

**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 20 November 2008, from the delegation of the United States is being circulated to the Members of the Council for Trade in Services.

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**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, received direct selling licenses. However, the United States understands that, since May 2007, China has not approved any new applications for direct selling licenses even though 16 domestic and foreign companies have applied. Can China explain the factors that have caused it to delay its consideration of these applications? Can China confirm that it will review these applications and approve any qualified applicants within the 90-day time period set forth in the direct selling regulations?
- (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 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 comment on whether it would be open to changing its requirements from one service center in each district to one service center in each city, with approval at the city level rather than the district level?

- (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 or a similar requirement on domestic companies. Will China change the provision in question so that the same requirements apply to both domestic and foreign companies?
- (e) The United States remains 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 unnecessarily limits 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. Will China consider amending its compensation practices to come into compliance with internationally accepted practices regarding direct selling?
- (f) The direct selling regulations 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 engaged in direct selling may earn compensation from the sales of both products and services. Will China consider amending its compensation restrictions to come into compliance with internationally accepted practices regarding direct selling?

## **II. DISTRIBUTION SERVICES: RETAIL SERVICES**

2. The United States appreciates that, on 12 September 2008, China's Ministry of Commerce (MOFCOM) issued a regulation providing that licensing authority for foreign retailers seeking to establish a new outlet (or store) would be devolved from the central government level to the provincial government level. This change could be an important step in facilitating the approval of new outlets, depending how the new approval process works in practice.

- (a) Can China confirm that the various provincial licensing authorities will apply similar approval procedures and requirements to foreign and domestic companies seeking to open new retail outlets?
- (b) Can China confirm that foreign retailers will no longer need to satisfy additional "informal" minimum capital requirements that are not imposed on domestic retailers?
- (c) Can China confirm that it will apply any other requirements, including zoning requirements, on the same basis to foreign and domestic retailers?

3. China's GATS commitment to allow majority foreign-owned chain store retailers with more than 30 outlets to sell motor vehicles was scheduled to be implemented no later than 11 December 2006. However, it does not appear that China has issued regulations to implement this commitment. Can China confirm that this right is being provided? If not, why not?

## **III. DISTRIBUTION SERVICES: CRUDE OIL AND PROCESSED OIL**

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

#### **IV. EXPRESS DELIVERY**

5. The United States is very concerned about certain aspects of China's current draft Postal Law, which is under consideration by the National People's Congress and has been made available for public comment.

- (a) Articles 50 and 83 of the draft Postal Law would exclude foreign express delivery service suppliers from its domestic express document delivery market. In contrast, Chinese domestic express delivery companies would be allowed to provide a full scope of domestic express delivery services – both document delivery and package delivery. Please confirm that China will take the necessary steps to amend its draft Postal Law to remove this discriminatory element.
- (b) The draft Postal Law also contains other troubling elements, including the lack of a specific definition of the postal monopoly (instead of a weight-price multiple that is the international norm) and a universal postal fund requirement that would subject express delivery companies to additional taxes that would benefit China Post. Please explain China's rationale for imposing universal postal fund requirements on express delivery companies. Please confirm that China will take these comments into account in re-drafting its draft Postal Law.

6. 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 describe any plans it has to facilitate the granting of licenses for trucking services?

#### **V. TELECOMMUNICATIONS**

7. 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.

8. On 15 September 2008, through State Council Decree No. 534, China reduced minimum registered capital requirements for foreign-invested telecommunications enterprises engaged in national or cross-provincial basic telecommunication services from RMB 2 billion (\$292 million) to RMB 1 billion (\$146 million). The United States notes this development but believes that this reduced capital requirement is still too high, both when viewed in relation to the norms in other economies and in the specific context of China's telecommunications market. During a past 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 focus on capital-intensive operations and seek market advantages and efficiencies based on economies of scale, it is not necessary to adopt this approach to succeed in telecommunications markets, either in China or elsewhere. Thus, China appears to be restricting market entry through this requirement to a subset of the potential telecommunications market entrants (i.e., large, highly capitalized enterprises). In many cases, the current high capital requirement appears to be an arbitrary hindrance to legitimate and rational business models that should be permitted based on China's WTO commitments. For example, resale-based operators, operators offering services over high-speed Internet connections, such as VOIP, and providers of niche services, such as leased line services or corporate data services, targeting a limited number of customers, require very little capital to operate. 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. As the United States has noted during past transitional reviews, the fact that there has been little or no new entry in China's basic telecommunications sector suggests that this high capital requirement is functioning as a market entry deterrent, for both Chinese and foreign operators.

- (a) Has this capital requirement reduction resulted in any new entry into the basic telecommunications market?
- (b) Will China consider significantly reducing its capital requirement for basic telecommunications services?

9. 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 a past transitional review about why China prohibits partnering with non-incumbent telecommunications 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." China went on to explain that most of the frequencies and other scarce resources had already been allocated to existing 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 these resources are exhausted, particularly given the evidence that incumbents continue to grow at a rapid rate?
- (b) What measures has China introduced to ensure that scarce resources can be efficiently shared among competitors? Has China introduced number portability or sharing access to physical infrastructure and rights of way?
- (c) Given that China has no more than two or three telecommunications operators 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 the Chinese government's concern over whether Chinese consumers are ready for 3G wireless services?
- (d) As the United States has noted above, to date, there have been no cases of China issuing licenses in the basic telecommunications sector where the Chinese joint venture partner was not also an existing basic telecommunications 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, (ii) China's commitment not to employ an economic needs test and (iii) China's commitment to permit foreign companies free choice of joint-venture partners?

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

11. 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 Industry and Information Technology (MIIT) ensure that MIIT'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 a measure providing advantages for deploying TD-SCDMA (such as loans, more rapid approval of a standard, preferential test licenses, policy support, etc.)?

12. China has repeatedly stated its commitment to licensing wireless technologies in a technology-neutral manner, letting operators choose technologies solely on commercial considerations. The United States is very concerned that China's TD-SCDMA 3G "test project" is already establishing a serious commercial foothold in the China market, an opportunity denied to suppliers of competing 3G services.

- (a) When will China formally begin licensing 3G providers to introduce competition in this key sub-sector?
- (b) Does China's commitment to technology neutrality extend to all wireless technologies, including wireless broadband technologies such as WiMax, or only established 3G technologies? Please explain.
- (c) What steps has China taken to ensure that procedures for the allocation of frequencies for all such services are administered in an objective, timely, transparent and non-discriminatory manner, consistent with China's Reference Paper commitments?

13. 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 provided to the National People's Congress for review and circulated for public comment?

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

15. The United States understands 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 from entering into similar arrangements, requiring them instead to contract through a domestic Chinese operator to reach their customers.

- (a) Please explain how this policy is consistent with China's MFN obligations under the GATS.
- (b) In the past, China has suggested that Hong Kong operators' services were "grandfathered" upon China's accession to the WTO. What evidence can China provide to demonstrate that these services were supplied prior to China's WTO accession? What is the basis for China's assertion that China has a right to maintain this discrimination post-accession?

16. 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 6B 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?

## VI. CONSTRUCTION SERVICES

17. The United States remains concerned about many aspects of China's regime for construction services and construction engineering and design services 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 fully respond to all of 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, the *Regulations on the Administration of Foreign-Invested Construction Enterprises*, jointly issued by the Ministry of Construction and the Ministry of Commerce in September 2002, foreign-invested enterprises are limited in the kinds of projects they can apply to undertake, raising national treatment issues because 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, the *Regulations on the Administration of Foreign-Invested Construction Engineering Design Enterprises*, jointly issued by the Ministry of Construction and the Ministry of Commerce in September 2002, it will take into account project experience outside of China in qualifying companies to carry out certain "grades" of projects?
- (d) The United States welcomes the implementing rules for Decree 114, set forth in Circular 18, the *Implementing Rules for the Regulations on the Administration of Foreign-Invested Construction Engineering Design Enterprises*, issued by the Ministry of Construction in January 2007. The United States notes that many of Circular 18's elements are temporary, including improvements relating to personnel qualifications. Can China confirm that it will make these changes permanent?
- (e) The United States appreciates that China also introduced the *Regulations on the Management of Qualifications for Construction and Engineering Supervision and Design Enterprises*, issued by the Ministry of Construction in June 2007 (known as Decree 160), which relates to the upgrading of qualifications for foreign-invested

enterprises providing engineering and design services. However, the United States urges China to allow all foreign-invested companies to take advantage of this liberalization, rather than subject foreign-invested design enterprises to more restrictive procedures under Circular 202, *Implementing Rules for the Regulations on the Management of Qualifications for Construction and Engineering Supervision and Design Enterprises*, issued by the Ministry of Construction in August 2007, which does not allow these enterprises to start at “Grade A” or above, i.e., the most comprehensive licenses. Can China confirm that it will consider modifications of this nature?

- (f) As a result of Circular 200, the *Provisional Measures for Construction Project Management*, issued by the Ministry of Construction in November 2004, 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 Decree 200 or other measures?

## **VII. LEGAL SERVICES**

18. While the United States acknowledges the steps that 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 an 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 these concerns.

## **VIII. TRANSPARENCY**

19. The United States appreciates China’s recent decision to publish in advance for public comment, subject to specified exceptions, all trade and economic-related administrative regulations and departmental rules that are proposed for adoption and provide a public comment period of not less than 30 days from the date of publication. China indicated that it would publish these proposed measures on a single Chinese Government website maintained by the Legislative Affairs Office of the State Council. Can China explain how this new system is operating in practice with regard to proposed measures that relate to the services sector?

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