WTO UPDATE: Comparing the U.S.-China Bilateral Agreement and the Working Party Report

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Corporate

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Introduction

On November 15, 1999, China and the United States signed a bilateral agreement ("U.S.-China Agreement") regarding negotiations for China's accession to the World Trade Organization ("WTO"). The U.S.-China Agreement identified China's commitments to liberalize its trade regime and important sectors of its economy as agreed conditions to its entry into WTO. While China entered into similar individual agreements with more than 40 other major trading partners, most notably with the European Union, for the next two years, the U.S.-China Agreement was the pivotal agreement by which China's WTO commitments were measured. China's negotiations on accession drew to a successful conclusion on September 17, 2001 when the WTO working party on China's accession adopted its report and an accession protocol ("Working Party Report") definitively spelling out China's rights and obligations as a WTO member. Since the U.S.-China Agreement represented the largest bulwark of concessions, the Working Party Report mirrored it in many respects. There were, however, some differences between the two documents which foreign investors should be aware of as well as certain notable developments over the past two years leading up to the China's recent formal accession on December 11, 2001. This article will explore those differences between the U.S.-China Agreement and the Working Party Report and the several developments in the following key sectors: Telecommunications, Professional Services, Other Services (including Computer and Related Services, Computer Reservation System Services, Advertising Services and Audiovisual Services), Insurance, Securities and Banking.

Telecommunications

With China's market of 150 million telephone lines, 100 million mobile phone users and over 25 million Internet users, [1] the telecommunications sector is one of the jewels in China's economic crown and was among the most contested areas during negotiations for China's WTO accession. Pre-WTO China severely restricted sales of telecommunications services and banned foreign investment. The U.S.-China Agreement marked China's first commitment to open its telecommunications sector by broadening the scope of services and by permitting direct investment in telecommunications services. Under the agreement, China committed to phase out all geographic restrictions for paging and value-added services within two years, for mobile services within five years, and for domestic basic services within six years. China also agreed to allow 50% foreign ownership for value-added and paging services in two years, for mobile services, 49% in five years, and for international and domestic services, 49% in six years. China's key telecommunications services corridor in Beijing, Shanghai and Guangzhou, which represents approximately 75% of all domestic traffic, will open at accession to 30% foreign ownership for all value-added and paging services.

There were only minor changes between the Working Party Report and the U.S.-China Agreement. One important exception is that the Working Party Report establishes a more aggressive timeline for opening China's mobile services market to foreign investors than the U.S.-China Agreement did. Under the Working Party Report, foreign service providers
will be permitted to own up to 25% of a joint venture ("JV") in and between the cities of Beijing, Shanghai and Guangzhou upon accession, instead of one year after accession, as agreed to in the U.S.-China Agreement. Within one year, instead of three years under the U.S.-China Agreement, 35% foreign ownership will be permitted and the geographic scope will be expanded to a further 14 cities. Within three years, instead of five years under the U.S.-China Agreement, 49% foreign ownership will be permitted and all geographic restrictions will be lifted.

Another important development since the signing of the U.S.-China Agreement occurred when China's Ministry of Information Industry ("MII") released Order No. 429 on June 11, 2001. The order clarifies the Appendix: Classification of Telecommunications Services that was attached to the PRC Telecom Regulations of September 2000. The schedules for telecommunications market access in both the U.S.-China Agreement and the Working Party Report delineate according to basic and value-added service classifications. The September 2000 regulations, and specifically the order, detail the classifications of specific services and clear up the related confusion that the U.S.-China Agreement had presented to foreign investors.

Also worthy of remark is the important step the MII took in honoring China's WTO commitments when it recently abolished two regulations that prohibited foreign investment in the telecommunication sector. Currently, the relevant Chinese authorities in various sectors are in the process of reviewing the Foreign Investment Industry Guidance Catalogues, which still list the telecommunication sector as a prohibited area for foreign investors.

Professional Services

Despite China's enormous population, it is only the world's 11th largest importer of professional services, and according to WTO figures, accounts for only 2.2% of the world's total importation of professional services. This is largely due to the tight restrictions China places currently on foreign professional service providers, notably on the operations of foreign law firms and accounting firms. Under the U.S.-China Agreement, China made wide-ranging commitments in the areas of legal, accounting, taxation, management consultancy, architecture, engineering, urban planning, medical and dental services. The Working Party Report reflects these commitments while providing further detail on the permitted scope of activities and the qualification requirements of such service providers.

Foreign law firms will no longer be restricted by the "one firm, one office" rule and current geographic restrictions which were put into place in 1992 with the promulgation of the Foreign Law Firms Establishing Offices in China Tentative Provisions. China's WTO commitments include allowing foreign firms, within one year of accession, to set up multiple profit-making representative offices without geographic restrictions. The restriction against practicing Chinese law will remain, an exception common to many members of WTO; however, the Working Party Report expands the scope of services over that permitted under the U.S.-China Agreement to include providing "information on the impact of the Chinese legal environment" and the allowance to directly instruct lawyers in a Chinese law firm that the foreign law firm has entrusted to deal with Chinese legal affairs. The exact interpretation of these terms by China's Ministry of Justice has yet to be seen; however, they represent the permission for increased involvement by foreign law firms in China-related legal matters over what the U.S.-China Agreement allowed.

In addition, unlike the U.S.-China Agreement, the Working Party Report distinguishes between representatives and the Chief representative of a foreign law firm. While the U.S.-China Agreement required representatives to have practiced no less than three years outside China, the Working Party Report requires only two years of practice outside China. Meanwhile, Chief representatives, not mentioned in the U.S.-China Agreement, require three years of practice outside China.
Under the U.S.-China Agreement, China agreed to eliminate a mandatory localization requirement and to allow unrestricted access to its market to accountants licensed by Chinese authorities. This means that foreigners who have passed the Chinese CPA examination will be permitted to form partnership or incorporated accounting firms upon accession. Furthermore, foreign accounting firms will be permitted to affiliate with Chinese firms and enter into contractual agreements with their affiliated firms in other WTO member countries. In comparison with the U.S.-China Agreement, the Working Party Report enlarges the scope of business that foreign accounting firms may engage in. Specifically, the report allows foreign accounting firms to engage in taxation and management consulting services without being subject to the foreign ownership rules that taxation and management consulting service providers are subject to. Taxation and management consulting service providers which are not accounting firms, however, may only establish in the form of a JV with foreign majority ownership permitted at accession and in the form of a Wholly Foreign-Owned Enterprise ("WFOE") subsidiaries six years after accession.

A further professional services concession that was made over the past two years benefits engineering and architectural firms. Whereas the U.S.-China Agreement only permitted engineering and architectural service providers to establish JVs, the Working Party Report permits them to establish WFOEs five years after accession. As stipulated in the report, construction and related engineering service providers will be permitted to establish WFOEs that may engage in a limited range of construction projects three years after accession, while the U.S.-China Agreement only permitted the establishment of JVs with majority foreign ownership.

Other Services

Computer and Related Services; Computer Reservation System Services; Advertising Services and Audiovisual Services

There were no significant changes between the U.S.-China Agreement and the Working Party Report in the sectors of computer and related services, [7] computer reservation system (CRS) services, and advertising services. Advertising services, pursuant to both the agreement and the report, may only be conducted by foreigners through advertising agents registered in China who have the mandate to provide foreign advertising services. At accession, foreign advertising service suppliers are permitted to establish advertising enterprises in China only in the form of JVs and take a 49% ownership which will rise to majority ownership two years after accession, and in the form of a WFOE four years after accession.

With regard to audiovisual services, there has been no change between the U.S.-China Agreement and the Working Party Report. Foreign service providers, upon accession, will be permitted to establish contractual JVs with Chinese partners to engage in distribution of audiovisual products (excluding motion pictures), with China retaining the right to examine the content of such products. [8] Importation and theatrical release of motion pictures will be permitted on a revenue-sharing basis at the rate of 20 motion pictures per year. Meanwhile, upon accession, foreign service providers will be permitted to construct or renovate cinema theaters and take a 49% ownership thereof.

Insurance

The terms of access to China's insurance market were the last issue that negotiators from China, the U.S. and the EU had to deal with just prior to China's September 17, 2001 adoption of the Working Party Report. [9] Just days earlier, all sides had come to an agreement in principle regarding the "grandfathering" clause in the U.S.-China Agreement, an issue that threatened to become the first formal dispute involving China and the WTO, and one which still may ultimately end up being settled by a WTO dispute panel. The issue pertained to life insurance and, specifically, American International Group's ("AIG") special position as the only foreign life insurance provider in China that has established a WFOE.
Since 1997, JVs, and not WFOEs, have been approved for foreign life insurers. Similarly, under both the U.S.-China Agreement and the Working Party Report, foreign life insurers upon accession are permitted only to form JVs with a maximum of 50% foreign ownership and only in limited geographic areas; there will be a staggered complete lifting of all geographic restrictions over a period of three years following accession. [10] It has been reported that the agreement among China, the US and the EU was to grant AIG licenses to establish two more branch WFOEs in Beijing and Suzhou prior to China’s accession (with exercise of the licenses thereafter), and a pledge to open these two cities to other foreign insurers when AIG starts its operations there. [11] Indeed, the Working Party Report has a more rapid schedule of easing geographic restrictions than the U.S.-China Agreement did as it allows foreign life insurers, non-life insurers, and insurance brokers to provide services at accession in Shanghai, Guangzhou, Dalian, Shenzhen and Foshan, while the U.S.-China Agreement only allowed for services in the first two cities upon accession. Additionally, the Working Party Report makes it clear, where the U.S.-China Agreement did not, that the partners in a sino-foreign insurance JV are free to agree to the terms of their engagement, provided they remain within the limits of the report.

At accession, under the U.S.-China Agreement as well as the Working Party Report, foreign non-life insurers will be permitted to establish branches or JVs with 51% foreign ownership, and then two years after accession, they will be permitted to establish WFOEs. This certainly is a welcomed opportunity by the foreign non-life insurance industry, as is the new implementation timetable for the industry under the Working Party Report which will permit foreign insurers to provide a full range of non-life insurance services to both foreign and domestic clients two years after accession, and to both foreign and domestic clients three years after accession. The U.S.-China Agreement scheduled the same business scope expansion yet at a slower pace by opening the market over a period of four years after accession. The Working Party Report also permits foreign insurers to provide health, group and pension/annuities insurance to foreign and domestic clients three years after accession, while the U.S.-China Agreement had a time line of four years.

The Working Party Report sets forth insurance brokerage schedules which the U.S.-China Agreement did not. Brokerage enterprises for insurance of large-scale commercial risks, reinsurance, international marine, aviation and transport insurance and reinsurance must be in the form of a JV with a maximum of 50% foreign ownership at accession, 51% three years after accession, and as a WFOE five years after accession. Unlike the U.S.-China Agreement, the report carves out license requirements for insurance brokers. Insurance brokers will not require the US$5 billion in assets that other foreign insurance companies will require to qualify for licensing permitting medium-sized players to enter China’s market. Instead, to qualify, insurance brokers will only require US$500 million in assets at accession, US$400 million one year after, US$300 million two years after and US$200 million four years after accession.

Finally, in the U.S.-China Agreement, China committed to eliminating a compulsory 20% cession for non-life, personal accident and health insurance to the state-invested China Reinsurance Company, and the Working Party Report augments this by setting forth a specific timetable to phase this cession out completely over four years after accession.

Securities

The securities industry in China is young and underdeveloped with 450 licensed operators and three forms of shares: A-, B- and H-shares. The opening of the securities market was not defined in detail in the U.S.-China Agreement, and there have been no changes under the Working Party Report. They both provide that foreign ownership of a fund management JV of up to 33% is permitted upon accession and 49% within three years. Foreign ownership of a brokerage JV of up to 33% is permitted within three years of accession.
Currently, foreign securities firms can only trade in B-shares via shared commission. Both the Working Party Report and the U.S.-China Agreement provide that foreign securities firms may underwrite A-share listings and trade in B- and H-shares as well as government and corporate debt and the launching of funds, all without the use of a Chinese intermediary, within three years after accession. Foreign securities firms may also engage in direct cross-border trading in B-shares without a Chinese intermediary upon accession.

Banking

Although foreign invested enterprises in China tend to prefer their loans in RMB rather than US dollars, foreign banks are extremely restricted in the RMB business they may engage in. China's WTO accession provides a great opportunity to foreign banks since China has committed to full market access to them within five years of accession.

The U.S.-China Agreement and the Working Party Report do not differ with regard to the banking sector; foreign banks will be able to conduct local currency business with Chinese enterprises starting two years after accession and with Chinese individuals five years after accession. While geographic restrictions will be completely lifted for foreign currency business at accession, there will be a staggered opening of cities in China to foreign banks engaging in RMB business over a period of five years. [13]

Conclusion

China's December 11, 2001 accession to WTO marked the end of over 15 years of negotiations stymied by difficult negotiations and various political developments. Thanks to the persistent work of China's representatives, and the representatives of other WTO members, we have a defining moment in the history of economic cooperation among nations with China's entry into the world economic stage and foreign access to the world's most populous market. The important conclusion of our survey is that there are few differences between the U.S.-China Agreement and the Working Party Report. As we knew from the length and intensity of negotiations between China and the U.S., and we have now confirmed by seeing the substantial similarities between the deal China made with the U.S. and the definitive agreement China has made with the world, indeed it was the U.S. team that hammered out the most far-reaching arrangement with China. The two countries achieved their goals through hard dialogue and mutual understanding.

China's chief WTO negotiator, Long Yongtu, told reporters at the final working party session that the Working Party Report marks only "the end of the beginning of a long, historic process... the key word 'negotiating' has now become a word of the past. From now on, we're thinking of another key word, enforcement." Indeed, Beijing's biggest challenge now will be to ensure local-level compliance with a deal that it made with the outside world. We will likely see the most important indications of this over the next couple of years as China implements its accession timetable. During this time, we can also expect to see, once again, the hard dialogue and mutual understanding between China and the U.S. driving the effort.


[2] There are no quantitative restrictions on the number of joint ventures a foreign service provider may establish.

[3] In addition to Beijing, Shanghai and Guangzhou, geographic restrictions will be lifted for the cities of Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Xiamen, Xian, Taiyuan and Wuhan.
These two regulations are the Tentative Measures on Administration of Examination and Approval of Open Telecommunications Business Operations promulgated on September 11, 1993 and the Tentative Rules on Administration of the Open Telecom Market, promulgated on November 10, 1995.


Foreign law firms can set up profit-making representative offices in Beijing, Shanghai, Guangzhou, Shenzhen, Haikou, Dalian, Qingdao, Ningbo, Yantai, Tianjin, Suzhou, Xiamen, Zhuhai, Hangzhou, Fuzhou, Wuhan, Chengdu, Shenyang and Kunming.

The exception is software implementation services and its subsectors such as systems analysis and programming services. Both the U.S.-China Agreement and the Working Party Report and Protocol permit foreign presence in the form of joint ventures; however, the Working Party Report and Protocol specifies further that foreign majority ownership in such a joint venture is permitted.

The Working Party Report and Protocol allows for foreign service suppliers to establish "contractual joint ventures," while the U.S.-China Agreement only uses the term "joint venture."

The agreement in principle regarding foreign ownership in the insurance sector was the last hurdle China had with the US and the EU prior to its accession. Meanwhile, China's last bilateral agreement was with Mexico, signed September 13, 2001.

Upon accession, foreign insurers and insurance brokers can provide services in Shanghai, Guangzhou, Dalian, Shenzhen and Foshan. Within two years, areas will be expanded to Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin. All geographic restrictions will be eliminated within three years.


B-shares are issues that can only be bought and sold by foreign investors.

Under the Working Party Report and Protocol, the city of Zuhai will open to foreign banks engaging in RMB business one year after accession instead of three years after accession under the U.S.-China Agreement. The following is the schedule for phasing out such geographic restrictions pursuant to the Working Party Report and Protocol: Upon accession, Shanghai, Shenzhen, Tianjin and Dalian; one year after accession, Guangzhou, Qindao, Nanjing, Wuhan, and Zuhia; two years after accession, Jinan, Fuzhou, Chengdu, and Chongqing; three years after accession, Kunming, Beijing and Ziamen; four years after accession, Shantou, Ningbo, Shenyang, and Xian; five years after accession, there will be no geographic restrictions.