WORLD TRADE ORGANIZATION

RESTRICTED

S/C/W/286
22 October 2007

(07-4557)

Council for Trade in Services Original: English

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 19 October 2007, 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 18 and paragraph V 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* Economic Needs Requirement (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 Requirement (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?

6. China's GATS commitments allow foreign representative offices to "provide information on the impact of the Chinese legal environment." While China has defined in the above-mentioned Regulations and Implementation Rules the services which cannot be supplied by foreign representative offices, the EC has not yet received a response to its question which specific activities foreign representative offices can engage when they provide information on the impact of the Chinese legal environment. Can China provide a positive list of activities which can be undertaken as regards the provision of information on the impact of the Chinese legal environment?

II. POSTAL & COURIER SERVICES, INCLUDING EXPRESS DELIVERY SERVICES

7. The EC has at the previous transitional review mechanism meetings 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.

(a) Is it correct that China has adopted a ninth revision of its draft postal law?

(b) Does China intend to make this draft available to WTO Members?

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) When China joined the WTO, it permitted foreign companies to provide express delivery services under government issued licenses, with a narrowly defined limitation on the delivery of private letters reserved to China Post. However, it seems that the 9th draft postal law would include a provision that would bar foreign invested express delivery services companies from delivering all documents, regardless of their weight. Can China confirm if this the case or not?

(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? When would China submit for consultation a new draft postal law?

9. China issued on 12 September 2007 postal industry standards for express service.

(a) Can China clarify if these standards are mandatory or voluntary standards?

(b) Can China confirm whether or not these standards treat domestic and international services suppliers formally differently?

(c) Can China clarify whether or not foreign services suppliers will be consulted in the further development of these standards?

III. TELECOMMUNICATIONS

10. Which are the requirements in China for the provision of "basic services"? 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? Is it correct that until present there is no single example of a foreign invested equity joint venture providing mobile or fixed services in China?

11. 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?

12. In the area of “value-added” telecom services, more than 22.000 licences have been issued to domestic operators, whereas only six 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) Can China confirm that foreign companies do not apply to enter the market? Can China provide with the measures it has taken in order to address the problems encountered by foreign companies entering the VAS market? In this context, can China confirm that its licensing procedures for value-added services are adequately streamlined, in line with international practice, so as to promote investment in this part of the telecoms sector?

(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 more specific information on the organisation (staffing, powers vested) of its regulatory authority responsible for telecommunications and especially, on the requirements guaranteeing the independence of its regulator?

13. In March 2007, China Telecom and China Netcom signed an agreement which seems to limit competition between both companies from 2007 onwards. Both companies would leave each other in control of its core markets.

(a) How is this agreement between China Telecom and China Netcom compatible with the key principles of the WTO Reference Paper on Telecom?

(b) What did the Ministry of Information Industry, which acts as regulator, do in response to this agreement between China Telecom and China Netcom?

IV. CONSTRUCTION, ARCHITECTURAL AND ENGINEERING SERVICES

14. The EC welcomes the efforts made by the PRC in further clarifying the regulatory framework applying to the construction sector, in particular through the release of the long awaited Decree 114 Implementation Regulations and the Joint Decree 155 on Foreign-Invested Construction Project Service Enterprises. However, the EC remains very concerned by the existence of a number of

barriers to market access in China's construction and design markets, resulting from the maintenance of a set of provisions that effectively hamper the ability of foreign companies to compete on the Chinese market.

15. Since the repeal of the Registered Foreign Contractor status granted by the former Decree 32, and the setting up of a revised qualification and licensing system, the situation of foreign construction companies in China has deteriorated. Many elements of this new system prove to be excessive and do not provide enough flexibility to allow foreign companies to compete on a level playing field with domestic enterprises, and can even be counterproductive by restricting possibilities of foreign investment in China and co-operation with Chinese companies.

16. 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 provide for sufficient flexibility to assess the actual ability of foreign construction companies to supply their services in the conditions required by their grade: according to the drafting of Circular 159, which introduced some changes to Decree 113, recognition of the performance gained outside China by foreign companies is not *systematically* taken into account, which leaves a great degree of uncertainty for foreign contractors wishing to apply for setting up a WFOCE. This system acts as a disincentive to the setting up of WFOCE, and therefore does not provide foreign construction companies with a real range of choices when willing to invest in China.

17. 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, as well as of any consortium of construction companies, under the qualification system is the lowest of each individual grades, even if one of the partner contractors brings to the joint-venture the technical staff and skills and capital that would be sufficient to qualify the consortium for the higher of all 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. In the same way, a Chinese construction company willing to associate with a small foreign specialised construction company holding a strong know-how will not be incited to do so.

18. Finally, when a foreign company wishes to acquire a Chinese construction entity, the regulation stipulates that the licenses and the qualifications have to be re-assessed. However, the criteria upon which this re-assessment will be based are not published, which gives no certainty to foreign companies to enter into the Chinese market through this way.

19. Thus, it clearly appears that the freedom of foreign contractors to set up companies in China under the new system is very limited and does not provide the appropriate conditions for foreign investors willing to develop a new business in China. It is detrimental to the development of both foreign and Chinese construction companies. The recent regulations promulgated by China still do not address these outstanding issues. Therefore, the EC would like to know when China does intend to solve them through a fair assessment of the hampering and discriminatory effects of the concerned provisions of its qualification system?

20. Regarding in particular the long-standing issue of burdensome capital requirements, the EC would like to know whether China is considering to relax the registered capital and net assets

requirements when alternative financial instruments are available - such as letters of guarantees, insurance bonds or bank guarantees, solutions that the banking market in China can already offer – or, alternatively, when major international contractors can provide sufficient security. This flexibility would better serve the purpose of providing safe guarantees by contractors and would allow a more effective use of capital by contractors.

21. Such barriers to market access particularly affect the sector of dredging, which faces additional constraints: as this system *de facto* prevents foreign dredging companies from setting up foreign-invested entities in China, dredgers try to operate 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 assess the difficulties faced in this sector and set out this issue?

22. The EC welcomes the issuance of the long-awaited implementing rules for Decree 114. These rules include positive measures which are however provided on a temporary basis: a) the possibility to use "temporarily" Chinese registered architects or engineers where relevant foreign architects or engineers also qualified in China cannot be found to meet the personnel requirements; b) the six-months residency requirement may not be applied where foreign architects or engineers cannot "temporarily" satisfy it. As there is no guidance about how these "temporary" provisions are to be interpreted, there is still an uncertainty which partly undermines the value of these implementing rules. Therefore, the EC would welcome any clarification about whether and when these "temporary" measures will be made permanent. With this respect, it is important to recall that, regarding requirements in terms of numbers of foreign professional staff for foreign-invested enterprises qualifying under the regime of Decree 114, as well as residency requirements pursuant to Article 16 of Decree 114, no mention is made of such limitations to National Treatment in China's WTO commitments in this sector.

23. In the same way, 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, although China's WTO commitments in the construction services sector do not mention any limitation as regards national treatment in mode 3. Could China please confirm when it intends to abolish these residency requirements in order to comply with its GATS commitments?

V. TOURISM

24. The EC understands that the Regulations on Administration of Travel Agencies dated 11 December 2001 establish, in article 11, an economics needs test (ENT) for the authorisation of new travel agencies. This market access limitation is not reflected in China’s GATS schedule of commitments. This has been raised to the attention of the Chinese authorities in several occasions, including the 2003, 2004, 2005 and 2006 TRM processes. China confirmed in the 2006 TRM that it does not intend to restrict market access through an economic needs test in this sector, and that the measure under discussion is non-discriminatory and applied in equal terms to national and foreign services suppliers. These points having been confirmed, there is an urgent need to align its legislation with its indicated purposes, and it should be noted that the current language of the law clearly and in unequivocal terms describes an economic needs test in the sense of GATS Article XVI.

25. 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

26. 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 is being done.

27. This law affected, among others, retail distribution services of several products for service suppliers with more than 30 stores. The law indicated 49% foreign ownership until December 2006 for distribution of books, pharmaceutical, and other products. Although this was at the time in compliance with China's GATS commitments, the situation changed as of January 2007, when China's WTO commitments to allow full foreign control started to apply. Would China please indicate what measures have been taken to implement this transition and align with its GATS commitments?

VII. AIR TRANSPORT SERVICES

28. China has commitments under GATS Article XVI and Article XVII for Mode 1 on Computer Reservation Systems (CRS). The EC understands that legislation concerning CRS is being prepared by China which would facilitate the openness of the market and equal treatment of Chinese and foreign operators. Could China provide the latest information on the issue?