

**COMMUNICATION FROM THE UNITED STATES**

Transitional Review Mechanism Pursuant to Paragraph 18 of the  
Protocol on the Accession of the People's Republic of China ("China")

The following communication, dated 5 November 2004, from the delegation of the United States, is being circulated to the Members of the WTO.

Questions from the United States to China concerning Services

**I. DISTRIBUTION SERVICES**

1. In the **Services Schedule accompanying its Protocol of Accession**, China committed to open up its distribution services sectors, including wholesaling, commission agency, retailing and franchising services, to majority foreign-owned joint ventures by December 11, 2003, and to wholly foreign-owned enterprises by December 11, 2004. In implementing these important commitments, China first issued the *Regulations on the Administration of Foreign Investment in the Commercial Sector* on April 16, 2004. Among other things, these regulations appear to have abolished onerous capital requirements. Nevertheless, it is still not clear how these regulations will be implemented, as China has not yet issued necessary implementing rules clarifying application procedures, including when approvals may be obtained from provincial authorities versus the Ministry of Commerce (MOFCOM) and permitted scope of activities. When does China intend to issue a draft of the necessary implementing rules for public comment?

2. In the **Services Schedule accompanying its Protocol of Accession**, China committed to open up its direct selling services sector to wholly foreign-owned enterprises by December 11, 2004. The United States understands that China has been circulating a draft of the necessary implementing regulations among Chinese and select foreign enterprises in the direct selling services sector, but has not made this draft publicly available. When does China intend to issue a draft of these regulations for public comment?

**II. EXPRESS DELIVERY SERVICES**

3. 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. The provision creating a 500 gram restriction was very similar to one that China had withdrawn from another measure in September 2002 following high-level U.S. engagement. Second, the draft amendments did not address the need for an independent regulator.

4. In the ensuing months, China circulated a number of revised drafts of these amendments. A November 2003 draft of the amendments again appeared to give China Post a monopoly on letters weighing under 500 grams, and it did not clearly separate China Post's regulatory and operational functions, while it apparently expanded the scope of China Post's regulatory powers through the creation of a new Postal Service Regulatory Authority. In addition, it created a new, more burdensome licensing process that appears to undermine the agreed conditions of the entrustment process. It also required express delivery companies for the first time to make payments into a universal service fund.

5. In April 2004, during high-level U.S.-China bilateral meetings, China committed that old problems, such as the weight restriction, would not become new problems. However, a new draft of the Postal Services Law circulated in July 2004 continues to include the problematic provisions described above, including a 350 gram restriction, which, like the earlier 500 gram restriction, includes no accompanying price-based criterion, e.g., a criterion that allows express delivery firms to deliver packages below 350 grams when the price charged is at least three times greater than the price for a first class letter.

- (a) Please explain how the creation of a China Post monopoly on the delivery of letters under 350 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 350 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. TRANSPORT SERVICES**

6. China's Civil Aviation Administration (CAAC) recently issued the *Regulations on the Administration of the Transport of Dangerous Goods*, which took effect on September 1, 2004. These new regulations require carriers to obtain licenses to handle dangerous goods. To the United States' knowledge, CAAC did not discuss the new regulations with U.S. or other foreign interested parties, nor did it provide any period for public comment, before issuing them. As a result, not only were foreign carriers unable to provide useful input, but they also were not in a position to prepare for the changes brought on by the new regulations. Greater transparency during the formulation of the regulations would likely have ensured more rapid compliance with them, as firms would have been able to prepare for necessary adjustments in advance of implementation, promoting China's goal of greater safety.

7. CAAC has indicated that it will allow China Eastern and Air China, both of which were licensed under prior regulations, to handle dangerous goods without new licenses until the end of this year. Other airlines are not eligible for this grace period. CAAC has indicated that it will consider applications for licenses under the new regulations on a case-by-case basis.

- (a) What is CAAC's rationale for not providing a grace period to airlines other than China Eastern and Air China?

- (b) Will CAAC expedite its review of applications submitted under the new regulations?

#### IV. TELECOMMUNICATIONS SERVICES

8. Article 5 of the *Regulation on the Administration of Foreign-Invested Telecommunications Enterprises*, issued by the State Council in Decree No. 333 on December 11, 2001 (effective January 1 2002), provides that, for foreign-invested telecommunications enterprises engaged in national or cross-provincial basic telecommunication services, registered capital must not be less than RMB 2 billion (\$241.2 million). This capital requirement is excessively high, both when viewed in relation to the norms in other economies and in the specific context of China's telecommunications market. A review of start-up capital requirements for basic telecommunications services providers around the world reveals essentially no capital requirement in the United States, European Communities member states, Canada, Japan, Australia, Argentina, Brazil or Chile. Hong Kong requires only a performance bond. India requires a bank guarantee ranging from \$5 million to \$80 million, depending on geographic scope. Korea requires a \$2.5 million performance bond or bank guarantee, while Singapore requires a performance bond, scaled according to business scope. Only Chinese Taipei maintains capital requirements that are comparable to those in China, and Chinese Taipei has been scaling them back following its accession to the WTO.

9. China's high capital requirement effectively bars foreign investors from China's telecommunications market and severely inhibits the long-term development of an economically efficient and competitive domestic telecommunications services market. For qualified foreign investors, commercial business models do not require a high capital expenditure or an investment in extensive new infrastructure. With a minimal need to build infrastructure, and given that China's Services Schedule permits the provision of telecommunications services by resale, the capital requirements of new basic telecommunications services ventures should be relatively low. It is therefore unclear what purpose is served by these requirements other than to limit the number of participants in the market.

10. Meanwhile, Article 5 of the *Regulation on the Administration of Foreign-Invested Telecommunications Enterprises* provides that, for foreign-invested telecommunications enterprises engaged in national or cross-provincial value-added telecommunication services, registered capital must not be less than RMB 10 million. Although this capital requirement is not as high as that for basic services, **China has taken other steps that limit market access in value-added services. In its April 2003 Catalogue of Telecommunications Services, the Ministry of Information Industry (MII) reclassified several telecommunications services (e.g., Customer Premise Network services) from the value-added category to the basic category, contrary to widely accepted international practice. MII also placed restrictions on what new services could be classified under the value-added category.**

**11. Taken together, China's high capital requirements and reclassification of value-added services are limiting the ability of U.S. and other foreign firms to access China's telecommunications market.**

- (a) Please explain China's rationale for establishing the RMB 2 billion capital requirement for foreign-invested telecommunications enterprises. How does China justify this high capital requirement in light of the very low capital requirements prevailing in Asia and around the world? How is any capital requirement consistent with a commitment to permit resale?
- (b) Is China reviewing this high capital requirement to determine whether it is necessary and not overly burdensome? If so, what is the status of that review?

- (c) Please explain why MII's Catalogue omits "code and protocol conversion" from the list of value-added services, particularly when China's Services Schedule identifies it as an example of a value-added service.
- (d) Please explain how resale service will be licensed.

12. **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 MII is not structurally and financially separate from all telecommunications operators and providers. Please provide an update on China's plans for establishing an independent regulator in the telecommunications sector.**

13. The United States understands that China's telecommunications law is circulating in draft form among China's ministries and agencies.

- (a) When will this draft law be circulated for public comment?
- (b) Will China provide a reasonable period for written comments to be submitted on the draft law?

14. In the *Administrative Measures on International Telecommunications Gateways*, issued by MII on June 21, 2002, China restricts the ownership, construction and administration of international gateways to state-owned enterprises. Please justify this restriction in light of the commitments that China made in **the Services Schedule accompanying its Protocol of Accession. In its Services Schedule, China assumed market access and national treatment obligations in the telecommunications services sector and did not allow for any limitations on the ownership of the suppliers of these services, other than joint venture requirements.**

15. In the paragraph 314 of the Working Party Report accompanying its Protocol of Accession, China committed that foreign service suppliers that were required to form joint ventures with Chinese entities to operate in China were free to chose their joint venture partner, and that they could choose a partner from a sector outside the sector of operation of the joint venture. Please confirm that this commitment applies to foreign service suppliers forming joint ventures in the telecommunications sector.

16. **In the Services Schedule accompanying its Protocol of Accession, China undertook the obligations set forth in the Reference Paper. Section 4 of the Reference Paper requires China to make licensing criteria publicly available. Please describe where this information is available and the period of time normally required to reach a decision for various license applications.**

17. Since China's accession to the WTO, how many applications has MII received from foreign carriers seeking to provide telecommunications services in the Chinese market? How many of these applications have been approved or denied? What criteria are used to evaluate these applications?

18. Pursuant to Section 2 of the Reference Paper, China agreed to ensure interconnection with major suppliers at cost-oriented rates and to make publicly available the procedures for interconnection negotiations. In addition, China agreed to ensure that major suppliers make publicly available their interconnection agreements. Please describe where this information can be found on an ongoing basis.

19. As part of its WTO telecommunications commitments in the Services Schedule accompanying its Protocol of Accession, China agreed that “further liberalization of this sector, including with respect to the level of foreign equity participation, will be discussed during the new round of trade talks.” China has not yet submitted an additional offer in the current round of talks. Does China intend to make a new offer by the current deadline for new offers, now set for May 2005?

## V. CONSTRUCTION SERVICES

20. In its WTO Accession Agreement, China scheduled commitments for construction and related engineering services, agreeing, *inter alia*, to permit wholly-foreign owned enterprises to supply services by December 11, 2004, with certain restrictions on permissible projects. Prior to China’s WTO accession, foreign firms have been able to operate in China on a project-by-project basis according to rules set forth in Ministry of Construction (MOC) Decree 32. MOC has now permitted **foreign-invested construction firms to operate on a project-by-project basis using licenses obtained pursuant to Decree 32 until July 1, 2005; thereafter, they will need to qualify** as construction firms under MOC Decree 113 or as construction design firms under MOC Decree 114. To obtain qualification certificates, foreign firms must satisfy various requirements, including requirements relating to registered capital, staffing and residency.

- (a) Please explain MOC’s rationale for requiring high capitalization for foreign construction firms pursuant to Decree 113.
  - (b) Please explain MOC’s rationale for requiring foreign technical staff of foreign-invested construction firms to reside in China for at least three months each year (pursuant to Decree 113) and requiring foreign technical staff of foreign-invested design firms to reside in China for at least six months each year (pursuant to Decree 114).
  - (c) **Please confirm that MOC will** consider a foreign construction firm’s global experience when reviewing and approving applications for Qualification Grades under Decree 113 and its implementing rules.
  - (d) **Please explain the rationale behind Decree 114’s requirement that wholly foreign-owned construction design enterprises hire one-fourth of their technical staff, and that joint ventures hire one-eighth of their technical staff, from abroad.**
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