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COMMUNICATION FROM THE UNITED STATES

Transitional Review Mechanism in connection with Paragraph 18 of the Protocol on the Accession of the People's Republic of China

The following communication, dated 24 November 2003, from the Delegation of the United States is being circulated to the Members of the Council for Trade in Services.

Questions from the United States to China concerning services

I. DISTRIBUTION SERVICES

1. In its accession agreement, China committed to eliminate national treatment and market access restrictions on foreign enterprises providing (through a local presence) wholesaling, commission agents', retailing and franchising services, along with related services, such as repair and maintenance services, within three years of its accession (or by 11 December 2004), subject to limited product exceptions.

(a) Please confirm that China will permit foreign enterprises to provide these distribution services by 11 December 2004.

(b) Has China begun drafting the necessary regulations to implement this commitment? Does China intend to circulate draft regulations for public comment, consistent with paragraph 2(C)2 of the Working Party Report? When will the draft regulations be circulated?

2. China committed that, immediately upon accession, it would permit joint ventures and wholly foreign-owned enterprises to distribute goods that they make in China, without any market access or national treatment limitations. Within one year after accession (or by 11 December 2002), China agreed to permit foreign service suppliers to supply wholesaling services and commission agents' services for almost all goods, whether made in China or imported, through joint ventures with minority foreign ownership. Excepted goods include salt, tobacco, chemical fertilizers, processed oil and crude oil as well as books, newspapers, magazines, pharmaceutical products, pesticides and mulching films. Within two years after accession (or by 11 December 2003), China agreed to permit foreign service suppliers to supply wholesaling services and commission agents' services through majority foreign-owned joint ventures, subject to the same exceptions.

3. China appears to have implemented its commitments regarding wholesaling services and commission agents' services provided by foreign-invested enterprises with respect to goods that they manufacture in China, as shown by the December 1987 *Regulations for the Implementation of the Law on Chinese-Foreign Equity Joint Ventures* and the April 2001 *Detailed Rules for the Implementation of the Law on Wholly Foreign-Owned Enterprises*. However, China appears to have

fallen behind in implementing its commitments regarding wholesaling services and commission agents' services insofar as they relate to foreign-invested enterprises seeking to distribute goods made by other enterprises in China or imported goods. To date, China has only opened up wholesaling services and commission agents' services to joint ventures with minority foreign ownership that can satisfy a number of stringent qualification requirements and other restrictions

4. One relevant measure, issued in June 1999, is the *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment*. Under this measure, China permits joint ventures with minority foreign ownership to apply for authority to engage in wholesaling services for domestic merchandise and merchandise imported for its own account in certain pilot areas (provincial capitals, certain municipalities and special economic zones), subject to certain product exceptions and stringent requirements relating to assets, wholesale volume, past import and export levels and prior experience, among other matters. Another measure, the January 2003 *Provisional Rules for the Establishment of Chinese-Foreign Equity Joint Venture Foreign Trade Companies*, extended the right to engage in wholesaling services to certain foreign-invested trading enterprises. Specifically, joint ventures that qualify for trading rights under this measure's stringent requirements regarding trade volumes, registered capital and prior experience may engage in wholesaling services for the goods that they import.

(a) Do any measures other than those discussed above govern the provision of wholesaling services and commission agents' services by foreign-invested enterprises?

(b) Can China confirm that the above statements accurately describe the conditions that must be fulfilled by foreign-invested enterprises? Please explain how conditions relating to registered capital, assets, past import and export levels and prior experience are consistent with the terms of China's accession agreement.

5. In addition to committing to permit joint ventures and wholly foreign-owned enterprises to distribute goods that they make in China immediately upon accession, without any market access or national treatment limitations, China agreed to permit foreign service suppliers to supply retailing services for almost all goods, whether made in China or imported, through joint ventures with minority foreign ownership, subject to geographic restrictions (allowing China to limit market access to five Special Economic Zones and eight cities) and quantitative restrictions (allowing China to limit the number of joint ventures that can operate in six of the eight cities). Excepted goods include tobacco, chemical fertilizers and processed oil, pharmaceutical products, pesticides and mulching films, and books, newspapers and magazines. The exceptions for the retailing of books, newspapers and magazines were scheduled to be removed within one year after accession (or by 11 December 2002). Within two years after accession (or by 11 December 2003), China agreed to permit foreign service suppliers to supply retailing services through majority foreign-owned joint ventures, subject to the product exceptions set forth above. China also reserved the right to continue to impose the geographic and quantitative restrictions set forth above, although the geographic restrictions are to be eased (with market access being extended to all provincial capitals and two other cities). Within three years after accession (or by 11 December 2004), China agreed to permit foreign service suppliers to supply retailing services through wholly foreign-owned enterprises. In addition, by this time, all geographic and quantitative restrictions are to be eliminated, and the exceptions for pharmaceutical products, pesticides, mulching films and processed oil are also to be eliminated. The exceptions for chemical fertilizers (but not tobacco) are to be eliminated within five years after accession (or by 11 December 2006).

6. As in the wholesale area, China appears to have implemented its commitment to permit foreign-invested enterprises to supply retailing services for their own goods manufactured in China, as shown by the December 1987 *Regulations for the Implementation of the Law on Chinese-Foreign Equity Joint Ventures* and the April 2001 *Detailed Rules for the Implementation of the Law on Wholly*

Foreign-Owned Enterprises. However, China appears to have fallen behind in implementing its retailing services commitments insofar as they relate to joint ventures that do not manufacture their own goods in China. To date, although China has authorized retailing services to be supplied through joint ventures with minority foreign ownership, it greatly restricts the supply of these services. For example, onerous threshold requirements (relating to minimum wholesale volume, minimum imports and exports, minimum assets, minimum registered capital and prior experience) significantly reduce the number of enterprises that can qualify for the right to supply retailing services, as set forth in the June 1999 *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment*.

(a) Do any measures other than those discussed above govern the provision of retailing services by foreign-invested enterprises?

(b) Can China confirm that the above statements accurately describe the conditions that must be fulfilled by foreign-invested enterprises? Please explain how conditions relating to registered capital, assets, past import and export levels and prior experience are consistent with the terms of China's accession agreement.

7. The United States understands that new regulations are being drafted that may severely impact the ability of U.S. and other foreign retailers to expand their presence in China. According to some reports, these regulations may impose a number of restrictions solely on foreign retailers, including high capital requirements for each new store, limits on the number of approved but unopened stores, and a compliance grading system that can result in suspension of the right to open new stores. The United States is concerned about these reports and the national treatment issues they raise.

(a) Does China intend to circulate a draft of these regulations for public comment, consistent with paragraph 2(C)2 of the Working Party Report? When will the draft regulations be circulated?

(b) What is China's timetable for issuing these regulations in final form?

II. EXPRESS DELIVERY SERVICES

8. In July 2003, China circulated draft amendments to its Postal Services Law, which generated two immediate concerns among U.S. companies. First, the draft amendments purported to give China Post a monopoly over the delivery of letters under 500 grams, which would have constituted a new restriction on the scope of activities of existing foreign-invested express delivery companies, in apparent conflict with the horizontal "acquired rights" commitment that China made in its Services Schedule. Second, the draft amendments did not address the need for an independent regulator. In the ensuing months, China has circulated a number of revised drafts of these amendments. The latest draft of the amendments appears to give China Post a monopoly on letters weighing under 500 grams, and it does not clearly separate China Post' s regulatory and operational functions, while it apparently expands the scope of China Post's regulatory powers through the creation of a new Postal Service Regulatory Authority. In addition, it creates a new, more burdensome licensing process that appears to undermine the agreed conditions of the entrustment process. It also requires express delivery companies for the first time to make payments into a universal service fund.

(a) Please explain how the creation of a China Post monopoly on the delivery of the delivery of letters under 500 grams does not conflict with China's WTO commitments, particularly the horizontal commitment in China's Services Schedule not to reduce market access by imposing conditions on ownership, operation or scope of activities that are more restrictive than those in place on the date of China' s accession.

(b) Please explain why China is now considering this 500 gram restriction after it withdrew a similar restriction with the issuance of the *Supplement Notice on the Engagement in Postal and Delivery Services for Cross-border Letters and Materials of Letters in Nature* in September 2002.

(c) What is China's timetable for issuing the draft amendments in final form?

(d) Please explain China's plans for separating China Post's regulatory and operational functions.

III. TELECOMMUNICATIONS SERVICES

9. In paragraph 309 of the Working Party Report, China agreed that, upon its accession to the WTO, the organizations regulating services industries in China would be independent of the services suppliers they regulate. Section 5 of the Basic Telecommunications Reference Paper also specifically calls for an independent telecommunications regulator that is separate from, and not accountable to, any supplier of basic telecommunications and makes decisions on an impartial basis. In the telecommunications sector, however, China has not yet established an independent regulator, as the Ministry of Information Industries (MII) is not structurally and financially separate from all telecommunications operators and providers. Please explain China's plans for establishing an independent regulator in the telecommunications sector.

10. In its April 2003 Catalogue of Telecommunications Services, MII reclassified several telecommunications services from the value-added category to the basic category, contrary to widely accepted international practice and, in some instances, in apparent contravention of China's scheduled commitments. MII also placed restrictions on what new services could be classified under the value-added category. These moves are likely to limit the ability of U.S. and other foreign firms to access China's telecommunications market. Under China's Services Schedule, basic services are on a slower liberalization schedule, and MII subjects them to higher capitalization requirements. Indeed, MII requires suppliers of basic services to satisfy an excessive registered capital requirement of RMB 2 billion ($241.2 million). Please explain the rationale for these reclassifications.