

COMMUNICATION FROM THE UNITED STATES

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

The following communication, dated 2 November 2007, 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

I. DISTRIBUTION SERVICES: SALES AWAY FROM A FIXED LOCATION

1. China issued regulations in August 2005 governing sales away from a fixed location, or direct selling. The United States supports China's efforts to protect the public from fraud while opening its market to direct selling. The United States notes that these efforts need not limit the growth of legitimate domestic and foreign direct selling operations.

- (a) Since the direct selling regulations became effective in December 2005, a number of companies, including foreign companies, have received direct selling licenses, although not always within the 90-day time period set forth in the direct selling regulations. What are China's plans for speeding up the processing of domestic and foreign applications for direct selling licenses? Will China be able to adhere to the 90-day time period set forth in the direct selling regulations? If not, please explain.
- (b) The United States understands that very few companies have been able to obtain licenses that would enable them to conduct direct selling in more than one province in China, which significantly restricts their ability to expand their businesses in China. Can China please explain why it imposes these restrictions on the geographic scope of licenses?
- (c) The direct selling regulations provide that a direct seller in a particular province must operate a provincial office in the provincial capital and a "service center" in each district where the direct seller sells products to consumers. Can China please confirm that direct selling service centers do not require a business license, and that no more than one service center per district is required to comply with the direct selling regulations? What steps is the central government taking to ensure consistent provincial interpretation and implementation of the service center requirements set forth in the direct selling regulations?

- (d) Article 7.2 of the direct selling regulations requires that foreign-invested companies have three years of direct selling experience in other markets to apply for a direct selling license in China, but does not impose the same requirement on domestic companies. Will China change the provision in question so that the same domestic experience requirements apply to both domestic and foreign companies?
- (e) In connection with last year's transitional review before this Council, the United States explained that it was concerned that the direct selling regulations include a compensation cap for salespeople of 30 percent of sales revenue. Based on international compensation practices, this cap would unnecessarily limit direct selling companies from sufficiently motivating their sales representatives. Except for Korea, which has a compensation cap higher and more narrowly defined than that proposed by China, no country limits the income received by direct sellers. Despite this international practice, China claimed at last year's transitional review that its compensation cap did not contravene any international practice, but it did not provide any information to support this claim. Could China please explain the factual basis for its claim that its compensation cap did not contravene any international practice?
- (f) The direct selling regulations also do not allow for compensation based on services rendered. This effectively denies payment for marketing services, and is a significant departure from international practice, including the United Nations' Consumer Product Code under which persons engage in direct selling may earn compensation from the sales of both products and services. On this point, too, China claimed that it had acted consistent with international practice. Could China please explain the factual basis for that claim? Will China consider amending its compensation restrictions to come into compliance with internationally accepted practices regarding direct selling?

II. DISTRIBUTION SERVICES: RETAIL SERVICES

2. Although China has made progress in licensing foreign retail outlets, foreign companies still report that they face extra burdens, compared with domestic retailers, in expanding their operations. For example, the licensing process led by China's Ministry of Commerce (MOFCOM) for foreign retailers seeking to establish a new outlet is multi-layered and slow-moving, requiring approvals at the local, provincial and central government levels. In contrast, domestic retailers can quickly obtain licenses directly from the State Administration of Industry and Commerce. Further, domestic retailers do not need to satisfy substantive requirements that are imposed on foreign companies, such as an additional minimum capital requirement for each new store or a requirement that the location city for the new outlet have an urban commercial network plan in place. Can China please confirm that it will expedite MOFCOM's review of foreign retailers' applications for new outlets and ensure that it applies the same substantive licensing requirements to both foreign and domestic retailers?

3. China's GATS commitment to allow foreign majority-owned chain store retailers with more than 30 outlets to sell motor vehicles phased in as of 11 December 2006. However, it does not appear that China has issued regulations to implement this commitment. Can China please confirm that this right is being provided?

III. DISTRIBUTION SERVICES: CRUDE OIL AND PROCESSED OIL

4. Can China please explain the steps that it has taken to fulfil its GATS commitments regarding wholesale and retail distribution of crude oil and processed oil?

IV. DISTRIBUTION SERVICES: FRANCHISING

5. Has China conducted a review of the operation of MOFCOM's *Rules on the Administration of Commercial Franchising*, issued on 31 December 2004? If so, please describe the status of that review.

V. EXPRESS DELIVERY

6. The United States understands that the postal system reform plan was approved by the State Council in July 2005. The plan reportedly contains details on important issues such as the amount of a universal services fund tax required from operators, how the operating divisions of China Post will be managed and other details of interest to foreign companies. When will China publish its postal system reform plan?

7. Please provide an update on the status of China Post's efforts to implement the State Council's postal system reform plan, including separating the regulatory and operational functions, and setting up the National Postal Regulatory Authority." Please also explain how the Express Mail Service (EMS) will be affected by these changes.

8. The United States understands that China has begun circulating a 9th draft of a new Postal Law. Is that the most recent draft? When will China make the draft publicly available for comment? What is the State Council's timetable for issuing the final draft of the Postal Law to the National People's Congress?

9. In connection with last year's transitional review before this Council, the United States asked several questions about the 8th draft of the Postal Law, but China did not respond to them. Many of these questions appear to remain relevant to the 9th draft of the Postal Law. The United States restates those questions below and asks that China provide responses to them during the upcoming transitional review before this Council.

10. The 8th draft of the Postal Law reportedly excluded foreign service providers entirely from the domestic express delivery market, while the 9th draft of the Postal Law reportedly removes this restriction? Is that correct? Please explain how this restriction is consistent with the commitments that China made in the GATS Schedule accompanying its Protocol of Accession with regard to courier services.

11. The 8th draft of the Postal Law reportedly reserved the delivery of addressed letters weighing less than 150 grams to China Post. The 9th draft of the Postal Law reportedly applies a similar restriction to the domestic express delivery market, pursuant to which only China Post (and not foreign companies and domestic companies other than China Post) can deliver items weighing less than 150 grams. Is that correct? If not, please explain the rationale for this restriction and how it is compatible with the commitments that China made in the GATS Schedule accompanying its Protocol of Accession with regard to courier services.

12. The 9th draft of the Postal Law reportedly reserves the delivery of letters and other documents weighing 150 grams or more to China Post and other domestic companies in the domestic express delivery market, meaning that foreign companies cannot deliver letters and other documents weighing 150 grams or more. Is that correct? Please explain the rationale for this restriction and how it is compatible with the commitments that China made in the GATS Schedule accompanying its Protocol of Accession with regard to courier services.

13. Please provide details on China's plans for a universal services fund tax that reportedly has been included in the 9th draft of the Postal Law. What would the amount of this new tax be? What

types of firms would it be imposed on, and how would this tax be calculated? If this tax would be imposed on private express delivery services companies, please explain China's rationale for doing so.

14. In September 2007, China issued "express delivery standards" with an effective date of 1 January 2008. China did not provide any formal opportunity for interested parties to provide comments on these standards before they were issued.

- (a) Are these standards mandatory or voluntary?
- (b) Can China confirm that it will delay implementation of the standards until interested persons have an opportunity to provide their views?
- (c) Can China confirm that the standards will not discriminate against foreign express companies or impose undue burdens on their operations?

15. Foreign express delivery companies have reported that China's licensing process for trucking services is complicated and prolonged and serves as an impediment to the efficient supply of express delivery services. Can China please describe any plans it has to facilitate the granting of these licenses?

VI. TELECOMMUNICATIONS

16. In the GATS Schedule accompanying its Protocol of Accession, China made commitments with regard to foreign equity and geographical limitations in the telecommunications sector. What specific measures has China issued and implemented to reflect the phased-in liberalization of these commitments to date? Are these measures public? Please identify them.

17. Article 5 of the *Regulation on the Administration of Foreign Invested Telecommunications Enterprises*, issued by the State Council in Decree No. 333 on 11 December 2001 (effective 1 January 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). As the United States has previously commented, 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. During last year's transitional review, China asserted (in document S/C/M/85 at para. 30) that "such requirement was necessary both to guarantee the normal business operation and to safeguard the interests of users of telecommunication services, as the telecommunications industry was a capital-intensive industry involving economies of scale." While many operators do engage in capital-intensive operations and take advantage of economies of scale, China appears to be restricting market entry through this requirement to a subset of the potential telecommunications market entrants. For example, resale-based operators, of which there are hundreds in many markets, operate successfully with relatively little capital outlay. Similarly, operators offering services over high-speed Internet connections, such as VOIP, require little capital to operate. Additionally, some companies forego economies of scale to provide niche services, such as leased line services or corporate data services, targeting a limited number of customers. Finally, even for capital-intensive services, if relying on infrastructure located substantially outside of China (e.g., satellite-based services, or submarine-cable based services), there would appear to be no reason to need to invest significantly in China to provide a broad range of services. In all these cases, the current high capitalization requirement appears to be an arbitrary hindrance to legitimate and rational business models that should be permitted based on China's WTO commitments. As the United States noted during last year's transitional review, the fact that there has been little or no new entry in the basic telecommunications sector suggests that this high capitalization requirement is functioning as a market entry deterrent, for both Chinese and foreign operators. We understand that China is currently reviewing these requirements with a view to making them less

burdensome, which would be welcome. Does China expect revisions to these requirements to be implemented this year? Please explain.

18. In paragraph 314 of the Working Party Report accompanying China's Protocol of Accession, China agreed to permit foreign applicants in any sector subject to joint venture requirements to freely choose a joint venture partner, even from outside the sector being applied for. In response to a question at last year's transitional review about why China prohibits partnering with non-incumbent operators, China stated that "the number of licenses for basic telecommunication services was limited due to the scarcity and availability of such scarce resources as frequencies, numbers and rights of way. In China, there were already six major national basic telecommunication service operators, and most of the frequencies and other scarce resources had already been allocated to these operators." This response, however, raises the same concerns described above. Many legitimate services, such as resale-based services, Internet-based services, niche-services, and services based on infrastructure located outside of China, can be provided without competing for scarce resources.

- (a) Even where scarce resources are implicated, as in the cases of rights of way, numbers or frequencies, what evidence does China have to demonstrate that such resources are exhausted, particularly given the evidence that incumbents continue to grow at a rapid rate?
- (b) Given that China has a duopoly in each major market segment, i.e., wireless, fixed, and satellite, it is hard to conceive of resource exhaustion, when major markets typically support dozens, even hundreds of operators in certain segments. Doesn't China have significantly unused spectrum (i.e. over 100 megahertz) that has yet to be released to the market given governmental concern over whether Chinese consumers are ready for 3G wireless services?
- (c) As the United States has previously noted, to date, there have been no cases of China issuing licenses in the basic telecom sector where the Chinese joint venture partner was not also an existing basic telecom licensee. Although Chinese officials have justified preventing additional market entry as prudent market management, designed to prevent "excessive competition", how is such a policy consistent with (i) China's commitment not to limit the number of market participants and (ii) China's commitment to permit foreign companies free choice of joint-venture partners?

19. Please provide an update on the number, nature and foreign affiliation of both basic and value-added service suppliers now operating in China.

20. In paragraph 309 of China's 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. What structural mechanisms within the Ministry of Information Industry (MII) ensure that MII's role in industrial promotion (e.g., for TD-SCDMA) does not conflict with its obligation to be impartial? How does China reconcile an obligation of its regulator to be impartial with measure providing advantages for deploying TD-SCDMA (loans, more rapid approval of a standard, preferential test licenses, policy support, etc.)?

21. China has repeatedly stated its commitment to licensing wireless technologies in a technology-neutral manner, letting operators choose technologies solely on commercial considerations. Does this commitment extend to all wireless technologies, including wireless broadband technologies such as WiMax, or only established "3G" technologies? Please explain.

22. Please provide an update on China's draft telecommunications law. Is it still being circulated in draft form among China's ministries and agencies? When will this draft law be circulated for public comment? How will China provide a reasonable period for written comments to be submitted on the draft law?

23. Is China planning on updating its domestic definition of value-added services? If so, what is the timetable?

24. We understand that China allows Hong Kong-based satellite operators to sell satellite capacity (space segment) directly to broadcasters located in China, who then use their own uplink facilities to distribute the programming throughout China. At the same time, China prohibits operators of other WTO Members similar arrangements, requiring them to contract through a domestic Chinese operator to reach their customers. How does China see this policy as consistent with its MFN obligations under the GATS?

25. China's State Administration of Radio, Film and Television (SARFT) issued Notice No. 72 on 24 July 2007.

(a) This notice requires CCTV and provincial satellite TV and radio channels to move their channels from certain foreign operated satellites to the domestic satellites Sinosat-3 and Chinasat 6 B satellites. Since this measure appears to provide a preference for a domestic operator, how is this measure consistent with the national treatment obligations China has undertaken under the GATS with respect to international telecommunications services?

(b) This Notice additionally requires certain DTH TV channels and 34 foreign TV channels to be moved from a China-based satellite (Sinosat 1) to a satellite owned by Hong Kong based satellite operator APT. Other foreign satellite operators, however, appear prohibited from carrying DTH signals. How is this measure consistent with China's MFN obligations under the GATS?

VII. CONSTRUCTION SERVICES

26. In September 2002, Ministry of Construction (MOC) and the Ministry of Foreign Trade and Economic Cooperation (now MOFCOM) issued the *Rules on Administration of Foreign-Invested Construction Enterprises* (known as Decree 113) and *Rules on the Administration of Foreign-Invested Construction Engineering and Design Enterprises* (known as Decree 114).

27. Decrees 113 and 114 create concerns for foreign firms by imposing new and more restrictive conditions than existed prior to China's WTO accession, when they were permitted to work in China on a project-by-project basis pursuant to MOC rules. In particular, these Decrees for the first time require foreign-invested enterprises to incorporate in China, and they impose high minimum registered capital requirements and technical personnel staff requirements that are difficult for many foreign-invested enterprises to satisfy. Decree 113 also limits the scope of projects (in terms of size and scale) permitted to foreign-invested enterprises in comparison with the rights enjoyed by domestic companies.

28. Although China issued implementing rules for Decree 114 in late 2006 that address some of the concerns of foreign construction engineering and design enterprises, other aspects of these rules are troubling.

29. In a related measure, Circular 200 imposes certain overly burdensome qualification requirements on foreign suppliers of project management services.

30. The United States remains concerned about many aspects of China's regime for construction services and for construction engineering and design services, including those described above, and how this regime conforms with China's GATS obligations. In connection with last year's transitional review before this Council, the United States asked questions about some of these concerns, but China did not respond to them. The United States repeats those questions below and asks some additional questions and would request that China provide responses to them during the upcoming transitional review before this Council.

- (a) Under Decree 113, foreign-invested enterprises are limited in the kinds of projects they can apply to undertake, raising national treatment issues since domestic enterprises face no such restrictions. Does China intend to broaden the scope of projects that foreign-invested enterprises can undertake?
- (b) With regard to Decree 113, can China confirm that it will consider reducing the registered minimum capital requirements? Will China also consider the financial strength of the parent company and/or bonding and other guarantee arrangements in lieu of the registered minimum capital requirements?
- (c) With regard to Decree 113, can China confirm that, similar to the practice under Decree 114, it will take into account project experience outside of China in qualifying companies to carry out certain "grades" of projects?
- (d) With regard to the implementing rules for Decree 114, can China confirm that it will consider the experience of parent and affiliated companies of the foreign enterprise when examining qualifications to carry out certain "grades" of projects? Can China also consider further relaxation of the personnel requirements under Decree 114? Will China consider revising Decree 114 to allow foreign companies to receive all classes of licenses without a trial period under a smaller-scale license? Along with these changes, will China consider making the implementing rules for Decree 114 permanent?
- (e) China does not allow foreign companies to provide project management services without already holding construction enterprise qualifications. Could China provide information on how it might remove this overly burdensome aspect of its regime, either through revising Circular 200 or other measures?

VIII. LEGAL SERVICES

31. While the United States acknowledges the steps China has taken toward opening the legal services sector, foreign firms continue to face onerous restrictions regarding market access and national treatment in China. For example, despite China's explanation at past transitional reviews before this Council, the United States remains concerned over China's imposition of a three-year waiting period before a foreign law firm can open each additional office in China, particularly because it includes an application process that could take as long as nine months and requires that market need be demonstrated. Please describe whether China has any current plans to address this concern.

IX. TRANSPARENCY

32. In China's Protocol of Accession and accompanying Working Party Report, Members recognized the overriding importance of transparency through a host of provisions. Since China's accession, China has made notable improvements in the transparency of its trade regime, particularly through the many notifications that it has made to the WTO's councils and committees as well as through its use of numerous official journals, other publications and the Internet to publicize new or

modified trade-related laws, regulations and other measures. Nevertheless, there remains much to be done to further improve transparency in China, as China itself has acknowledged. Transparency is a critically important area, both from a governmental perspective and from a business perspective.

33. In Section 2(C) of its Protocol of Accession, China specifically committed to establish or designate an official journal dedicated to the publication of all trade-related measures, including, *inter alia*, “all laws, regulations and other measures pertaining to or affecting trade in . . . services.” The term “laws, regulations and other measures” is defined broadly as “laws, regulations and other measures of the central government as well as local regulations, rules and other measures issued or applied at the sub-national level.”

34. During past transitional reviews, China has stated that its official journal was the *China Foreign Trade and Economic Cooperation Gazette*, now published by MOFCOM and known as the MOFCOM Gazette. Until March 2006, however, only trade-related measures issued by MOFCOM, either on its own or jointly with other ministries or agencies, were published in the MOFCOM Gazette; trade-related measures issued by other ministries and agencies were not published in the MOFCOM Gazette. In March 2006, China’s State Council issued a notice directing all central, provincial and local government entities to begin sending copies of all of their trade-related measures to MOFCOM for immediate publication in its Gazette.

- (a) Please provide an update on the progress being made by central, provincial and local government entities in fulfilling the State Council’s directive to send measures pertaining to or affecting trade in services to MOFCOM for publication in the MOFCOM Gazette. As part of that update, please identify the government entities that regularly send their services measures to MOFCOM for publication in the MOFCOM Gazette. Please also describe the types of services measures (e.g. laws, regulations, rules, measures, notices, decisions, etc.) regularly being sent to MOFCOM for publication in the MOFCOM Gazette.
- (b) With regard to measures pertaining to or affecting trade in services, please describe any progress that China has made during the past year in implementing the commitment that it made in Section 2(C) of its Protocol of Accession to provide a reasonable period for public comment on new or modified measures before implementing them, except in certain specified instances.
