, however. Through the Working Party examination, and the record of the discussions in the Working Party report, the contracting parties established their views as to appropriate commitments necessary on China's part to bring its trade regime into GATT conformity.

In addition, the information originally supplied by China and its answers to further questions in these meetings would become the basis for future evaluation by the contracting parties of China's progress towards convergence of its foreign trade system with the principles and obligations reflected in GATT. The Working Party record formed the justification for the results: the protocol that established China's rights and obligations with the other contracting parties to the General Agreement.

2.11 The member further said that a great deal of work was lying ahead of the Working Party in the examination of the consistency of China's current trade regime vis-à-vis the General Agreement. In the course of the examination, his delegation would be asking more questions concerning the documentation already supplied by China to the contracting parties. It would also be trying to compare this information with data supplied from other sources, including academic reports and the submissions of the private sector, and with the experience gained in his country's trade relations with China. After having reflected on the information provided, his delegation would be prepared to state for the record its views on the relationship of China's trade regime to the General Agreement. A major objective of his authorities in the deliberations was to clearly lay out the issues they believed had to be addressed in the negotiations to come and to outline the elements of undertakings and changes they believed were consistent with China's decision to align its trading system with GATT principles. The elements that his delegation would outline encompassed the basic obligations contained in the General Agreement. In the view of his Government, attention to these points in this examination and, ultimately, in the protocol, would be necessary if China's approach to the GATT was to be a force for strengthening and improving the GATT system. His government accepted China's assurances that it was committed to increasing the market-orientation of its economy and trading system, to decentralizing its management and to introducing a pricing system that reflected supply and

demand. His Government also recognized that China's political leadership was irrevocably committed to carrying out the reforms it had announced. It understood that it was in the context of this commitment that China sought to take up contracting party status with the GATT. It was not known, however, at what pace these changes would actually take place or how effective they would be in creating a more market-oriented system. These were important questions for the GATT since, to a large extent, the contracting parties' confidence that China could accept and fulfil its GATT obligations depended upon the success of China's economic reforms.

2.12 The member added that GATT provisions were based on the assumption that import and export flows were responsive to price changes and that importers and exporters were free to make commercial decisions based on price criteria. When a market-economy country undertook GATT obligations, it was believed that adherence to GATT Articles would improve the climate surrounding trade decisions and result in an actual improvement in the level of market access for imports and in export flows based on comparative advantage. In the case of centrally-planned economies where sales and purchasing decisions were not based on real costs and that did not have price systems which reflected market forces, it was generally agreed that normal GATT obligations could not be undertaken. More accurately, under these circumstances, technical adherence to GATT Articles would not, in and of itself, affect the basis upon which trade decisions were made and therefore not actually increase market access or discipline export practices. Experience had shown that even if elements of centrally-planned systems could absorb significant market-oriented reforms, the nature of the system would continue to impede the operation of GATT Articles that ensured market access, i.e., to limit or negate the balance of rights and obligations contained in the Articles. Since the GATT was essentially an agreement by its contracting parties to exchange rights and obligations in each others' markets rather than an organization with

"membership" in the traditional sense, the structural inability of a country's economic and trade system to respond to the obligations of the General Agreement was a breach of contractual participation. In previous accessions to the GATT by socialist, centrally-planned or non-market economy countries, the contracting parties had recognized the inability of such economies to respond to GATT provisions by negotiating special commitments in the accession protocols or insisting on lengthy provisional periods prior to full accession. In China's case, these negotiations were predicated on the conviction that China intended to alter the balance of market and non-market forces within its economy and to give thereby price-based market forces a prominent role in the decisions driving trade. For this reason, a key aspect of the examination in the Working Party had to be the extent to which China's economic reform process had been, or had not been, implemented and what contracting parties could expect in the future. It was necessary to find ways for the contracting parties to address not only those aspects of China's current trade regime that were inconsistent with GATT provisions, but also those aspects of China's trade and economic system that precluded market access, market prices and fair trade practices.

2.13 Concerning the issue of whether China was "acceding" to the GATT or "resuming" a previous membership, the member said that his Government viewed this process as the same as an accession process. It recognized that China viewed these negotiations as part of the "resumption" of GATT membership. Whatever the description of its form, the terms of China's GATT membership had to be negotiated with the contracting parties. Those terms, in the final analysis, had to ensure both the willingness and the ability of China to adhere to the provisions of the General Agreement. It also recognized that China had indicated a desire to accede to the GATT as a developing country, with the understanding that this would qualify China for the special and more favourable treatment reserved to developing countries in the GATT. Developing country status in the GATT was not

conferred, but rather self-proclaimed. His Government recognized that China was, in many respects, a developing country. More significantly, however, China was a non-market economy country whose ability to extend GATT rights to other contracting parties might be compromised by its centrally-controlled economic and trade system. While recognizing the importance of this issue to China, the member did not believe that it could be addressed prior to the completion of the examination of China's foreign trade regime and the drafting of terms in a protocol. The title applied to China was irrelevant if the Working Party could not establish an understanding of how the GATT would be applied to the economic development and trade policy in China and how China would uphold the obligations of GATT Articles in return for enjoying the benefits of association with the General Agreement. China had made it clear from the start that it wished to negotiate a schedule of tariff concessions. Although it was hoped that such tariff bindings would aid in access to China's market, their value as a regulator of trade access was meaningless unless the schedule established was based on a foundation of obligations, such as those found in Part II of the GATT. For this reason, his Government viewed the substantive terms of China's accession to GATT as the most important part of this negotiation.

2.14 In conducting the review in the Working Party, his delegation would be focussing its examination in the following areas:

- (a) The current GATT consistency of China's trade administrative practices, with special reference to subsidies, import licensing and quantitative restrictions, including those taken for temporary protection; customs procedures, including valuation, customs fees, and classification; non-tariff border charges and taxes; the application of the most-favoured-nation principle; and the trade practices of state-operated manufacturing facilities.

- (b) Transparency in the operation of China's import and export regime, with particular reference to the provisions of Article X and the problems associated with unpublished information that traders need to obtain access to China's market.
- (c) The availability of trade and other economic data, including information on prices and pricing policies.
- (d) The scope and timing of China's trade and price reform programs, with particular reference to how, and how broadly, these reforms affect trade decision-making, currently and in the future, and when the contracting parties could expect to see the reforms completed.

The information supplied by China up to this point, especially in the extensive responses supplied in its written answers to contracting party questions on the Foreign Trade memorandum, had clarified a number of points for his delegation, and had helped it get a better picture of how China regulated trade at the border and within its economy. On some issues, however, a clearer picture needed to be drawn, and his delegation would be asking further questions to complete its understanding, for the record, of China's trade policy and administration.

2.15 Without prejudging the outcome of the examination to be conducted by the Working Party, his authorities had already given a great deal of thought to the specific aspects of China's trade regime that they would be looking at as the discussions proceeded. These points related to the areas of China's association with GATT that in the view of his Government had to be covered by the terms of China's GATT protocol. First, his Government wanted China's obligations under the General Agreement to be comprehensive within the Chinese market, i.e., that they were applied equally in all geographic regions to all imports from all countries. In its view, the

nature and scope of exceptions to this rule should be clearly understood by the contracting parties. Such exceptions had to be described, notified and subjected to normal GATT procedures of review and justification.

2.16 Second, there was a need for much greater transparency in China's trade administration. The criteria in Article X of the GATT were a good starting point, but were not sufficient to deal with the special factors associated with trade that was still, to a large extent, government-controlled. There was a need for a clearer understanding of how and where exporters could get the information necessary to conduct trade with China. A better understanding of the official processes that had to be undertaken to trade with China was also needed. For example, there was a need for more information about foreign exchange allocation, who had the authority to import and who could issue import licenses as well as the criteria and procedures used by state, provincial or municipal government enterprises and foreign trade corporations in import purchasing. The equivalent of such information was easily, and often freely, accessible in the economies of most GATT contracting parties. It should also be available in China. Since substantial elements of foreign trade decision-making authority had devolved from China's central government to other governmental entities, this information should also cover regulations and import plans issued by those entities. China should also agree to provide broad economic and trade data, including prices and the true resource costs of production. This information should be made available to the contracting parties on a regular basis so that the economic inter-relationships became clearer. Concerning trade data, the discrepancies in China's bilateral trade data currently supplied should be reconciled and China should agree to adopt trade recording methodologies commonly used by other GATT contracting parties as a contribution to addressing this problem.

2.17 Third, through these negotiations, his delegation would encourage China to undertake to administer its non-tariff trade regulations in conformity with GATT Articles and principles and ensure that state

intervention in the trading process that blocked the protections of GATT Articles against non-tariff barriers to imports be strictly defined and limited. In this regard, quantitative restrictions, to the extent they were maintained, should be applied in strict conformity with GATT provisions concerning justification, duration, and notification. His Government also wished the operations of China's state-trading enterprises to be consistent with the provisions of Article XVII, particularly those aspects of China's trade practices that, through state control, effectively denied market access to imports. State trading operations should not be used to administer quantitative restrictions or other non-tariff measures on imports. Concerning subsidies, his Government expected that China and the contracting parties would come to a better mutual understanding of the need to eliminate practices that acted to subsidize export production and trade. Contracting parties that provided unfettered access to their markets for Chinese goods within GATT provisions had to be protected from trade that was driven by non-market and non-economic forces. Concerning border charges, including the import regulatory tax, his Government wanted to explore how these charges were applied, and their relationship to tariffs and GATT provisions governing measures taken for balance-of-payments purposes.

2.18 Fourth, his Government would be looking for the most specific description possible of China's plans for implementation of its trade and price reforms. This information was necessary because of the link between a market price system and the GATT Articles. Without such information, the contracting parties would not have a clear basis for their decision concerning the applicability of GATT provisions to China, now or in the future, as China's evolution to a planned commodity economy proceeded. The pace of implementation of these reforms was, of course, a matter only China could determine. The relationship of these reforms to GATT, however, was a matter for the contracting parties to determine. Pending completion of China's trade and price reforms, some safeguard mechanism would be necessary to protect contracting party trade from the remaining non-market

aspects of China's trade regime. In light of the reciprocal nature of GATT benefits and obligations, GATT contracting parties would need some protection in their markets from trade affected by non-market and non-economic decisions. The concept of such a mechanism was not novel. Other accessions had made use of such provisions, particularly in the case of centrally-planned economies. What would be different for China would be the transitional nature of this mechanism, pending the changes in China's economy and trade regime that would make it unnecessary. Such a mechanism had been applied to economies with non-market characteristics and would be appropriate for China in this context.

2.19 The member concluded his statement by pointing out that the complexity of the issues before the Working Party and the amount of information sought for its examination suggests that defining the terms of China's association with the General Agreement would not be an easy task. China and the contracting parties, however, had a strong interest in bringing that examination to a mutually acceptable conclusion.

2.20 Another member of the Working Party noted that China was envisaging far-reaching economic reforms. The ambitious nature of the reforms meant that it would quite likely take some considerable time before they were fully operational and that, along the way, there may be certain policy readjustments. The relationship between the contracting parties and China had to take this fact into account. While the reform process was under way the rights of other contracting parties faced with a changing policy structure in China had to be safeguarded. Specific conditions for China's membership, in the form of a particular protocol or agreement, were therefore clearly necessary.

2.21 The member noted that there were at present no economic mechanism ensuring that the pricing of goods for sale in the home market or in export markets corresponded to market forces. There was in particular no

mechanism ensuring that exports were priced at levels which were profitable and not causing disturbance. The present Chinese system allowed, and indeed encouraged, a degree of export subsidization to ensure foreign currency earnings. There was an unmeasurable potential for increases in exports at prices which were not related to those of world markets. The contracting parties had to be able to defend themselves against any injurious effects resulting from these elements in the Chinese system.

2.22 The member further stated that, while reforms were being planned, the present Chinese economic system operated on the basis of close government supervision and planning. The fact that the import plan was not published in its precise details meant that there was no certainty as to what China's purchases would be. A high degree of policy control and guidance was exercised by government departments and imports by private enterprises and trade transactions outside the import plan were virtually impossible. The foreign exchange control system, together with the planning mechanism and the import licensing system, submitted all imports to tight government supervision. Furthermore, there were elements in the Chinese foreign trade system which appeared to be discriminatory. For instance, there were governmental regulations according to which the products from countries having joint ventures and co-operative arrangements with China were to be given preference over products from third countries. Such preferences appeared to be given in the import planning process and in the allocation of foreign exchange. Preferential treatment was going to be given also to enterprises importing technology and products for the purpose of import substitution and export promotion. The Chinese authorities were also prepared to give assistance to enterprises which faced economic difficulties in foreign trade, for instance through the exemption from customs duties and special tax treatment. The extent of such special regimes and their effects had to be clarified before conclusions on the conditions for China's GATT membership could be reached.

2.23 Another member said that her authorities would like the Working Party to address the Chinese tariff since they were seeking extensive tariff bindings at reduced levels. They also wished the Working Party to examine, in the light of the provisions of the General Agreement, the wide range of non-tariff measures which played an important part in the Chinese economy. That examination should include questions of transparency, foreign exchange allocation, import licensing, the system of price determination for imports and exports and f measures.

2.24 One member stated that the Working Party should examine the case of China on its own merits without any unfounded or inappropriate generalizations, and the conditions of China's reintegration into the GATT should be determined solely on the basis of that examination.

2.25 The members of the Working Party that made general statements all emphasized that they were approaching China's request in a constructive spirit and that they were confident that the Working Party would reach conclusions satisfactory to both China and the contracting parties.