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COMMUNICATION FROM THE EUROPEAN COMMUNITIES

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

The following communication, dated 10 October 2006, from the delegation of the European Communities is being circulated to the Members of the Council for Trade in Services.

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1. The EC would like to transmit the following questions and comments on the implementation by China of its commitments on trade in services, in advance of the meeting of the Council for Trade in Services.

2. The EC's questions and comments relate to the following services sectors: legal services, postal and courier, including express delivery services, telecommunications, construction, architectural and engineering services, tourism, distribution services, and air transport services.

3. The EC reserves its right to raise additional questions, upon receipt of responses to its questions and comments by China, in accordance with paragraph 8 and paragraph IV.3 (a) of Annex 1A of the Protocol of Accession of China.

I. LEGAL SERVICES

4. The EC recognises the ongoing efforts of China in implementing its WTO commitments in the area of the legal services. The EC notes, however, that certain measures which are incompatible with China's GATS commitments are being maintained in the legal services sector. The EC wishes to enquire when China will remove these requirements.

5. The *Administrative Regulations on Representative Offices of Foreign Law Firms in China*, which are in effect since 1 January 2002 state in its Article 7 (3) that, as a condition for applying to establish a representative office, foreign law firms need to demonstrate an "actual need to establish a representative office in China to conduct legal service business." The *Implementation Rules of the Administrative Regulations on Representative Offices of Foreign Law Firms in China*, in effect since 1 September 2002, set out in its Article 4 the specific factors used to assess this "need". Such a need requirement, seen in conjunction with the conditions for the determination of a need, constitutes a *de facto e*conomic needs test (ENT). Such a requirement is not listed in China's Schedule of Specific Commitments. China argued in last year's Transitional Review Mechanism that this requirement is maintained to assess the actual "receptivity" of legal services in China. This explanation confirms the EC's understanding that the measure referred to amounts to an economic needs test (ENT). Another reason that China quoted to maintain this "need" measure is that it is deemed necessary to analyse a foreign law firms' legal practice history, professional capability etc. The EC fails to understand how

China can verify the need of a foreign law firm to supply legal services on the basis of such measures, i.e. do the professional capabilities of a law firm indicate anything on a firm's "need" to establish in China?

(a) Can China explain when it will remove this ENT?

(b) Can China explain how many applications for the establishment of representative offices of foreign law firms have been rejected since 2002 on the grounds of a failure to demonstrate the need requirement in Article 7(3) and Article (4) of the above-mentioned legislation?

II. POSTAL & COURIER SERVICES, INCLUDING EXPRESS DELIVERY SERVICES

6. The EC has at previous occasions already raised a number of questions and comments with regard to the reform of postal law in China. The EC would like to understand what progress China has made in reforming its postal law. Is it correct that China has adopted an eighth revision of its draft postal law? Does China intend to make this draft available to WTO Members?

7. China explained in last year's Transitional Review Mechanism that a plan of the postal system reform was approved by the State Council. When will China publish this plan of the postal system reform?

8. Based on the information that has been circulated on the drafts of the postal law, the EC would like to raise a number of questions regarding this reform, on which it would be grateful to receive detailed replies:

(a) The revised draft postal law would seem to include express delivery of addressed letters weighting less than 150 grams in the reserved area. Outside this threshold, domestic express delivery of letters would remain open to non-postal Chinese companies, but not to foreign-invested express delivery operators. Is this correct? Can China explain if foreign-invested express delivery operators will under the revised postal law be able to handle letters in China?

(b) Can China confirm that the new postal law will provide for a definition of express delivery that is in line with international practices, such as by adding a reasonable price criterion to the weight criterion used to define the monopoly?

(c) Article 91, paragraph 2 of the seventh draft postal law forbids the operation of delivering letters, printed matters and parcels except in the form of express delivery service. Can China explain how such a provision is compatible with its specific commitments for all courier services listed under CPC 75121, which includes, *inter alia*, the handling of parcels and newspapers, periodicals and magazines, since these do not mention national treatment limitations other than foreign-equity caps? Can China explain if this provision is removed in a new draft law?

(d) The licensing procedures for express delivery operators are reportedly modified in the postal reform. Furthermore, it would seem that express delivery businesses and Express Mail Service (EMS) will be supervised by different regulatory authorities, and that EMS will be supervised by the relevant postal universal service section. Could China please confirm that it will ensure that (i) existing licences will be grandfathered? (ii) the licensing procedure will be managed at central level for foreign or foreign-owned operators? (iii) the impartiality of the licensing procedure will be guaranteed, for instance by ensuring the independence of the regulator from all operators, including China Post

and its subsidiaries? (iv) EMS and other postal units engaged in competitive business operations will be separated from universal service, and will have the same status as non-postal express companies?

(e) Several proposed provisions of the draft law which grant China Post and its subsidiaries a preferential treatment have been maintained or introduced, even for activities which could be understood as being outside the scope of the universal service and opened to competition. They reportedly include an exemption of business tax, State compensation of losses, specific liability regime and exemption from licensing for express delivery of addressed letters. China's current commitments in courier services do not mention national treatment limitations other than a foreign-equity cap. Could China please confirm that it will ensure, in the final draft law, that foreign and foreign-owned operators shall have no less favourable treatment than China Post and its subsidiaries for their activities?

(f) When would China submit for consultation a new draft postal law that takes account of the above-mentioned comments?

III. TELECOMMUNICATIONS

9. Can China confirm that it does not maintain a requirement for foreign investors to venture with a main Chinese partner in the "basic" telecom sector, in accordance with paragraph 314 of the Working Party report?

10. The Regulation on the Administration of Foreign Invested Telecommunications Enterprises sets an excessively high minimum registered capital requirement (RMB two billion for a nationwide provider). Is a reduction of these requirements under consideration in China?

11. In the area of "value-added" telecom services, more than 15.000 licences have been issued to domestic operators, whereas only five licenses have been issued to foreign-invested enterprises. Foreign-invested enterprises report that they encounter impediments in obtaining licences and are more restricted than domestic enterprises in the type of "value-added" services which they may be able to supply.

(a) In this context, can China confirm that its licensing procedures for value-added services follow the principles on licensing criteria provided for by the Reference Paper on Basic Telecommunications and are streamlined, in line with international practice, so as to be reflected in the number of licences issued?

(b) Can China provide information on the type of value-added services that domestic suppliers can provide and in particular whether foreign services suppliers can provide the same value-added services as domestic operators?

(c) Can China provide the EC with information on the regulatory authority responsible for telecommunications and especially, on the requirements guaranteeing the independence of its regulator?

IV. CONSTRUCTION, ARCHITECTURAL AND ENGINEERING SERVICES

12. The EC remains very concerned by the market access barriers existing in China's construction and design markets. Although China claims that foreign and domestic companies are subject to similar regulatory requirements, the situation on the ground proves to be discriminatory and has deteriorated for foreign companies since the repeal of the Registered Foreign Contractor status

granted by the former Decree 32. In addition, residency requirements for construction companies and construction and engineering design companies are still not WTO-compliant.

13. First, although Wholly Foreign Owned Construction Enterprises (WFOCE) have to satisfy all the requirements which Chinese contractors have to satisfy, including the minimum amount of registered capital, management and technical personnel requirements, number of projects to be carried out each year etc., their scope of activity is limited to the four categories of construction projects specified in China's WTO schedule. As a consequence, the requirements that these companies have to satisfy in comparison with the market access they are granted are heavier (in particular capital requirements) than those of Chinese contractors of the same grade that do not face any restriction as regards the kind of projects they are allowed to undertake. In addition, the Chinese qualification system does not generally take into consideration those references obtained outside of China, and Circular 159, which introduced some changes to Decree 113, was not drafted in a way that provides foreign contractors with a *systematic* recognition of their performance gained outside China, leaving a large amount of discretion to the competent Chinese authorities and a great uncertainty for foreign contractors wishing to apply for setting up a WFOCE.

14. These specific constraints on WFOCE could be an incentive for foreign contractors to set up joint-ventures with Chinese partners. However, the qualification grade of a Joint-Venture under the new qualification system is the lowest of both individual grades, even if one of the partner contractors brings to the joint-venture the technical staff and skills that would be sufficient to qualify the consortium for the higher of both grades. As a consequence, foreign contractors with high qualifications are constrained to find only highly qualified Chinese construction companies as partners in order to undertake projects in China corresponding to their abilities.

15. The freedom of foreign contractors to set up companies in China under the new system is therefore very limited and does not provide the appropriate conditions for foreign investors willing to develop a new business in China. The EC would like to know when China does intend to solve this issue through a fair assessment of the discriminatory effects of the concerned provisions of its qualification system?

16. Regarding in particular the long-standing issue of burdensome capital requirements, the EC would like to know whether China is considering to replace registered capital and net assets requirements with the possibility of alternative financial instruments such as letters of guarantees, insurance bonds or bank guarantees, solutions that the banking market in China can already offer and which would better serve the purpose of providing safe guarantees by contractors?

17. Resulting from such barriers to market access, foreign dredging companies consider it almost impossible to set up foreign-invested companies in China and are therefore operating as chartering companies, renting foreign dredging vessels to Chinese dredging companies. However, in such a case, and for a same project, a foreign company chartering a dredging vessel is subject to far higher taxes than a local dredging company directly importing a foreign dredging vessel, thus resulting in a strong unbalance in the respective competitiveness of local and foreign dredging companies. When does China intend to solve this particular issue?

18. The EC would like to be informed of the planned timetable for the issuance of the draft implementing rules for Decree 114, which was announced to be released very soon. Would these implementing rules state that the overseas experience of foreign-invested design enterprises applying for qualification under Decree 114 would systematically be taken into account?

19. China's WTO commitments in the construction services sector do not mention any limitation as regards national treatment in mode 3. However, the residency requirements imposed by point IV.5 of Notice No 73 for foreign personnel of construction enterprises of three months a year have not been

removed by Circular 159. Similarly, although WTO commitments in architectural, engineering and integrated engineering and urban planning services do not mention residency requirements, they still exist for construction engineering and design enterprises pursuant to Article 16 of Decree 114 (six months a year). Could China please confirm when it intends to abolish these residency requirements in order to comply with its GATS commitments?

20. Requirements in terms of numbers of foreign professional (architects/engineers) staff still exist for foreign-invested enterprises qualifying under the regime of Decree 114, as China has confirmed in its previous reply to the question raised by the EC about construction and engineering design. Such limitations to national treatment do not appear in China's GATS commitments: could China please indicate when it intends to comply with its GATS commitments regarding this issue?

V. TOURISM

21. Article 11 of the *Regulations on Administration of Travel Agencies*, dated 11 December 2001, reads as follows:

> *"The tourism administration department shall, after receipt of an application, carry out the examination according to the following principles:*
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> *1. whether or not it conforms to the tourism development planning,*
> *2. whether or not it meets the need of tourist market, and*
> *3. whether or not it satisfies the conditions as specified in article 6 of these Regulations. […]"*

22. The EC understands that this Article 11 of the *Regulations on Administration of Travel Agencies* establishes an economic needs test (ENT) for the authorisation of new travel agencies. This market access limitation is not listed in China's GATS schedule of commitments. This limitation has been brought to the attention of the Chinese authorities on several occasions, including during the 2003, 2004 and 2005 Transitional Review Mechanism.

23. Would China please provide Members with information about its plans for aligning the regulation of travel agencies with China's GATS commitments in the sector?

VI. DISTRIBUTION SERVICES

24. The Chinese authorities produced in 2004 legislation affecting the distribution sector in order to implement the corresponding phase of market liberalisation in line with China's GATS commitments. In particular, a text of Measures for the Administration of Foreign Investment in the commercial sector was approved in April 2004, being effective as of June. Several questions remain about this legislation and how the adjustment to subsequent phases of trade liberalisation will be done.

25. This law affects, among others, retail distribution services of several products for service suppliers with more than 30 stores. The law indicates 49% foreign ownership until December 2006 for distribution of books, pharmaceutical, and other products. Although this is currently in line with China's GATS commitments, the situation will change as of January 2007, when China's WTO commitments to allow full foreign control will apply. Would China please explain how it is planning to manage this transition?

VII. AIR TRANSPORT SERVICES

26. China has undertaken commitments under GATS Article XVI and Article XVII for mode 1 on Computer Reservation Systems (CRS). The EC notes that a regulation is still under preparation to cover this area. CRS providers need certainty about the legal environment under which they are

operating, and a guarantee on their scope of business and on non-discriminatory principles to be applied. The EC already asked China about the timing of this legislative process in previous Transitional Review Mechanisms, but so far no progress seems to have been achieved. Could China please update Members on the progress of the long-awaited legislation that will create a legal framework for the sector? Can China explain how many applications have been made for CRS licenses, how many have been rejected and how many have been awarded in the last year?