



**European Chamber**  
中国欧盟商会

European Business in China

# **POSITION PAPER**

## **2015/2016**



The *European Business in China Position Paper 2015/2016* represents the views of the European Union Chamber of Commerce in China. Our working groups, fora and nearly 1,800 member companies have together compiled the latest assessments, concerns and recommendations of European businesses operating in China.

We hope that this position paper will promote constructive dialogue between Europe and China, at both the political and business levels. We look forward to continued improvement in business cooperation, to the benefit of both Europe and China.

## **European Union Chamber of Commerce in China**

[www.europeanchamber.com.cn](http://www.europeanchamber.com.cn)

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## Message from the President

As President of the European Union Chamber of Commerce in China (European Chamber), I am proud to present the *European Business in China – Position Paper (Position Paper) 2015/2016*. The writing of our annual *Position Paper* has remained the European Chamber's most important task since we published our first edition back in 2000, in the run-up to China's accession to the World Trade Organisation (WTO). Every issue since has been written with the express purpose of relaying the concerns of European business directly to the Chinese Government.

While last year's paper focused on analysing the Third Plenum's *Decision*—2013's landmark reform vision that sets forth China's policy direction up to the year 2020—this year's paper takes stock of the developments so far. Each of the 27 vertical industry position papers and 10 horizontal position papers contain informed evaluations of the progress—or lack thereof—of China's ambitious reform agenda – our 'Third Plenum Reality Check'.

Another highlight of this year's *Position Paper*, is the inclusion of the topics that European business in China has indicated it wishes to form part of the current negotiations for an EU-China Comprehensive Agreement on Investment (CAI) – our 'wish list' for Brussels. The blue flags throughout this publication indicate the issues that our members would like EU policy-makers to pay particular attention to during discussions with their Chinese counterparts.

All of the European Chamber's nearly 1,800 member companies have, via our working groups, shared their extensive on-the-ground experience over the course of a six-month consultation and drafting process. Their insights are garnered from years of operating in China, but are also informed by the experiences they have gained operating in many other countries across the globe—in developed and developing economies and under various investment regimes—enabling them to draw on a wealth of knowledge and best practices. Each individual position paper is intended to draw attention to the concerns European business has with regard to discriminatory treatment, the existence of market access barriers, increasing tendencies towards protectionism and the continued existence of import substitution policies, as well as China's compliance with its WTO commitments.

The recommendations they make are carefully-considered, constructive proposals from European business to Chinese policy-makers as to how market and operating conditions in China can be improved for the benefit of both foreign and domestic companies.

The following *Executive Position Paper* aims to distil the essence of the many views of the European Chamber's working groups, to provide macro-level commentary and policy recommendations to China's policy-makers as to how the country can continue its impressive economic growth record in the spirit of the Third Plenum's *Decision*.

On behalf of all our members, I would like to express my sincere gratitude to the central and local departments of the Chinese Government that we work with every year. In particular, the Ministry of Commerce (MOFCOM) and the China Council for the Promotion of International Trade (CCPIT) are to be thanked for their cooperative efforts. The dialogue that we have built with them, as well as other important Chinese ministries and agencies, has enabled the European Chamber to address the *Position Paper* recommendations in a positive but, nonetheless, frank way.



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Finally, I would like to extend my gratitude to the individuals who contributed to this *Position Paper*, including the chairs and vice chairs of our working groups and fora, members of the Advisory Council, Executive Committee, Supervisory Board and local boards as well as the staff in all of the European Chamber's regional chapters. All the milestones reached by the European Chamber to date were made possible only thanks to their dedication.

Jörg Wuttke  
President  
European Union Chamber of Commerce in China

## About the European Chamber

The European Union Chamber of Commerce in China (European Chamber) was founded in 2000 by 51 member companies that shared a goal of establishing a common voice for the various business sectors of the European Union and European businesses operating in China. It is a members-driven, non-profit, fee-based organisation with a core structure of 45 working groups and fora representing European business in China.

The European Chamber has nearly 1,800 members in seven chapters operating in nine cities: Beijing, Nanjing, Shanghai, Shenyang, South China (Guangzhou and Shenzhen), Southwest China (Chengdu and Chongqing) and Tianjin. Each chapter is managed at the local level by local boards reporting directly to the Executive Committee.

The European Chamber is recognised by the European Commission and the Chinese authorities as the official voice of European business in China. It is recognised as a foreign chamber of commerce by the Ministry of Civil Affairs.

The European Chamber is part of the growing network of European Business Organisations (EBO). This network connects European business associations and chambers of commerce from 20 non-EU countries around the world.

### Principles

- We are an independent, non-profit organisation governed by our members.
- We work for the benefit of European business as a whole.
- We operate as a single, networked organisation across Mainland China.
- We maintain close, constructive relations with the Chinese and European authorities, while retaining our independence.
- We seek the broadest possible representation of European business in China within our membership: large, medium and small enterprises from all business sectors and European Member States throughout China.
- We operate in accordance with Chinese laws and regulations.
- We treat all our members, business partners and employees with fairness and integrity.



Adam Dunnett  
Secretary General  
European Union Chamber of Commerce in China



## Executive Summary

The Chinese economy is faced with the onset of a permanent slowdown. To mitigate its adverse effects the Chinese Government needs to change its old ways.

Foreign business hailed the promulgation of the Third Plenum's *Decision*,<sup>1</sup> China's reform vision until 2020. Two years on, it is now clear that some reform momentum has been lost and the hopes of foreign business have given way to a more subdued optimism in an emerging political-economic environment that can be described as one of 'reform and closing up'.

The Chinese Government must avoid giving in to the protectionist tendencies that are continuing to curtail legitimate market access, whether on the grounds of national security or other concerns. Its most pressing issue now is how to forge ahead with the reforms that will help to bring about the rebalancing of the economy. China needs to employ a 'new toolbox' capable of successfully delivering an economic model that the European Chamber defines as:

*"An economic model in which market forces decide on the allocation of resources in the economy under the auspices of rule of law; consumption holds a significantly larger share of GDP; there exists no discrimination between domestic and foreign investment; there is harmonisation with global standards and supply chains; and the state plays a reduced role in the economy, acting solely as regulator and enforcer. An economy in which—due to a more sophisticated regulatory environment—the services sector has become the dominant engine of growth, supported by an education system and a flexible and open labour market that endow China's workforce with the required skillset. An economic model that will result in greater innovative capacity and a higher quality of life for the individual."*

In order to get there, China will need to address a number of key challenges.

### 1. The Reality Check

#### 1.1 The Chinese Economic Slowdown

China's gross domestic product (GDP) growth dropped to seven per cent in the first half of 2015,<sup>2</sup> the lowest level since 2009. Financial leverage is precipitously high, with total debt having ballooned to 282 per cent of GDP in 2014.<sup>3</sup> China's total trade declined by 6.9 per cent in the first half of 2015<sup>4</sup> and aggregate productivity of China's economy is also at a significant low.<sup>5</sup> European companies have reported for the third year in a row that their earnings before interest and tax (EBIT) margins are more likely to be greater outside of China than they are inside China.<sup>6</sup> The four successive interest rate cuts from November, 2014 to mid-2015, and the volatility and sharp declines in the Chinese stock market in 2015, point towards increasing misgivings over whether China actually retains the capacity

1 The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform (Decision)*. All quotations from the *Decision* are taken from, China.org.cn, 16<sup>th</sup> January, 2014, <[http://www.china.org.cn/china/third\\_plenary\\_session/2014-01/16/content\\_31212602.htm](http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm)>

2 *China Surprises With 7% Growth in Second Quarter*, *Wall Street Journal*, 15<sup>th</sup> July, 2015, viewed 20<sup>th</sup> July, 2015, <<http://www.cnbc.com/2015/07/14/>>

3 *Debt and (not much) deleveraging*, McKinsey, February 2015, viewed 29<sup>th</sup> June, 2015, <[http://www.mckinsey.com/insights/economic\\_studies/debt\\_and\\_not\\_much\\_deleveraging](http://www.mckinsey.com/insights/economic_studies/debt_and_not_much_deleveraging)>

4 *China trade slumps in first half of year, dealing blow to global economy*, *The Guardian*, 13<sup>th</sup> July, 2015, viewed 21<sup>st</sup> July, 2015, <<http://www.theguardian.com/business/2015/jul/13/china-trade-slumps-first-half-year-blow-global-economy>>

5 Hoffman, D., Polk, A., *The Long Soft Fall in Chinese Growth: Business Realities, Risks and Opportunities*, The Conference Board, 2014, viewed 16<sup>th</sup> July, 2015, <<https://www.conference-board.org/retrievefile.cfm?filename=KBI-FY15---China-Slowdown---Final-Draftv2.pdf&type=subsite>>

6 *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, June 2015, page 50, <<http://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

to meet its projected economic growth targets.

### 1.2 Towards the ‘New Normal’

In brief, the ‘new normal’ will be an era characterised by lower, but more qualitative economic growth.

### 1.3 Third Plenum Reality Check

European business fully subscribes to the principle that China has to “let the market play the decisive role in allocating resources and let the government play its functions better.”<sup>7</sup> However, European business is now witnessing the government’s reform agenda seemingly occupying opposite ends of the spectrum: both improvements and deteriorations are taking place to varying degrees.

## 2. The ‘New Toolbox’

### 2.1 Accelerating Reform of the Financial System

China’s financial system needs to become more efficient in allocating capital if the economy is to grow more sustainably. This has to be at the core of the government’s reform drive and will require some fundamental reforms to ensure that funds are being lent on a more viable basis.

### 2.2 Limiting State Engagement in the Economy

Over the past decades, the state loomed large in the Chinese economy. It has been dominated by strong state-owned enterprises (SOEs), to which the government channelled the population’s savings in order to develop large-scale projects on the back of clearly defined industrial policies. This approach has been costly and inefficient, and has to be abandoned now if the market is to play a decisive role in the economy.

### 2.3 Increasing Market Access for the Private Sector, Including Foreign Business

One of the greatest policy tools that is still at the Chinese Government’s disposal—unlike many governments in developed economies—is the possibility of allowing the private sector to fully play out within the economy and to harness the substantial gains this will bring. China needs to establish an open market economy in order to unlock the substantial potential of private companies. This was clearly recognised in the *Decision*, but uncertainty remains over whether it will be forthcoming.

### 2.4 Committing to the Rule of Law

Greater implementation of rule of law is undoubtedly the most important tool in the box and will be the top driver for China’s economic development in the coming years.<sup>8</sup> Transparency, legal certainty and public consultation are all central elements of rule of law that will ensure the proper functioning of an economy. However, China needs to do more to increase investors’ trust in its judicial system.

### 2.5 Abolishing the Foreign Investment Catalogues and Committing to a Nationwide Roll-out of the Negative List

The continued adherence to the *Foreign Investment Industry Guidance Catalogue* falls short of the Chinese Government’s stated ambition to give full play to the market. Instead, China should proceed with a nationwide roll-out of the ‘negative-list’ approach.

### 2.6 Fostering an Innovative Environment

Innovation is one of the most important drivers of economic growth. In order for China to successfully create the right conditions for it to take place it must, first and foremost, guarantee a competitive market that is open to all companies, regardless of nationality. China also needs to have an education

<sup>7</sup> The *Decision*

<sup>8</sup> *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, June 2015, page 39, <<http://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>



system and a flexible and open labour market in place, to continue improving its workforce.

### 3. China and the World

#### 3.1 National Security Concerns

In 2015, several Chinese government agencies have issued a number of laws that make reference to national security. The definitions included in these laws are very vague, which creates a great deal of uncertainty for business and is detrimental to the credibility of the Chinese marketplace.

#### 3.2 China's New International Institutions

China is swiftly and resolutely moving ahead with developing its own set of international institutions and development agendas – this could profoundly shape the future of the global trading system. European business welcomes these developments, but thinks that China should prioritise taking a greater leadership role in the established global trading system, with the World Trade Organisation (WTO) at its centre.

#### 3.3 Taking a Leading Role in Global Affairs

China has benefitted immensely from its entry into the WTO some 15 years ago, and now has the opportunity to shape and ensure the success of future development rounds by, among other things, lobbying for progress with the Doha Development Agenda and making a more compelling, revised offer to join the Government Procurement Agreement.<sup>9</sup>

### 4. Expectations of the European Union

The European Chamber believes the European Union's (EU's) economic and trade relations with China should be prioritised. Despite its challenging business environment, China still offers significant potential to European companies, including small and medium-sized enterprises. As such, European business views the ongoing negotiations for an EU-China Comprehensive Agreement on Investment as the biggest opportunity to reset EU-China relations and boost the fledging growth of both economic blocs.

### 5. The Audacity to Change

The Chinese leadership is faced with the considerable challenge of successfully navigating the adverse effects of permanently lower economic growth. A large part of the solution will be the successful transition to the 'new normal', an era in which China will embrace an economic model that can deliver sustainable, qualitative growth. This is well within the Chinese Government's reach if it can have the courage of its convictions and stick to the bold reform pledges made in the *Decision*.

A successful rebalancing of the Chinese economy will require an adroit sequencing of macroeconomic policies; it will require the ability to let go of the impulse to micro-manage the domestic economy; and it will require the courage to follow through with overdue, but critical, structural reforms. In short, it will require the audacity to change.

<sup>9</sup> *Agreement on Government Procurement*, World Trade Organisation, 2015 (updated information), viewed 10<sup>th</sup> July, 2015, <[https://www.wto.org/english/tratop\\_e/gproc\\_e/gp\\_gpa\\_e.htm](https://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm)>



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# **Section One:**

## **Executive Position Paper**



# Executive Position Paper

## 1. The Reality Check

- 1.1 The Chinese Economic Slowdown
- 1.2 Towards the 'New Normal'
- 1.3 Third Plenum Reality Check

## 2. The 'New Toolbox'

- 2.1 Accelerating Reform of the Financial System
- 2.2 Limiting State Engagement in the Economy
- 2.3 Increasing Market Access for the Private Sector, Including Foreign Business
- 2.4 Committing to the Rule of Law
- 2.5 Abolishing the Foreign Investment Catalogues and Committing to a Nationwide Roll-out of the Negative List
- 2.6 Fostering an Innovative Environment

## 3. China and the World

- 3.1 National Security Concerns
- 3.2 China's New International Institutions
- 3.3 Taking a Leading Role in Global Affairs

## 4. Expectations of the EU

## 5. The Audacity to Change

### 1. The Reality Check

The Chinese economy is faced with the onset of a permanent slowdown. If China is to effect the necessary transition to a more sustainable economic growth model, it will depend on the speedy and thorough introduction of a new set of policy 'tools', which include:

- accelerating reform of the financial system;
- limiting state engagement in the economy;
- increasing market access for the private sector, including foreign business;
- committing to the rule of law;
- abolishing the foreign investment catalogues and committing to a nationwide roll-out of the *Negative List*; and
- fostering an innovative environment.

Once deployed, these tools will allow the drivers of sustainable growth to emerge from the business

sector, which are:

- services;
- value-added production;
- quality investment;
- innovation;
- competition; and
- compliance.

It has been two years since the promulgation of the Third Plenum's *Decision*,<sup>1</sup> a document of 60 decisions or principles that are supposed to guide the Chinese Government's policies throughout the current administration and beyond.<sup>2</sup> Because the *Decision* placed such an emphasis on market forces, the hopes of foreign business that meaningful economic reforms would be forthcoming were raised to an all-time high. However, these hopes have now given way to a more subdued optimism in an emerging political-economic environment that can be described as one of 'reform and closing up'.

### 1.1 The Chinese Economic Slowdown

China's gross domestic product (GDP) growth dropped to seven per cent in the first half of 2015,<sup>3</sup> the lowest level since 2009. Financial leverage is precipitously high, with total debt having ballooned to 282 per cent of GDP in 2014.<sup>4</sup>

China's total trade declined by 6.9 per cent in the first half of 2015<sup>5</sup> and aggregate productivity of China's economy is also at a significant low.<sup>6</sup> European companies have reported for the third year in a row that their earnings before interest and tax (EBIT) margins are more likely to be greater outside of China than they are inside China.<sup>7</sup>

The reasons are many, including the misallocation of capital, an unproductive state-sector, lower external demand, less favourable demographics, a heavily-controlled regulatory environment, as well as the natural trajectory of moving up from a low base over the last 30 years.

The current slowdown could evolve into a soft landing if China manages to rebalance its economy. However, its window of opportunity to successfully roll out the structural reforms needed to do so is rapidly closing: its working age population is rapidly declining, as more and more people retire, putting massive pressure on public finances and the welfare system;<sup>8</sup> and millions of new university graduates—a record 7.3 million in 2014<sup>9</sup>—are entering the labour force every year, and the economy must grow to

1 The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform (Decision)*. All quotations from the *Decision* are taken from, China.org.cn, 16<sup>th</sup> January, 2014, <[http://www.china.org.cn/china/third\\_plenary\\_session/2014-01/16/content\\_31212602.htm](http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm)>

2 *Prosperous society task key to realizing 'Chinese dream'*, *China Daily USA*, 26<sup>th</sup> February, 2015, viewed 13<sup>th</sup> July, 2015, <[http://usa.chinadaily.com.cn/china/2015-02/26/content\\_19663149.htm](http://usa.chinadaily.com.cn/china/2015-02/26/content_19663149.htm)>

3 *China Surprises With 7% Growth in Second Quarter*, *Wall Street Journal*, 15<sup>th</sup> July, 2015, viewed 20<sup>th</sup> July, 2015, <<http://www.wsj.com/articles/china-surprises-with-7-growth-in-second-quarter-1436927081>>

4 *Debt and (not much) deleveraging*, McKinsey, February 2015, viewed 29<sup>th</sup> June, 2015, <[http://www.mckinsey.com/insights/economic\\_studies/debt\\_and\\_not\\_much\\_deleveraging](http://www.mckinsey.com/insights/economic_studies/debt_and_not_much_deleveraging)>

5 *China trade slumps in first half of year, dealing blow to global economy*, *The Guardian*, 13<sup>th</sup> July, 2015, viewed 21<sup>st</sup> July, 2015, <<http://www.theguardian.com/business/2015/jul/13/china-trade-slumps-first-half-year-blow-global-economy>>

6 Hoffman, D., Polk, A., *The Long Soft Fall in Chinese Growth: Business Realities, Risks and Opportunities*, The Conference Board, 2014, viewed 16<sup>th</sup> July, 2015, <<https://www.conference-board.org/retrievefile.cfm?filename=KBI-FY15---China-Slowdown---Final-Draftv2.pdf&type=subsite>>

7 *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, June 2015, page 50, <<http://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

8 *China Sets Timeline for First Change to Retirement Age Since 1950s*, *Wall Street Journal*, 10<sup>th</sup> March, 2015, viewed 10<sup>th</sup> July, 2015, <<http://blogs.wsj.com/chinarealtime/2015/03/10/china-sets-timeline-for-first-change-to-retirement-age-since-1950s/>>

9 *Li visit hints at future policy*, *Shanghai Daily*, 6<sup>th</sup> July, 2014, viewed 9<sup>th</sup> July, 2014, <<http://www.shanghaidaily.com/national/Li-visit-hints-at-future-policy/shdaily.shtml>>



ensure jobs for them.<sup>10</sup>

If China is to succeed in its transition from a heavily state-led economy to one that is market-driven, broad, substantive reforms need to be implemented.

Although the *Decision* outlined numerous objectives with clearly-stipulated deadlines, many of these have not yet been achieved. A review of the *Decision* by 37 of the European Chamber's working groups and sub-working groups shows that while much has been said, actual reforms have only just begun to surface. In some instances, the government's actions even appear to run contrary to the very tenets of the *Decision*, as witnessed in the government's bailout of the Shanghai stock market in July 2015. The major overhaul that needs to take place clearly requires a fundamental change in the mind-set of many senior policy-makers.

## 1.2 Towards the 'New Normal'

The phrase 'new normal' was introduced into the political discourse by President Xi Jinping in May 2014.<sup>11</sup> The finer points of this phrase were elaborated on by Premier Li Keqiang during his presentation of the annual government work report to the National People's Congress (NPC) and the Chinese People's Political Consultative Conference (CPPCC)—the *lianghui*—in March 2015.<sup>12</sup> Premier Li delivered a very candid assessment of China's current macroeconomic situation and expanded on its needs and required direction.<sup>13</sup> In brief, the 'new normal' will be an era characterised by lower, but more qualitative economic growth.

## 1.3 Third Plenum Reality Check

Taken at face value the *Decision* represented a watershed moment. Its articulation of how, and where, reforms should be implemented was a statement of intent – China seemed to be clear about where it needed to go and how it was going to get there. It would create the conditions for an open market economy, and the government would take a step back.

*"The underlying issue is how to strike a balance between the role of the government and that of the market, and let the market play the decisive role in allocating resources and let the government play its functions better."*

*Third Plenum Decision, Article 3*

European business fully subscribes to this principle and recognises the related, and other, following improvements over the past year:

- The State council "canceled the requirement of or delegated the power for review on 246 items ... canceled 29 performance evaluations, inspections on the meeting of standards, and commendations, and 149 verifications and approvals of vocational qualifications."<sup>14</sup> (sic)
- The expansion of pension and healthcare insurance coverage and the expansion of trials of serious illness insurance for rural and non-working urban residents to all provincial-level administrative areas.
- Budgetary and local debt reforms.
- The launch of the deposit insurance scheme and the lifting of the deposit rate ceiling.
- The establishment of specialised IPR courts in Beijing, Shanghai and Guangzhou.
- Reduction of the *Foreign Investment Industry Guidance Catalogue (Foreign Investment Catalogue)*.

<sup>10</sup> *What do you do with millions of extra graduates?*, BBC, 1<sup>st</sup> July, 2014, viewed on 10<sup>th</sup> June, 2015, <<http://www.bbc.co.uk/news/business-28062071>>

<sup>11</sup> *Xi Says China Must Adapt to 'New Normal' of Slower Growth*, Bloomberg, 12<sup>th</sup> May, 2014, viewed 19<sup>th</sup> June, 2015, <<http://www.bloomberg.com/news/articles/2014-05-11/xi-says-china-must-adapt-to-new-normal-of-slower-growth>>

<sup>12</sup> *Report on the Work of the Government (2015)*, State Council, 16<sup>th</sup> March, 2015, viewed 10<sup>th</sup> July, 2015, <[http://english.gov.cn/archive/publications/2015/03/05/content\\_281475066179954.htm](http://english.gov.cn/archive/publications/2015/03/05/content_281475066179954.htm)>

<sup>13</sup> Ibid

<sup>14</sup> Ibid

On top of this, the European Chamber acknowledges the impressive achievements of the Chinese Government's anti-corruption campaign,<sup>15</sup> which gathered pace over the past year and so far shows no signs of abating.

However, at the same time, some developments in 2015 have cast doubt over the extent to which the reform agenda will actually benefit foreign companies, with some companies claiming that reforms are having a negative impact on them:

- The continued adherence to the *Foreign Investment Catalogue* (even though it has been reduced).
- The promulgation of the National Security Law.
- Import substitution schemes, such as the recent *Guidelines on Banks Using Secure and Controllable Information Technology 2014-2015 (China Banking Regulatory Commission (CBRC) Guidelines)*.<sup>16</sup>
- The circulation of the draft Foreign NGO Management Law.
- Increasingly limited access to websites and other online tools outside of China.
- The use of industrial catalogues for procurement.
- The use of technical barriers to trade.
- The draft Cyber Security Law and draft Counter-terrorism Law.

Never before has the European Chamber witnessed the government's reform agenda seemingly occupying opposite ends of the spectrum.

Certain government actions could not be more encouraging – steps such as the introduction, and subsequent reduction of, the *Negative List*, a reduced *Foreign Investment Catalogue* and the progress on the Comprehensive Agreement on Investment (CAI) all seem to bode well for EU-China commercial relations.

Yet at the same time, the level of concern over national security-related issues and the expansive wording in related legislation, as well as the markedly slow progress in the overall implementation of reforms is very unsettling for business. It sends a mixed message and suggests that at least part of the reform agenda includes elements of 'closing up'.

As a way of evaluating the current situation regarding Third Plenum reforms, 37 of the European Chamber's working groups have provided a 'reality check' to track the actual progress that has been made so far.

The European Chamber identified five overarching reform themes from the *Decision*, which are referred to in the table on the following page:

1. The market's decisive role
2. Limiting state engagement in the economy
  - a. State-owned enterprise (SOE) reform
  - b. Independent decision making of enterprises and fair competition
3. Administrative reform
4. Rule of law
5. Market access / Foreign investment management

<sup>15</sup> *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, June 2015, page 42, <<http://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

<sup>16</sup> The *Guidelines on Banks Using Secure and Controllable Information Technology 2014-2015*, were promulgated to CBRC branches and local banks—though apparently not to the banks' IT suppliers— and became effective on 26<sup>th</sup> December, 2014, (Yin Jian Ban Fa [2014] No. 317). They outline specific procurement requirements in China's banking sector. The *CBRC Guidelines* are based on the *Guidelines for Applying Secure and Controllable Information Technology to Enhance Banking Industry Cybersecurity and Informatisation Development* (CBRC No. [2014]39) issued on 3<sup>rd</sup> September, 2014. Although the *CBRC Guidelines* were officially suspended on 13<sup>th</sup> April, 2015, pending further stakeholder input and revision, they are still a great cause for concern among foreign players in the banking sector and, indeed, foreign industry as a whole.





The 'traffic lights' in the table below, and throughout the rest of this paper, indicate the following:




	The working group perceives that little or no progress has been made, or that the situation has even deteriorated.		The working group perceives that some progress has been made, but work still remains.  It is unclear as to whether the overall target(s) will be achieved within the stipulated timeframe.		The working group perceives that the target(s) has (have) basically been reached, or that there is a clear working plan so that it can be reasonably expected that the target(s) will be reached within the stipulated timeframe.
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### Third Plenum Reality Check<sup>17</sup>

#### The market's decisive role



What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
<p>"Accelerate pricing reform for natural resources and their products to give full expression to their market supply and demand."</p> <p>...and...</p> <p>"Establish a market-oriented mechanism to attract private capital to ecological and environmental protection, and implement third-party treatment of environmental pollution. "</p> <p><b>"Implementing sound compensation systems for use of resources and for damage to the ecological environment."</b></p> <p style="text-align: right;"><i>The Decision, Article 53</i></p>	<p><b>Environment:</b> Under the pressure of a rising consumer price index, local governments tend to delay or reduce any market-based increase of the price of drinking water. This puts pressure on water suppliers who, in response, have to manage their service quality to a lower level to offset the additional loss.</p>	
<p>"We must actively and in an orderly manner promote market-oriented reform in width and in depth, greatly reducing the government's role in the direct allocation of resources, and promote resources allocation according to market rules, market prices and market competition, so as to maximise the benefits and optimise the efficiency."</p> <p style="text-align: right;"><i>The Decision, Article 3</i></p>	<p><b>Energy:</b> Although China has started with reforming national gas pricing, there is still a need for a clear scheme to this reform. Any such scheme should include a pricing structure that rewards gas for the value it offers, while simultaneously discouraging the use of coal.</p>	

<sup>17</sup> This table only features a sample of 'reality checks'. For a full list please refer to page 401; for industry- or horizontal issue-specific lists, please refer to the relevant individual working group's position paper.

<p><i>“We will ... implement a trading system for... carbon emission, ... establish a market-oriented mechanism to attract private capital to ecological and environmental protection.”</i></p> <p><b>“Implementing sound compensation systems for use of resources and for damage to the ecological environment.”</b></p> <p><i>The Decision, Article 53</i></p>	<p><b>Carbon Market:</b> The launch of the Emissions Trading Scheme pilots in 2013 represented one of the first attempts in using the market as a tool to allocate resources and determine the price of a commodity. However, there is still a need to further develop the market in a fair, open and transparent way.</p>	
<p><b>“Improving the mechanism whereby prices are mainly determined by the market.”</b></p> <p><i>The Decision, Article 10</i></p>	<p><b>Pharmaceuticals:</b> The control on maximum retail prices for drugs has been abolished. However, the system still allows hospitals to manipulate the bidding system to extract their own revenue from the process.</p>	
<p><i>“Establishing a unified, open, competitive and orderly market system is the basis for the market to play a decisive role in the allocation of resources. We must put in place a modern market system in which enterprises enjoy independent management and fair competition ... products and factors of production flow freely and are exchanged on an equal basis, strive to remove market barriers, and raise the efficiency and fairness of resource allocation.”</i></p> <p><b>“Accelerating the Improvement of the Modern Market System.”</b></p> <p><i>The Decision, III</i></p>	<p><b>Automotive:</b> A foreign investor’s maximum share in the automotive industry is limited to 50 per cent and each foreign car maker is limited to establish no more than two such Sino-foreign joint ventures (JVs) for the production of passenger cars, and two for commercial vehicles (‘2+2’).</p>	

**Limiting state engagement in the economy**

**a) SOE reform**



What did the Third Plenum’s Decision say?	What is the reality?	Status
<p><i>“We will ... oppose monopoly and unfair competition.”</i></p>	<p><b>Energy:</b> The power grid and gas networks are monopolised by a few state-owned grid companies that are not subject to appropriate supervision and transparency requirements. This makes China’s on-grid system opaque to foreign companies and in this way adds market access barriers.</p>	
<p><b>“Enacting market rules that are fair, open and transparent.”</b></p> <p><i>The Decision, Article 9</i></p>	<p><b>Consumer Finance and Non-Banking Financial Institutions:</b> While the consumer finance industry is still SOE-dominated, a number of private companies (including European players) are taking their stake. There is a whole range of innovative companies operating via online channels, where there is free competition – at least so far.</p>	



<p>“We will encourage non-public enterprises to participate in SOE reform, foster mixed enterprises with non-public capital as the controlling shareholder and encourage qualified private enterprises to establish the modern corporate system.”</p> <p>“<b>Supporting the healthy development of the non-public sector.</b>”</p> <p><i>The Decision, Article 8</i></p>	<p><b>Petrochemicals, Chemicals and Refining:</b> There have been positive developments in the sector, regarding ‘mixed ownership’-reforms in central SOEs as well as the promotion of the public-private partnership model in sectors like infrastructure and environmental protection.</p>	
<p>“<b>Vigorously develop a mixed economy.</b>”</p> <p><i>The Decision, Article 6</i></p>	<p><b>Private Equity and Strategic Mergers &amp; Acquisitions:</b> No real systematic change has been seen. The market dominance of SOEs has not been reduced.</p>	
<p>“Both the public and non-public sectors are key components of the socialist market economy...”</p> <p>“<b>Adhering to and Improving the Basic Economic System.</b>”</p> <p><i>The Decision, II</i></p>	<p><b>Energy:</b> Some local manufacturers and service suppliers receive subsidies and preferential treatment in certain segments of the energy equipment market.</p>	

### Limiting state engagement in the economy

#### b) Independent decision making of enterprises and fair competition







What did the Third Plenum’s <i>Decision</i> say?	What is the reality?	Status
<p>“<b>Enacting market rules that are fair, open and transparent.</b>”</p> <p><i>The Decision, Article 9</i></p>	<p><b>Auto Components:</b> European auto component suppliers are forced to establish JVs with Chinese original equipment manufacturers (OEMs) in order to get business.</p>	
	<p><b>Private Equity and Strategic M&amp;A:</b> The draft Foreign Investment Law (FIL) has significant issues that go against the sentiment of the <i>Decision</i> and FIEs are still treated differently to domestic companies.</p>	
	<p><b>Rail:</b> Foreign players in the rail industry are often not given the opportunity to comment on drafts of standards and specifications, which may lead to entry barriers and unfair competition.</p>	

<p><i>“We must put in place a modern market system in which enterprises enjoy independent management and fair competition ... products and factors of production flow freely and are exchanged on an equal basis, strive to remove market barriers, and raise the efficiency and fairness of resource allocation.”</i></p> <p><b>“Accelerating the Improvement of the Modern Market System.”</b>  <i>The Decision, III</i></p>	<p><b>Renewable Energy:</b> Although the Chinese Government has approved a series of regulations reflecting a desire to further promote the development of renewable energy, those measures primarily support the development of Chinese companies and technologies. Therefore, more transparency—particularly in the bidding system—and a level playing field are needed.</p>	
	<p><b>Energy:</b> Foreign investors in China are excluded from direct bidding in shale gas licence rounds, and rules on indirect access through production sharing contracts are unclear. Technical data are rarely available for foreign and private investors to allow independent technical evaluation of the resource potential of any exploration a site.</p>	
<p><b>“Supporting the healthy development of the non-public sector.”</b>  <i>The Decision, Article 8</i></p>	<p><b>Small and Medium-sized Enterprises:</b> Access to financing for SMEs is still a major challenge.</p>	
<p><b>“Deepening reform of the management system for science and technology.”</b>  <i>The Decision, Article 13</i></p>	<p><b>Inter-Chamber Small and Medium-sized Enterprises:</b> The Central Government SME Development fund will be used to support SME development in innovation to promote a healthy business environment and fair market competition. The working group hopes foreign SMEs will benefit from this positive development.</p>	

**Administrative reform**




What did the Third Plenum’s <i>Decision</i> say?	What is the reality?	Status
<p><i>“All enterprise investment projects ... should be decided by the enterprises independently in accordance with the law, and no longer require government approval.”</i></p> <p><b>“Improving the macro control system.”</b>  <i>The Decision, Article 14</i></p>	<p><b>Aviation and Aerospace:</b> Burdensome administrative approval processes are still common in certain areas, for instance aircraft purchase and registration.</p>	
<p><i>“We will implement a unified market access system...”</i></p> <p><b>“Enacting market rules that are fair, open and transparent.”</b>  <i>The Decision, Article 9</i></p>	<p><b>Standards and Conformity Assessment:</b> Several administrative licensing processes are simplified, for instance medical devices and cosmetics licensing, but more efforts are needed.</p>	




<p><i>“We will improve and unify an authoritative food and drug safety supervision organisation.”</i></p> <p><b>“Improving the public security system.”</b> <i>The Decision, Article 50</i></p>	<p><b>Agriculture, Food and Beverage:</b> At the central level, the framework is already set up. At the local level, however, implementation does not strictly follow the central framework. In some areas, there is no coordination among local authorities.</p>	
<p><i>“We will improve the government organisational structure, function composition and work procedures so that the working group will have a good administrative system with decision-making.”</i></p>	<p><b>Automotive:</b> Multiple government agencies regulate the automotive industry in an uncoordinated manner, resulting in different understanding, inefficient work and unnecessary costs.</p>	
<p><b>“Streamlining the government structure.”</b> <i>The Decision, Article 16</i></p>	<p><b>Banking and Securities:</b> A lack of coordination between various authorities results in laws and regulations being applied and interpreted differently.</p>	
<p><i>“We will persist in equality of rights, opportunities and rules, abolish all forms of irrational regulations for the non-public economy, remove all hidden barriers, and adopt specific measures for non-public enterprises to enter franchising fields.”</i></p> <p><b>“Supporting the healthy development of the non-public sector.”</b> <i>The Decision, Article 8</i></p>	<p><b>Petrochemicals, Chemicals and Refining:</b> Over the past two years, with the streamlining of government approvals, the scope of projects requiring government approvals has narrowed, and more project approval power is now controlled by local governments.</p>	
<p><i>“Relaxing control over investment access. We will have the same laws and regulations on Chinese and foreign investment, and keep foreign investment policies stable, transparent and predictable.”</i></p> <p><b>“Relaxing control over investment access.”</b> <i>The Decision, Article 24</i></p>	<p><b>Insurance:</b> Investment in the industry remains over-regulated, especially regarding limitations for setting up operations or obtaining licences, i.e. there are restrictions on ownership or the establishment of JVs.</p>	
<p><i>“We will promote the reform of value-added tax, and simplify the tax rate appropriately.”</i></p> <p><b>“Improving the taxation system.”</b> <i>The Decision, Article 18</i></p>	<p><b>Finance and Taxation:</b> Reform of value-added tax (VAT) is in progress to reach completion in 2015. The tax rate has been simplified.</p>	

<p><i>“We will further streamline the administration and delegate more power to lower levels, deepen the reform of the system concerning matters subject to government examination and approval, and reduce the central government’s administration in micro affairs to the greatest extent. We will cancel all administrative approval procedures for economic activities under the effective regulation of the market mechanism. We will manage matters that require administrative approval according to procedures and with high efficiency. We will transfer largescale and widely-participated-in social and economic projects to local and community-level management for convenience and efficiency.”</i></p> <p><b>“Fully and correctly performing government functions.”</b></p> <p><i>The Decision, Article 15</i></p>	<p><b>Cosmetics:</b> Imported, non-special cosmetics are required to be registered with the China Food and Drug Administration (CFDA) before entering the Chinese market. Complicated review and approval procedures are inefficient, and the policy for delegating powers to lower-levels of government has not been implemented.</p>	
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**Rule of law**









What did the Third Plenum’s Decision say?	What is the reality?	Status
<p><b>“Promoting the rule of law.”</b> <i>The Decision, IX</i></p>	<p><b>Legal and Competition:</b> Lack of transparency in the promulgation, elaboration and implementation of laws and regulations by legislative, judiciary and administrative bodies remains an issue.</p>	
<p><b>“Enacting market rules that are fair, open and transparent.”</b> <i>The Decision, Article 9</i></p>	<p><b>Legal and Competition:</b> Many aspects of the application of the Anti-Monopoly Law (AML) remain unclear, detailed reasoning in important cases remains unpublished and an increasing number of transactions approved by the Ministry of Commerce are subject to remedies which can be far reaching.</p>	
<p><i>“We will strengthen the application and protection of intellectual property rights (IPR), improve the technological innovation incentive mechanism, and explore ways to set up IPR courts.”</i></p> <p><b>Deepening reform of the management system for science and technology.</b> <i>The Decision, Article 13</i></p>	<p><b>Intellectual Property Rights:</b> Parts of this promise are on track for implementation, namely the implementation of a separate specialised system of IPR Courts.</p>	



<p><i>“We will establish and improve an environmental protection system that strictly supervises the emission of all pollutants, and independently conduct environmental supervision and administrative law enforcement.”</i></p> <p><b>“Reforming the ecological protection management system.”</b> <i>The Decision, Article 54</i></p>	<p><b>Energy:</b> Enforcement of the advanced fuel standards—National IV and V—which would improve the quality of transportation fuels, is lacking.</p>	
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### Market access / Foreign investment management


What did the Third Plenum’s Decision say?	What is the reality?	Status
<p><i>“Establishing a unified, open, competitive and orderly market system is the basis for the market to play a decisive role in the allocation of resources. We must put in place a modern market system in which enterprises enjoy independent management and fair competition ... products and factors of production flow freely and are exchanged on an equal basis, strive to remove market barriers, and raise the efficiency and fairness of resource allocation.”</i></p> <p><b>“Accelerating the Improvement of the Modern Market System.”</b> <i>The Decision, III</i></p>	<p><b>Smart Grid:</b> Non-discriminatory access to power system infrastructure and information is still lacking.</p> <p><b>Smart Grid:</b> There is a strict control of foreign participation in the standardisation process and the State Grid Corporation of China (SGCC) has a huge influence on the standards setting process.</p>	 
	<p><b>Energy:</b> Discriminatory barriers are preventing China from establishing an equal and transparent market to achieve China’s long-term clean coal strategy.</p>	
	<p><b>Banking and Securities:</b> Foreign banks face restrictions to their organic and non-organic growth limiting their market share in China</p>	
	<p><b>Insurance:</b> Foreign market players face a host of different limitations preventing them from receiving effective and equal national treatment.</p>	
	<p><b>Rail:</b> Market access remains a major issue: no foreign entity is allowed to bid directly for a project in the rolling stock or signalling segments.</p>	

<p><b>“Enacting market rules that are fair, open and transparent.”</b>  <i>The Decision, Article 9</i></p>	<p><b>Public Procurement:</b> There is still a discrepancy between restrictions to foreign investment and actual market access. Because foreign-invested enterprises (FIEs) are not considered ‘local Chinese’ enterprises, they may be established but they still face market access restrictions.</p>	
	<p><b>Legal &amp; Competition:</b> Many aspects of the application of the AML remain unclear, detailed reasoning in important cases remains unpublished and an increasing number of transactions approved by the Ministry of Commerce (MOFCOM) are subject to remedies which can be far reaching.</p>	
	<p><b>Metals and Mining:</b> There are concerns, resulting from the aspiration for market leadership by SOEs. Market leadership as such carries potential problems to the detriment of functioning, level markets, regardless if in China or elsewhere. The Chinese Government has shown an impressive determination to deal with market-domineering forces, however, the working group is concerned about a high potential for conflict of interests when it comes to state organs dealing with SOEs. The disproportionate number of exits of private enterprises from the SOE-dominated steel market bears witness to such concerns. Another concern is that SOEs deny private, foreign-owned enterprises access to their business, as experienced by working group members.</p>	
	<p><b>Consumer Finance and Non-Banking Financial Institutions:</b> Given that the development of consumer finance is still in the pilot phase, there are limits to the total number of players in the market as well as strict geographical restrictions for foreign companies.</p>	
<p><b>“Relaxing control over investment access.”</b>  <i>The Decision, Article 24</i></p>	<p><b>Banking and Securities:</b>  <b>Insurance:</b>                      The industry remains over-regulated when it comes to investments, especially regarding limitations for setting up operations or obtaining licences, i.e. there are restrictions on ownership or the establishment of JVs.</p>	
	<p><b>Legal and Competition:</b> Legal services have been moved from the “restricted” to the “prohibited” category.</p>	
	<p><b>Legal and Competition:</b> Foreign law firms cannot practice PRC law in China.</p>	
	<p><b>Logistics:</b> Domestic express companies still receive preferential treatment in certain areas related to investment.</p>	





<p><i>“Market access standards will be reinforced regarding ... environment...”</i></p> <p><b>“Improving the macro control system.”</b> <i>The Decision, Article 14</i></p>	<p><b>Environment:</b> Foreign professional companies are unable to invest in developing proper infrastructure due to the limited number of licences available, most of which are allocated to Chinese companies.</p>	
<p><i>“We will encourage private funds to flow to medical services, first supporting them to flow to not-for-profit medical institutions. We will allow private funds to invest directly in services that are short of resources or are to meet diverse demands, and to participate in the reform and restructuring of public hospitals in various forms.”</i></p> <p><b>“Deepening reform in medicine and healthcare.”</b> <i>The Decision, Article 46</i></p>	<p><b>Healthcare Equipment:</b> In the <i>Foreign Investment Catalogue (2015 revision)</i>, medical institutions are still in the “restricted” category.</p>	
<p><i>“We will explore a management model for foreign investors make the business registration system more convenient by reducing the number of items that require qualification verification, turning certification before licensing into licensing before certification, and gradually changing the paid-in capital registration system into a subscribed capital registration system.”</i></p> <p><b>“Enacting market rules that are fair, open and transparent.”</b> <i>The Decision, Article 9</i></p>	<p><b>Quality and Safety Services:</b> <i>The Foreign Investment Catalogue (2015 revision)</i> has removed the inspection and certification industry from the “restricted” category, but in reality, this has not been carried out by the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), even in the China (Shanghai) Pilot Free Trade Zone. The management model has not yet been made public, and the number of items that require qualification verification has not been reduced. The system of certification before licensing was turned into licensing before certification when it comes to certification industry and the registration of import and export product testing institutions.</p>	

<p><i>“We will implement a unified market access system; and on the basis of making a negative list, all kinds of market players may enter areas not on the negative list on an equal basis and according to law.”</i></p> <p><b><i>“Enacting market rules that are fair, open and transparent.”</i></b>  <i>The Decision, Article 9</i></p>	<p><b>Quality and Safety Services:</b> The general negative list has not been released yet. The new rules published by the AQSIQ this year, which apply until 2020, still distinguish between foreign and domestic investments.</p>	
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## 2. The ‘New Toolbox’

It is clear that since the promulgation of the *Decision* some reform momentum has been lost. The Chinese Government’s most pressing issue now is how to forge ahead with the reforms that will help to bring about the rebalancing of the economy. China needs to employ a ‘new toolbox’ that can deliver an economic model in which:

- market forces decide the allocation of resources in the economy under the auspices of rule of law;
- there is a focus on quality of life for the individual;
- domestic and foreign companies are treated equally, not only under the law, but also within the law;
- there is harmonisation with global standards and supply chains;
- the state plays a reduced role in the economy, acting solely as regulator and enforcer;
- the services sector is the dominant engine of growth, supported by an education system that endows the workforce with the required skill set;
- consumption holds a much larger share of GDP; and
- there is a system in place that allows and encourages innovation.

In order to get there, China will need to address a number of key challenges including, but not limited to, points 2.1–2.6, outlined below.

### 2.1 Accelerating Reform of the Financial System

Reforming the financial system has to be at the core of the government’s reform drive, as it has a complimentary role in nearly all other reforms of the real economy. China’s financial system needs to become more efficient in allocating capital if the economy is to grow more sustainably. This will require some fundamental reforms to ensure that funds are being lent on a more viable basis, founded on sound financial appraisals of the longer-term financial return on investment of any one project or individual, and not simply on its one-off contribution to GDP in a given year. Some of the key financial reforms that China still needs to tackle are:

- A liberalisation of interest rates;
- Boosting market-based lending; and



- Further opening up the banking, insurance and consumer finance sectors.

### Interest rate liberalisation

A full liberalisation of interest rates is an important development for China to transition to the 'new normal'.

In March 2015, People's Bank of China (PBOC) Governor Zhou Xiaochuan stated that it is "very likely" that China will finish interest rate liberalisation this year,<sup>18</sup> which will make China's financial system more efficient and lower the cost of equity so the companies that deserve access to finance can get it readily. This intention was also articulated in the *Decision*.

### Boosting market-based lending

The European Chamber welcomed the Chinese Government's announcement on 25<sup>th</sup> June, 2015, that the loan-to-deposit ratio (LDR) cap would be discontinued.<sup>19</sup> The LDR cap had pushed up the funding costs of banks and had fuelled, in part, the development of shadow banking.<sup>20</sup>

Abandoning the LDR cap will now open up additional sources of funding to banks in China, particularly the interbank market. The European Chamber believes that this policy decision will decrease the leverage in the Chinese economy and contribute to the long-term health of the domestic banking system.

### Banking sector opening

Further opening up the domestic banking sector, both in terms of services and geographical coverage, will benefit both individuals and corporations.

Many foreign banks remain attracted to the Chinese market and are prepared to invest more and expand their operations. However, they are deterred from doing so due to restrictions to branch expansion.

### ▶ Limitations to foreign banks' expansion<sup>21</sup>

There are currently many restrictions that prevent foreign banks from expanding and contributing to China's development.

**Banking:** Foreign banks are limited mainly to organic growth as they are not allowed to acquire more than 20 per cent of a local Chinese bank. However, foreign banks' organic growth, e.g. via an expansion of their Chinese branch network, is also hampered due to an overly complex system of submissions, the rules of which are subject to various interpretations.

**Recommendation:** By allowing locally-incorporated banks to provide regulators with annual master plans for branch and sub-branch expansion, or by providing clearer regulations that highlight how many branches each locally-incorporated bank can apply for and how concurrent applications are treated, foreign banks could make better strategic decisions for their business' expansion.

By contrast, the five largest commercial Chinese banks are increasingly acquiring or investing in foreign banks in Europe and elsewhere without similar ownership restrictions, and find it very easy to open branch networks within the European Union (EU).

▶ Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.

18 *PBOC Pledges to Press on With Rate Liberalization Amid Slowdown*, Bloomberg, 12<sup>th</sup> March, 2015, viewed 17<sup>th</sup> March, 2015, <<http://www.bloomberg.com/news/articles/2015-03-12/pboc-s-zhou-touts-prudent-policy-in-new-normal-of-slower-growth>>

19 *China moves to scrap long-held cap on loan-to-deposit ratio*, Financial Times, 25<sup>th</sup> June, 2015, viewed 20<sup>th</sup> July, 2015, <<http://www.ft.com/intl/cms/s/0/49955320-1ad4-11e5-8201-cbdb03d71480.html#axzz3gOi2XoeQ>>

20 See page 362 of the *Banking and Securities Position Paper 2015/2016* for more information.

21 See page 363 of the *Banking and Securities Position Paper 2015/2016* for more information.

**Chinese banks setting-up operations in Europe<sup>22</sup>**

The EU Member States' regulations on this matter are based on European directives that have to be transposed into their national legal systems in order to establish a harmonised framework. The basic rule is that the licence approval has a silent confirmation approval procedure after a certain period of time (i.e. 120 days in the case of most EU Member States) from the moment of application. Although there may be a need for requesting more than one licence if different banking businesses are covered, each follows the same terms.

**Case of ICBC in Europe<sup>23</sup>**

ICBC opened their Milan Branch on 21<sup>st</sup> January, 2011. In that same week, it opened four other branches in Madrid, Amsterdam, Paris and Brussels. For the Milan Branch, the time taken to obtain the licence was one month. This is due to the fact that European regulations allow the establishment of a subsidiary with much shorter application procedures when that entity has already been established in another EU country. If ICBC wanted to set up a new independent branch (as opposed to a sub-branch dependent on the Luxembourg subsidiary), it would have to wait for a period of around seven months—a period still shorter than that faced by foreign banks in China.

Given that Chinese companies have broad access to the European banking market, and coupled with the importance the *Decision* places on the financial industry and market opening, the European Chamber hopes China would recognise the importance of extending reciprocal terms to European banks in China. For this reason, the European Chamber is advocating that these issues be addressed during the EU-China CAI negotiations.

**Insurance sector liberalisation**

The opening up and development of the insurance industry can contribute significantly to China's economic and societal development through the transfer of risk between different actors. Having the certainty that the risks individual actors take will be borne and absorbed equitably by many, can enable bolder and more creative decision-making, which may then translate into increased entrepreneurship and innovation. In a similar fashion, a liberalised insurance sector will mobilise more savings for investment, thereby creating greater liquidity in many asset classes.

As the Chinese insurance sector is still underdeveloped, it will require greater foreign participation in order for the sector to fulfil its proper function. However, foreign insurers still have a limited presence in the Chinese market. Their respective nationwide branch networks remain small in comparison to domestic insurance companies due to a time-consuming and non-transparent licence application process. This puts them at a significant disadvantage to domestic players.<sup>24</sup>

**Insurance:** Although there is no formal regulation restricting the number of new branches that can be opened by insurers, or any discrimination against foreign-invested insurers in this respect, in practice additional branches are only approved consecutively, with a processing time between two approvals of around one year. Foreign-invested insurers thus suffer from a lack of branches, which limits their capacity to compete with their domestic competitors, which were allowed to open many branches rapidly in the past.<sup>25</sup>

**Consumer finance sector opening**

China's drive to increase the share of consumption within its economy will come from several sources including income growth and diversification of channels resulting in better access to finance, as well as broader trends such as greater mobility, rapid urbanisation and changing aspirations of Chinese

<sup>22</sup> See page 363 of the *Banking and Securities Position Paper 2015/2016* for more information.

<sup>23</sup> Ibid

<sup>24</sup> See page 381 of the *Insurance Position Paper 2015/2016* for more information.

<sup>25</sup> Ibid



consumers. The development of the still-nascent consumer finance sector represents a unique opportunity to contribute to China's consumption drive. However, the total number of consumer finance companies (CFCs) in the domestic market is limited, with foreign participation still being markedly restricted.<sup>26</sup>

## 2.2 Limiting State Engagement in the Economy

Over the past decades, the state loomed large in the Chinese economy. It has been dominated by strong SOEs, to which the government channelled the population's savings in order to develop large-scale projects on the back of clearly-defined industrial policies. State-owned enterprises also received support in the form of subsidies, either directly or in the form of below-market prices. This approach has been costly and inefficient. If the market is to play a decisive role in the economy, then the Chinese Government must:

- let prices be determined by market forces;
- reduce the reliance on subsidies; and
- reform SOEs.

### Pricing of factors of production

China has historically suppressed the prices of factors of production, such as energy and raw materials, in order to help decrease the costs faced by SOEs. This continues today, albeit to a much lesser extent. Making companies and individuals pay the market price for such inputs will force companies to become more efficient, put less pressure on the environment and encourage China's transition to a more service-orientated economy.

### Subsidisation policies

Historically, SOEs have been a long-standing beneficiary of subsidies, with the particular aim of developing them into formidable exporters. However, receiving large-scale state subsidies has not fostered market-based decision-making, instead it has led to large-scale overcapacity in many sectors – sectors that had been designated as “pillar industries” by the Chinese Government.<sup>27</sup>

### SOE reform

European business appreciates the distinct and unique role SOEs can play in an economy.

This includes socially-important functions such as the provision of social services, something that had historically been done under the auspices of SOEs.<sup>28</sup> However, while China has emphasised the important role that market forces must play on the one hand, it has sent a mixed message in the *Decision* by also highlighting the dominant position of public ownership.

*“We must unswervingly consolidate and develop the public economy, persist in the dominant position of public ownership, give full play to the leading role of the state-owned sector, and continuously increase its vitality, controlling force and influence.”*

*Third Plenum Decision, Article II*

The European Chamber believes that SOE reforms should focus on:

- 1) reforming incentive systems to better link executives' and employees' compensation and bonuses to corporate profits and share performance;

<sup>26</sup> See page 372 of the *Consumer Finance and Non-Bank Financial Institutions Position Paper 2015/2016* for more information.

<sup>27</sup> *China builds up new pillar industries*, *Xinhua*, 6<sup>th</sup> November, 2012, viewed 13<sup>th</sup> July, 2015, <[http://news.xinhuanet.com/english/china/2012-11/06/c\\_131954795.htm](http://news.xinhuanet.com/english/china/2012-11/06/c_131954795.htm)>

<sup>28</sup> *The Business(es) of the Chinese State*, World Bank, 2001, viewed 20<sup>th</sup> July, 2015, <[http://siteresources.worldbank.org/INTAFROFFCHIECO/Resources/The\\_Business\(es\)\\_of\\_the\\_Chinese\\_State.pdf](http://siteresources.worldbank.org/INTAFROFFCHIECO/Resources/The_Business(es)_of_the_Chinese_State.pdf)>

- 2) increasing private participation by accelerating price reforms and deregulation in the previously-restricted energy, utilities and service sectors; and
- 3) improving the operating environment by ensuring a more level playing field for SOEs and non-SOEs. Local-level SOE reform may progress faster given the swelling local debt servicing burden on local governments, thus providing a stronger incentive for divestment.

The Chinese Government initiated an SOE reform trial in July 2014, to assess the feasibility of such reform.<sup>29</sup> This was viewed as encouraging by European business as it highlighted the political will to guide SOEs towards market-based efficiency.<sup>30</sup> However, in practice the Chinese Government still maintains majority control of the restructured SOEs.<sup>31</sup> As such, any subsequent reform trials have not resulted in the privatisation needed to provide market-based incentives and international standards for corporate governance. This means that current standards of corporate governance will unlikely be a factor in effectively driving SOEs towards efficiency.

Recent announcements of mergers in the railways and nuclear energy sectors<sup>32</sup> are further adding to the concerns of European business that meaningful SOE reform will not be forthcoming any time soon. It gives the impression that SOE reform will still be driven by vested interests, will be exempted from the core principles of the *Decision* and may still be a major drag on the economy given their historical performance once all the costs of their special treatment is taken into consideration.

The European Chamber remains supportive of China's SOE reform drive, but would like to see it happen in earnest and in adherence to the overall principles of the *Decision*. Ignoring *true* SOE reform risks undermining the credibility and importance of the *Decision* and may jeopardise its future implementation.

### 2.3 Increasing Market Access for the Private Sector, Including Foreign Business

One of the greatest policy tools that is still at the Chinese Government's disposal—unlike many governments in developed economies—is the possibility to let the private sector fully play out within the economy and to harness the substantial gains this will bring. Private Chinese companies are arguably some of the most entrepreneurial and creative in the world. However, they need an open market economy in order to blossom – this, of course, also holds true for foreign companies. The need to establish an open market economy was clearly recognised in the *Decision* as a pre-requisite to achieving the government's aim of efficiently allocating resources.

*“Establishing a unified, open, competitive and orderly market system is the basis for the market to play a decisive role in the allocation of resources.”*

*Decision, Article III*

However, many foreign companies still face market access barriers to doing business in China and so the Chinese economy is deprived of an important input.<sup>33</sup>

29 *Four Item Reform*, China's State-Owned Assets Supervision and Administration Commission (SASAC), (European Chamber translation), 15<sup>th</sup> July, 2015, viewed 15<sup>th</sup> July, 2015, <<http://www.sasac.gov.cn/n1180/n1566/n259730/n264168/15962412.html>>

30 *European Business in China – Position Paper 2014/2015*, European Union Chamber of Commerce in China, 2014, viewed 10<sup>th</sup> July, 2015, <[http://www.europeanchamber.com.cn/en/publications-archive/292/Executive\\_Position\\_Paper\\_2014\\_2015](http://www.europeanchamber.com.cn/en/publications-archive/292/Executive_Position_Paper_2014_2015)>

31 *China SOE's restructuring leaves state ownership intact*, *Financial Times*, 12<sup>th</sup> March, 2015, viewed 18<sup>th</sup> May, 2015, <<http://www.ft.com/intl/cms/s/0/902826f4-c878-11e4-8617-00144feab7de.html#axzz3f12yO8sY>>

32 *With a Rail Merger, China Is Forging an Industrial Giant Second Only to GE*, *Bloomberg*, 8<sup>th</sup> June, 2015, viewed 18<sup>th</sup> June, 2015, <<http://www.bloomberg.com/news/articles/2015-06-07/china-forges-industrial-giant-second-only-to-ge-with-rail-merger>>

33 *China 2030: Building a Modern, Harmonious, and Creative Society*, World Bank and the Development Research Centre of the State Council, PR China, 2013, Washington, DC: World Bank, p. 104



The Organisation for Economic Cooperation and Development (OECD) identifies China as having the most restrictive regime for foreign investment out of all the G20 countries.<sup>34</sup> China continues to retain a distinction between domestically-invested and foreign-invested businesses – something that does not exist in the EU.

While China has opened up various sectors to foreign industry, many remain under strict conditionality through, for example, requirements to transfer technology to mandated JV partners or to localise production, in line with clearly-stipulated industrial policies. While foreign business acknowledges that China is reforming in parts, it is the persistence of market access barriers that has left some foreign businesses wondering if China's reform agenda is really intended for them as well.

**Rail:** Foreign players in the Chinese railway manufacturing sector only enjoy partial market access and can normally only access markets under conditions of technology transfer to local partners. No foreign entity is allowed to bid directly for a project in rolling stock or signalling segments. This has a negative impact on the dynamism and strength of China's manufacturing capabilities in this field, and leads to less investment.<sup>35</sup>

The European Chamber believes that the Chinese Government can achieve its policy aims by harnessing the boost that the participation of both domestic private enterprises and foreign companies will bring to the Chinese economy by breaking down indirect and hidden market access restrictions such as those listed below:

- Licensing constraints

**Construction:** Foreign construction service providers (CSPs) cannot use their international track record to apply for engineering and design qualifications. They can only initially apply for a Grade-B qualification certificate, which prevents them from sharing their world-class expertise and cutting-edge technology with Chinese CSPs.<sup>36</sup>

**Environment:** Foreign professional companies are unable to invest in developing proper infrastructure due to the limited number of licences available, most of which are allocated to favoured Chinese companies. Recent tenders that opened in some cities in China for municipal solid waste incineration plants have set prequalification criteria, which limit access to the Chinese market for foreign waste treatment companies with a global track record.<sup>37</sup>

- Discriminatory treatment in public procurement processes

**Public Procurement:** Although great efforts to strengthen China's public procurement framework have been made over the past few years, a significant difference between China's domestic procurement regulations and the provisions of the Government Procurement Agreement (GPA) of the WTO remains. A substantial part of the existing regulatory framework is not in line with the overarching GPA principles of competition, transparency, integrity and sufficient remediation. Moreover, some local and sector-specific regulations dilute or contradict the expected application of the Bidding and Tendering Law, which calls for open bidding and equal competition.<sup>38</sup>

- Restricted access via standards, certification and/or licensing processes

**Standards and Conformity Assessment:** Foreign products entering the Chinese market need to fulfil multiple uncoordinated market access requirements, which may consist of mandatory standards, compulsory certification schemes and administrative licensing schemes. As these are published by different ministries and authorities, they are not well coordinated with each other which creates market access barriers.<sup>39</sup>

<sup>34</sup> The OECD FDI Regulatory Restrictiveness Index, OECD, 2015, viewed 15<sup>th</sup> July, 2015, <[www.oecd.org/investment/index](http://www.oecd.org/investment/index)>. The FDI Index measures statutory restrictions on foreign direct investment in 55 countries, including all OECD and G20 countries. China is ranked as having the most restrictive FDI climate of all the 55 countries.

<sup>35</sup> See page 253 of the *Rail Position Paper 2015/2016* for more information.

<sup>36</sup> See page 295 of the *Construction Position Paper 2015/2016* for more information.

<sup>37</sup> See page 49 of the *Environment Position Paper 2015/2016* for more information.

<sup>38</sup> See page 107 of the *Public Procurement Position Paper 2015/2016* for more information.

<sup>39</sup> See page 125 of the *Standards and Conformity Assessment Position Paper 2015/2016* for more information.

Making use of a functioning global standards system—the WTO's technical barriers to trade (WTO/TBT) committee and the International Organisation for Standardisation (ISO)—allowed Chinese companies to integrate into complex global supply chains. At the same time, they could be assured that China's trade partners would notify proposed technical regulations and conformity assessment procedures to members of the WTO/TBT committee.

The need for harmonisation of China's regulatory and standards system is ever more critical for the continued success of its companies as they will incur significant costs if standards mandated in China do not have global interoperability, and they in turn need to recalibrate them to suit global markets. As such, the European Chamber welcomed the *Notice on the Deepening Reform Plan for Standardisation Work*<sup>40</sup> released by the State Council on 26<sup>th</sup> March, 2015, as it includes reform objectives and a three-phase implementation timeline planned for completion by 2020.<sup>41</sup>

As per its WTO accession agreement, China is itself obliged to give due notification on proposed technical regulations and conformity assessment procedures to members of the WTO/TBT committee. Such notifications have to include a brief indication of their objectives and rationale at an early stage, which enables amendments and comments to be taken into account.<sup>42</sup>

However, a number of China's own practices do not fully comply with many WTO/TBT principles. Non-compliance with the WTO/TBT notification rules has been observed in cases of mandatory industry standards, voluntary standards included in mandatory certification schemes and some regulations requiring conformity assessment procedures for market access, for example, the energy labelling scheme, mining safety certification and wind power equipment certification.<sup>43</sup> There are further indirect restrictions, such as the adoption of national standards without any input from foreign industry, or the provision of favourable access to financing and subsidies to domestic enterprises, among others.

The situation that foreign-invested enterprises (FIEs) face in China is very different to the equal treatment that Chinese-invested enterprises enjoy in Europe. If China is serious about moving up the global value chain, this approach is becoming increasingly anachronistic: foreign businesses must be afforded increased market access.

## 2.4 Committing to the Rule of Law

European business understands that greater implementation of rule of law is undoubtedly the most important tool in the box and will be the top driver for China's economic development in the coming years.<sup>44</sup> Transparency, legal certainty and public consultation are all central elements of rule of law to ensure the proper functioning of an economy. Another key aspect is ensuring that court decisions are issued independent of third-party influence. The establishment of circuit courts in Shenzhen and Shenyang is a first step in the right direction. However, more remains to be done to ensure investors' trust in the Chinese judicial system.

The European Chamber supports the Fourth Plenum's explicit statements committing to the principles of "judicial fairness", "governing the country according to the law", "equality under the law" and "fair and

40 *Notice on the Deepening Reform Plan for Standardisation Work* (Guofa [2015] No.13), State Council, 26<sup>th</sup> March, 2015, viewed on 15<sup>th</sup> April, 2015, <[http://www.gov.cn/zhengce/content/2015-03/26/content\\_9557.htm](http://www.gov.cn/zhengce/content/2015-03/26/content_9557.htm)>

41 See page 122 of the *Standards and Conformity Assessment Position Paper 2015/2016* for more information.

42 Ibid

43 Ibid

44 *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, June 2015, page 39, <<http://www.eurochamber.com.cn/en/publications-business-confidence-survey>>





civilised law enforcement”.<sup>45</sup> The European Chamber hopes that this commitment will translate into further concrete actions, and China will be able to improve its international ranking of 71<sup>st</sup> out of 102 countries surveyed in the *Rule of Law Index 2015*.<sup>46</sup>

A fair and efficient legal system that strengthens trust among all stakeholders in the economy will ultimately increase compliance and reduce transaction costs. The following improvements are still needed:

- Transparency in the promulgation, elaboration and implementation of laws and regulations by legislative, judicial and administrative bodies

**Legal and Competition:** The 2014 version of the *Implementing Regulations to the PRC Law on the Protection of State Secrets* remains a concern for foreign business, as it does not provide a clear scope as to what constitutes a ‘state secret’. Therefore, foreign investors and their advisors still lack sufficient legal certainty to determine with confidence that they are not in breach of any such regulations. For example, the stance taken by the Ministry of Environmental Protection in 2014, with regard to the transfer of soil contamination information as falling under the category of state secrets, reinforced the view that any information could constitute a state secret at the sole discretion of officials.<sup>47</sup>

- Public consultation, to help ensure that laws and regulations are properly developed and understood before they are applied in a practical sense

**Public consultation:** At the time of writing, the European Chamber had submitted comments on 24 public consultations on draft regulations from different Chinese ministries and administrations in 2015. Of these, 21 stipulated a deadline for feedback, with an average time of 28 calendar days given; 62 per cent of these gave at least 30 calendar days as a consultation period. This is a small sample, yet it represents an improvement from the previous year when only 35 per cent of public consultations gave at least 30 calendar days to respond. However, there are still some negative examples: the *PRC Patent Law Amendment (Draft for Comments)* allowed only 20 calendar days for public consultation; and the call for comments on the *Regulation Regarding Government Approval and Filing of Investment Projects* allowed only 10 calendar days, of which four days fell over a weekend and a holiday period.

- Predictability of legal outcomes, to give investors legal certainty

**Legal and Competition:** Even though China’s Anti-Monopoly Law Enforcement Agencies (AMEA)—the NDRC, the MOFCOM and the SAIC—are improving, there is still uncertainty among businesses regarding enforcement processes of China’s Anti-monopoly Law (AML). This uncertainty derives from the lack of clarity with regards, but not limited, to: (i) the rights to confidentiality; (ii) standards, fairness and proportionality of the proceedings; (iii) deadlines that apply to notified parties; and (iv) the number and type of additional implementing regulations/guidance that can be expected from AMEA bodies.<sup>48</sup>

45 The Fourth Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in October 2014, and concluded with a decision laying out new economic and policy initiatives, the *CCP Central Committee Decision Concerning Some Major Questions in Comprehensively Moving Governing the Country According to the Law Forward (Fourth Plenum Decision)*. All quotations from the *Fourth Plenum Decision* are taken from, Chinalawtranslate.com, 28<sup>th</sup> October, 2014, viewed 15<sup>th</sup> July, 2015, <<http://chinalawtranslate.com/fourth-plenum-decision/?lang=en>> and *Xinhua*, 28<sup>th</sup> October, 2014, viewed 15<sup>th</sup> July, 2015, [http://news.xinhuanet.com/politics/2014-10/28/c\\_1113015330.htm](http://news.xinhuanet.com/politics/2014-10/28/c_1113015330.htm).

46 *Rule of Law Index 2015*, the World Justice Project, 2015, viewed 16<sup>th</sup> July, 2015, <[http://worldjusticeproject.org/sites/default/files/roli\\_2015\\_0.pdf](http://worldjusticeproject.org/sites/default/files/roli_2015_0.pdf)>

47 See page 102 of the *Legal and Competition Position Paper* for more information.

48 See page 99 of the *Legal and Competition Position Paper 2015/2016* for more information.

## 2.5 Abolishing the Foreign Investment Catalogues and Committing to a Nationwide Roll-out of the Negative List

The continued adherence to the *Foreign Investment Catalogue* falls short of the Chinese Government's stated ambition to give full play to the market. The introduction of the 'negative-list' concept, first unveiled in the China (Shanghai) Pilot Free Trade Zone (CSPFTZ), was seen as a major step towards the opening-up of the Chinese market and the creation of a level playing field for domestic and foreign business.

European business welcomed the 'negative-list' approach – it was anticipated that once successfully piloted within the CSPFTZ it would be rolled out to the rest of the country.<sup>49</sup> These hopes were dashed somewhat when it was announced that three new FTZs were to be established in Guangdong and Fujian provinces and the city of Tianjin. If China is to shift towards a consumption-based economy a nationwide roll-out of the *Negative List* should be in range. The gradual approach currently being adopted risks compromising this aim: increasing the number of FTZs to pilot reforms in restricted geographical areas creates 'reform pockets' and acts as a bottleneck to the implementation of reforms nationwide.

## 2.6 Fostering an Innovative Environment

Innovation is one of the most important drivers of economic growth. In order for China to successfully create the right conditions for it to take place it must, first and foremost, guarantee a competitive market that is open to all companies, regardless of nationality.<sup>50</sup> It also needs to:

- encourage R&D in the private sector;
- ensure IPR protection, including ensuring that technology transfers only happen on a voluntary basis;
- make R&D funding and grants available to all companies, regardless of nationality;
- ensure mobility of talent;
- leverage the Internet for future economic growth; and
- discontinue state-led approaches to innovation.

### Encouraging R&D in the private sector

China already has an extremely impressive R&D track record. In 2012, it surpassed Europe in terms of gross domestic expenditure of research and development (GERD) as a share of GDP (commonly referred to as research intensity), one of the key metrics for gauging innovation. China's research intensity has essentially tripled over the last twenty years and is expected to overtake the US on the GERD metric by 2020.<sup>51</sup>

The European Chamber has consistently supported the Chinese Government in encouraging European businesses to commit more of their R&D capabilities to China, to set up regional headquarters here and to increase their already-robust investments. Currently, 25 per cent of European companies have an R&D centre in China, and 85 per cent of these companies are likely to increase R&D expenditure or operations in China in the near future, demonstrating the importance of China to the long-term strategies of European

49 *European Chamber Press Release on the publication of the revised Foreign Investment Catalogue*, European Union Chamber of Commerce in China, 5<sup>th</sup> November, 2014, viewed 24<sup>th</sup> July, 2015, <[http://www.europeanchamber.com.cn/en/press-releases/2193/european\\_chamber\\_press\\_release\\_on\\_the\\_publication\\_of\\_the\\_revised\\_foreign\\_investment\\_catalogue](http://www.europeanchamber.com.cn/en/press-releases/2193/european_chamber_press_release_on_the_publication_of_the_revised_foreign_investment_catalogue)>

50 *China 2030: Building a Modern, Harmonious, and Creative Society*, World Bank and the Development Research Center of the State Council, PR China, 2013, Washington, DC: World Bank, p. 104

51 *European Business in China – Beijing Position Paper 2015/2016*, European Union Chamber of Commerce in China, April 2015, pp.13-14, <[http://www.europeanchamber.com.cn/en/publications-archive/331/Beijing\\_Position\\_Paper\\_2015\\_2016](http://www.europeanchamber.com.cn/en/publications-archive/331/Beijing_Position_Paper_2015_2016)>



companies that are already here.<sup>52</sup>

However, there is much greater untapped potential – more than two thirds of European companies that could establish R&D operations in China are currently not exercising this option.<sup>53</sup>

### IPR protection

There is a general consensus among European Chamber member companies that China has done a good job with their written IPR laws, with 53 per cent judging them to be “adequate” and eight per cent regarding them as “excellent”.<sup>54</sup> However, a majority of European businesses is still concerned about the *enforcement* of China’s IPR laws, with 56 per cent considering regulatory enforcement to be “inadequate”.<sup>55</sup>

**Intellectual Property Rights:** The experience of heavy users of the administrative channel for copyright enforcement, including the music, software and film industries, is that greater commitment is given to the enforcement of illegal/unlicensed media and cultural activities (matters regulated by State Administration of Press, Publication, Radio, Film and Television and the Ministry of Culture) at the expense of ‘pure’ copyright enforcement issues. This is manifested in a number of ways, including a frequent lack of either a formal acceptance or rejection of complaints, meaning that complaints are simply ‘lost in the system’; as well as failure to enforce and/or an over-reliance upon mediated solutions to avoid a formal decision or associated punishment and fine.<sup>56</sup>

The European Chamber was strongly encouraged by the NPC’s decision, promulgated on 31<sup>st</sup> August, 2014, to establish specialised IPR courts in Beijing, Shanghai and Guangzhou, as it demonstrates China’s commitment to improving IPR enforcement. The European Chamber would encourage a nationwide roll-out of such initiatives if proven to be successful, to inspire greater levels of confidence in China’s general IPR landscape.

### Funding and grant schemes

There is a variety of funding and grant schemes available in China to help innovative companies. These can broadly be divided into ‘strategic support’, such as long-term structural incentives like the high- and new-technology enterprise (HNTE) status or the super-deduction scheme; and ‘tactical support’, such as focused grants for projects with a definite scope and target.<sup>57</sup> Such schemes are important for carrying out basic research and can be beneficial overall for the economy. However, such schemes should be accessible to all companies registered in China regardless of nationality, like they are in Europe, and should not require a transfer of technology in return.

**R&D:** Foreign companies operating R&D centres in China are facing increased difficulties to apply for and obtain public funding and grants for R&D compared with Chinese domestic companies. They are restricted to only applying in certain strategic sectors, where the selection process is often not transparent and there is scope for awards to be made in favour of domestic champions at the discretion of local authorities.<sup>58</sup>

### Mobility of talent

Foreign companies are faced with ever-stricter immigration policies as well as the inconsistent implementation thereof in different regions of China. This has a strong negative impact on talent attraction,

<sup>52</sup> *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, June 2015, pp.27-28, <<http://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

<sup>53</sup> Ibid

<sup>54</sup> Ibid

<sup>55</sup> *European Business in China – Business Confidence Survey 2015*, June 2015, European Union Chamber of Commerce in China, <<http://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

<sup>56</sup> See page 87 of the *Intellectual Property Rights Position Paper 2015/2016* for more information.

<sup>57</sup> See page 115 of the *Research and Development Position Paper 2015/2016* for more information.

<sup>58</sup> Ibid

retention and development as foreign companies find it increasingly challenging for them to hire or transfer foreign talent for their China-based R&D operations.<sup>59</sup>

As such, multinational corporations are unable to bring a sufficient number of foreign scientists, engineers and other skilled talent into the country, and China is consequently failing to reap the benefits of the creativity, knowledge transfer and best practices sharing that a cosmopolitan work environment brings with it.<sup>60</sup> Specifically, two cases stand out here: young talent with less than two years of work experience and experienced professionals at a late stage of their career.

#### a) Young talent

Regulations on the number of required years of work experience deters fresh graduates from moving to China and prevents young European talent already residing here from gaining experience through internships. The European Chamber is pleased to hear that this has recently been liberalised in Shanghai<sup>61</sup> and hopes that a nationwide roll-out follows soon.

Since the *Regulations on the Entry and Exit Administration of Foreigners*<sup>62</sup> became effective on 1<sup>st</sup> September, 2013, foreign companies have experienced increasing difficulties obtaining work-visas for foreign interns.<sup>63</sup> The European Chamber thinks that a business-friendly overhaul of this system is needed. Given the continued importance of China in European companies' global strategies, European Chamber member companies hope to provide greater exposure for young European talent to the Chinese market via locally-based internships.<sup>64</sup>

#### b) Senior professionals

Experienced employees seeking employment in China are often denied a work visa if they have surpassed the Chinese retirement age of 55 for women and 60 for men.<sup>65</sup> These employees bring valuable experience and could still be employed by companies or work as consultants or entrepreneurs, thereby contributing to China's economic development.

The European Chamber believes that by having such stringent visa restrictions in place, China is depriving itself of an important stimulus that can bolster its ambition to transition to an innovation-driven economy.

### Leveraging the Internet for future growth

China has the largest number of Internet users in the world, with over 649 million people at the end of 2014, a penetration rate of approximately 48 per cent.<sup>66</sup> It has been projected that over the next decade Internet applications could be responsible for anywhere between seven and 22 per cent of the Chinese economy's incremental GDP growth<sup>67</sup> – albeit this depends on the rate of adoption of these technologies.<sup>68</sup>

However, the European Chamber believes that the size of the Internet's contribution to China's economy

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59 Ibid

60 Ibid

61 *Foreign student gets first new work permit in Shanghai*, China Daily, 25<sup>th</sup> July, 2015, viewed 27<sup>th</sup> July, 2015, <[http://www.chinadaily.com.cn/china/2015-07/25/content\\_21405065.htm](http://www.chinadaily.com.cn/china/2015-07/25/content_21405065.htm)>

62 *Exit and Entry Administration Law of the People's Republic of China*, National People's Congress, 30<sup>th</sup> June, 2012, viewed 23<sup>rd</sup> July, 2015, <[http://english.gov.cn/archive/laws\\_regulations/2014/09/22/content\\_281474988553532.htm](http://english.gov.cn/archive/laws_regulations/2014/09/22/content_281474988553532.htm)>

63 See page 71 of the *Human Resources Position Paper 2015/2016* for more information.

64 Ibid

65 Ibid

66 *CNNIC Released the 35<sup>th</sup> Statistical Report on Internet Development in China*, China Internet Network Information Centre, 3<sup>rd</sup> February, 2015, viewed 10<sup>th</sup> July, 2015, <[http://www1.cnnic.cn/AU/MediaC/rdxw/2015n/201502/t20150204\\_51650.htm](http://www1.cnnic.cn/AU/MediaC/rdxw/2015n/201502/t20150204_51650.htm)>

67 *China's digital transformation*, McKinsey, July, 2014, viewed 17<sup>th</sup> July, 2015, <[http://www.mckinsey.com/insights/high\\_tech\\_telecoms\\_internet/chinas\\_digital\\_transformation](http://www.mckinsey.com/insights/high_tech_telecoms_internet/chinas_digital_transformation)>

68 Ibid



is actually contingent upon meaningful reforms being undertaken to increase China's Internet speeds—which currently has a comparatively low international ranking—and by changing the way the government 'manages' the Internet.<sup>69</sup>

The European Chamber greatly appreciated the firm pledge by the State Council to increase China's Internet speeds and to lower prices of Internet services, and views Premier Li's assurance that the development of China's national broadband network will be accelerated as an affirmation that China is pursuing innovation-driven growth.<sup>70</sup> Yet improvements to China's Internet apparatus must not stop here. Equally important is guaranteeing unrestricted access to legitimate online content that businesses need to conduct their day-to-day operations.

#### a) Impact on business

China's Internet restrictions have a large, detrimental impact on the conduct of business operations within the country. In effect, these restrictions constitute a corporate 'Internet tax' that all companies, both domestic and foreign, have to pay.<sup>71</sup> The European Chamber's 2015 member poll on how Internet restrictions affect business operations in China, revealed that:

- 86 per cent of respondents experienced a negative effect on their business as a result of certain websites and online tools being blocked – a 15 per cent increase compared to June 2014.
- Some 80 per cent of respondents recorded a worsening business impact as a result of the recent further tightening of Internet controls that took place in early 2015.<sup>72</sup>

#### b) Impact on research

Slow, unreliable and restricted Internet access strongly deters foreign companies from undertaking R&D investment in China. The European Chamber's 2015 member poll revealed that:

- 13 per cent of respondents have recently deferred R&D investment or have become unwilling to establish R&D operations in China since Internet restrictions were tightened in early 2015.<sup>73</sup>

It is critical that the Chinese Government reconsiders its approach towards managing the Internet if they want to achieve their new developmental plans – Made in China 2025 and Internet Plus.

### Discontinuing state-led approaches to innovation

In addition to things which China should consider doing, there are equally some policies that should be rescinded as they negatively impact attempts to foster innovation:

#### a) Top-down catalogues

Trying to centrally control a process that is supposed to identify future growth areas, and thereby guide technological development, is contrary to the very definition of 'innovation'. Innovation comes naturally, based on a supportive environment, not by a limited list that can become quickly outdated or cut innovative companies out of the picture.

69 *Internet Restrictions Increasingly Harmful to Business, say European Companies in China*, European Union Chamber of Commerce in China, 12<sup>th</sup> February, 2015, viewed 15<sup>th</sup> July, 2015, <[http://www.europeanchamber.com.cn/en/press-releases/2235/internet\\_restrictions\\_increasingly\\_harmful\\_to\\_business\\_say\\_european\\_companies\\_in\\_china](http://www.europeanchamber.com.cn/en/press-releases/2235/internet_restrictions_increasingly_harmful_to_business_say_european_companies_in_china)>

70 Ibid

71 Ibid

72 Ibid

73 Ibid

### b) Quantitative innovation targets

The practice of setting quantitative innovation targets, under which industry is offered financial incentives to meet them, also risks undermining China's broader innovation goals. Without a proper method for evaluating the *quality* of the resulting innovations, huge amounts of resources are wasted on filing large quantities of low-quality 'inventions'.

## 3. China and the World

China's interactions with the rest of the world are dominating news headlines like never before. What China does today arguably matters more than at any time in history and has a bigger impact.

For European business in China, it is essential for the world to more clearly understand China for what it really is, and what it is *becoming*. Likewise, it is important for China to understand how its actions are being perceived by businesses and societies both inside and outside its borders. In terms of business commentary, national security issues, the development of Chinese institutions and investment initiatives, and discussions on bilateral and multilateral trade and investment deals are all topics that have taken on international prominence.

### 3.1 National Security Concerns

Over the course of recent months, several Chinese government agencies have issued a raft of legislation making reference to national security. While the European Chamber recognises that China, like EU Member States and other countries, has a legitimate right to ensure its national security, it is concerned that much of this legislation goes beyond essential national security concerns:

#### a) National Security Law

The National Security Law was promulgated by the NPC on 1<sup>st</sup> July, 2015,<sup>74</sup> after a public consultation process in which the European Chamber had participated.

#### b) National security review in China's FTZs

In April, 2015, the State Council rolled out new security regulations for investment in China's FTZs, the *Trial Measures for the National Security Review of Foreign Investments in China's Pilot Free Trade Zones (Trial Measures)*.<sup>75</sup>

#### c) Draft Cyber Security Law

The National People's Congress released a draft for public comments of the Cyber Security Law<sup>76</sup> on 6<sup>th</sup> July, 2015 with a public consultation period until 5<sup>th</sup> August, 2015. The European Chamber commented on this draft.<sup>77</sup>

#### d) Draft Counter-terrorism Law

The draft Counter-terrorism Law had its first reading on 27<sup>th</sup> October, 2014, followed by a public consultation phase from 3<sup>rd</sup> November to 3<sup>rd</sup> December, 2014.<sup>78</sup> It went through a second reading on 25<sup>th</sup> February, 2015.

74 National Security Law, National People's Congress, 1<sup>st</sup> July, 2015, viewed 24<sup>th</sup> July, 2015, <[http://www.npc.gov.cn/npc/xinwen/2015-07/07/content\\_1941161.htm](http://www.npc.gov.cn/npc/xinwen/2015-07/07/content_1941161.htm)>

75 *Trial Measures for the National Security Review of Foreign Investments in China's Pilot Free Trade Zones (Trial Measures)* (2015), State Council, 8<sup>th</sup> April, 2015, viewed 19<sup>th</sup> July, 2015, <[http://www.gov.cn/zhengce/content/2015-04/20/content\\_9629.htm](http://www.gov.cn/zhengce/content/2015-04/20/content_9629.htm)>

76 Cyber Security Law (Draft), National People's Congress, 6<sup>th</sup> July, 2015, viewed 24<sup>th</sup> July, 2015, <[http://www.npc.gov.cn/npc/xinwen/lfgz/flca/2015-07/06/content\\_1940614.htm](http://www.npc.gov.cn/npc/xinwen/lfgz/flca/2015-07/06/content_1940614.htm)>

77 *European Chamber Comments on Cyber Security Law of the People's Republic of China (Draft)*, 6<sup>th</sup> August, 2015, viewed 6<sup>th</sup> August 2015, <[http://www.eurochamber.com.cn/en/lobby-actions/986/\\_](http://www.eurochamber.com.cn/en/lobby-actions/986/_)>

78 Counter-terrorism Law (Draft), National People's Congress, 3<sup>rd</sup> November, 2014, viewed 26<sup>th</sup> July, 2015, <[http://www.npc.gov.cn/npc/xinwen/lfgz/flca/2014-11/03/content\\_1885027.htm](http://www.npc.gov.cn/npc/xinwen/lfgz/flca/2014-11/03/content_1885027.htm)>



The definitions included in the *Trial Measures*—which were promulgated without public consultation—as well as those in the National Security Law and the draft Cyber Security Law, are extensive in both wording and scope. This vagueness creates a great deal of uncertainty for business, as it implicitly leaves the Chinese Government with the option of undermining foreign market access based on unclear and broad national security considerations. How these laws will be implemented remains to be seen.

The European Chamber is concerned that the broad definitions in all the aforementioned laws are misaligned with China's commitment to pursuing predictable and open investment conditions and might challenge international agreements such as the CAI which is currently under negotiation with the EU.

The development of national security-related legislation is, however, not a new trend. In the past, legitimate market access has often been constrained through the abuse of WTO national security provisions allowing China to impose regulations that explicitly bar foreign companies' products from government tenders.

**Information Security:** China's Multi-level Protection Scheme (MLPS) prevents certain businesses and administrations from using IT products containing foreign intellectual property by declaring them to be essential to national security interests, which is a reason within the WTO for opting out of national treatment provisions for foreign companies. However, the scope of the MLPS extends vastly beyond provisions required to protect essential national security interests and, as such, acts as a trade barrier to restrict the market access of foreign information security technology.<sup>79</sup>

### OECD Guidelines

It is particularly instructive to compare the National Security Law and the *Trial Measures* with the OECD's *Guidelines for Recipient Country Investment Policies Relating to National Security (OECD Guidelines)*,<sup>80</sup> which is essentially a best practices guide as to how national security laws should be formed so as to not wield a negative effect on foreign investment.

*"[The OECD] recommends that, if governments consider or introduce investment policies (including measures) designed to safeguard national security, they should be guided by the principles of non-discrimination, transparency of policies and predictability of outcomes, proportionality of measures and accountability of implementing authorities, as set forth in the guidelines attached hereto as an Annex to this Recommendation, of which it forms an integral part."*

*OECD Guidelines for Recipient Country Investment Policies Relating to National Security*

The *OECD Guidelines* are designed to offer support when designing and implementing national security policies in such a way that they achieve their national security goals with minimum impact on investment flows. They state that a national security review process should provide precise, narrowly-tailored definitions for the key considerations governing the review process. The *OECD Guidelines* are very much intrinsic to internationally-accepted definitions of what constitutes rule of law.<sup>81</sup>

The European Chamber is concerned that the definition of what constitutes 'national security' in the aforementioned laws is too expansive in wording and scope. Of particular concern is the introduction of the concept of 'economic security', which could be used to protect local industry to the detriment of foreign investment through industrial policies.

<sup>79</sup> See page 323 of the *Information Security Position Paper 2015/2016* for more information.

<sup>80</sup> *OECD Guidelines for Recipient Country Investment Policies Relating to National Security*, OECD, 25<sup>th</sup> May, 2009, viewed 15<sup>th</sup> July, 2015, <<http://www.oecd.org/investment/investment-policy/43384486.pdf>>

<sup>81</sup> *What is the rule of law?*, United Nations Rule of Law, viewed 14<sup>th</sup> July, 2015, <[http://www.unrol.org/article.aspx?article\\_id=3](http://www.unrol.org/article.aspx?article_id=3)>

As such, the European Chamber suggests greater alignment of these laws and their implementation with the *OECD Guidelines*.

### 3.2 China's New International Institutions

China is swiftly and resolutely moving ahead with its own set of international institutions and development agendas, which could profoundly shape the future of the global trading system. Over the course of the last two years, China has established its own mode of globalisation with the innovative introduction of the One Belt, One Road (OBOR) initiative and has founded an international development bank, the Asian Infrastructure Investment Bank (AIIB). This strategy is very much in line with China's stated intention to embrace economic globalisation trends and could greatly benefit the Eurasian region.

The European Chamber welcomes China's increased leadership in this respect and believes that both initiatives have the potential to redefine China's position, influence and contribution to the world in the 21<sup>st</sup> century.

#### One Belt, One Road

The OBOR is comprised of the Silk Road Economic Belt and the 21<sup>st</sup> Century Maritime Silk Road. The former will connect the two largest trading blocs in Eurasia, the EU and China, and the latter could serve to greatly increase seaborne trade for the countries located around the Indian Ocean.<sup>82</sup> The OBOR can also help China to harness gains by expanding over-land trade with the EU.

#### Asian Infrastructure Investment Bank

The AIIB can help to alleviate global investment needs, something that the G20 countries have agreed is an issue that needs to be tackled. While participation of EU countries in the AIIB can serve to strengthen this cause,<sup>83</sup> the AIIB and its forthcoming investment projects can also offer an excellent opportunity for EU companies to participate and market their products and services. While the European Chamber supports its creation, it is important to ensure that the AIIB follows the best practices and standards in terms of corporate governance and transparency, as well as in terms of procurement and lending policies.

### 3.3 Taking a Leading Role in Global Affairs

The European Chamber believes that it is important that the development of China's international institutions complements the existing, well-established world trading system. China has benefitted immensely from its entry into the WTO some 15 years ago, and now has the opportunity to shape and ensure the success of future development rounds.

One way for China to take a greater leadership role in the WTO would be to lobby for progress with the Doha Development Agenda; another way would be to make a more compelling, revised offer to join the Government Procurement Agreement (WTO/GPA).<sup>84</sup>

China has made great efforts to strengthen its public procurement framework over the past few years – in its fifth offer to join the WTO/GPA, submitted in December, 2014, five provinces were added and China

82 *Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road*, National Development and Reform Commission, Ministry of Foreign Affairs, Ministry of Commerce, 28<sup>th</sup> March, 2015, viewed 15<sup>th</sup> July, 2015, <[http://en.ndrc.gov.cn/newsrelease/201503/t20150330\\_669367.html](http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html)>

83 At the time of writing, the following EU Member States had signed up for membership of the AIIB: Austria, Denmark, Finland, France, Germany, Iceland, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Spain, Sweden and the United Kingdom.

84 *Agreement on Government Procurement*, World Trade Organisation, 2015 (updated information), viewed 10<sup>th</sup> July, 2015, <[https://www.wto.org/english/tratop\\_e/gproc\\_e/gp\\_gpa\\_e.htm](https://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm)>





lowered the threshold of projects to be covered by the WTO/GPA by about 50 per cent.<sup>85</sup> Yet a significant difference still remains between China's domestic procurement regulations and the provisions of the WTO/GPA. It is disappointing that the offer does not include coverage of SOEs,<sup>86</sup> and that a geographically large part of China—including all of Western China—is not included in the offer.<sup>87</sup>

In addition, China ought to afford greater priority to pursuing other plurilateral agreements within the WTO, such as the WTO Environmental Goods Agreement, the proposed expansion of the WTO Information Technology Agreement<sup>88</sup> and the WTO Trade in Services Agreement. Greater participation in the International Working Group on Export Credits would also be welcome, to arrive at a more comprehensive approach related to the regulation of export credits across all sectors.

Increased participation in the development of the WTO rounds and agreements would send a positive signal to China's partners, in particular the EU, and may influence their willingness to enter into negotiations for possible free trade agreements (FTAs).

### Global free trade agreements

The world is taking large steps forward with the creation of trade and investment agreements, be it bilateral or multilateral, outside of the WTO. All countries risk being left out if they do not actively engage. If China fails to promote global trade liberalisation it too could potentially risk isolating itself from its global partners.

Particularly significant are the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership Agreement (TPP). When ratified, these agreements will encompass nations accounting for vast swathes of global trade. While China will certainly benefit substantially from these agreements, due to the integration of many Chinese firms into global supply chains, it also risks losing out in global trade, as these agreements—to which China is not a party—will serve to ease trading conditions among their respective signatories.

## 4. Expectations of the EU

Since the entry into force of the Lisbon Treaty in late 2009, the EU has held exclusive competence to negotiate on foreign trade and investment matters on behalf of its 28 Member States.<sup>89</sup> Although there are presently many concurrent issues vying for the EU's attention, the European Chamber believes the EU's economic and trade relations with China should be prioritised. China, despite its challenging business environment, still offers significant potential to European companies. It is also a source of growth for Europe and a strategic partner for companies that do business globally, thus ensuring jobs in Europe as well, and is a place where European small and medium-sized enterprises (SMEs) have been and can continue to be successful.

In order to engage with China effectively, the EU needs a comprehensive strategy that is based on a deep understanding of China's business environment and investment climate. The European Parliament should

<sup>85</sup> See page 109 of the *Public Procurement Position Paper 2015/2016* for more information.

<sup>86</sup> Ibid

<sup>87</sup> Ibid

<sup>88</sup> *Deal reached on cuts to global IT tariffs*, *Financial Times*, 19<sup>th</sup> July, 2015, viewed 21<sup>st</sup> July, 2015, <<http://www.ft.com/intl/cms/s/0/5f581672-2dce-11e5-8873-775ba7c2ea3d.html#axzz3gOi2XoeQ>>

<sup>89</sup> *Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community*, European Commission, 13<sup>th</sup> December, 2007, viewed 10<sup>th</sup> July, 2015, <<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:12007L/TXT>>

regularly analyse China's trade policies and actions—as is common practice in the US<sup>90</sup>—in order to make the informed decisions needed to instigate meaningful dialogue with Beijing.

At the same time, it is fundamentally important that there is greater alignment between the European Parliament, the European Commission and the EU's 28 Member States – they need to have a unified, results-orientated strategy and speak with one voice. Messages must not be diluted by partisan policy considerations to the benefit of one individual Member State but the detriment of others.

No ongoing policy initiatives between the EU and China should be interpreted outside the context of bilateral economic negotiations. On the contrary, these exchanges need to afford our bilateral trade relationship—the second biggest in the world<sup>91</sup>—the importance it deserves, and feed into it in a positive way.

The EU's and China's interests in maintaining the openness of the international trading system are aligned precisely because of their successful trade relationship. The European Chamber greatly appreciated that the EU and China reaffirmed their shared commitment to ensure an “open global economy” and a “fair, transparent and rules-based trade and investment environment” at the 17<sup>th</sup> EU-China Summit held in Brussels on 29<sup>th</sup> June, 2015.<sup>92</sup>

The sheer complexity of China's reform endeavour means that the implementation of reforms that would meaningfully benefit both foreign enterprises and China is far from a foregone conclusion, though, and the EU leadership would be unwise to take it for granted that this will eventually happen – the continued existence of vested interest groups in various parts of the Chinese economy is still an obstacle in this respect.

It is necessary for the European Commission to frequently engage in structured dialogue and negotiations with its Chinese counterparts. The kind of high-level engagement undertaken by the new Commission is exactly what is required, and is a fundamental aide to helping European business achieve its aims. The European Chamber applauds the EU-China High-Level Economic Dialogue and the positive outcomes that have resulted from it.

The European Chamber believes that the ongoing CAI negotiations provide by far the best platform for resetting EU-China bilateral economic relations and levelling the playing field for European and Chinese business.

### **The EU-China Comprehensive Agreement on Investment**

The EU and China entered into bilateral negotiations for a CAI in January, 2014, and European business is pleased to see that the negotiations are advancing. Hopes are high for a successful conclusion to the negotiations – a treaty that could promise China a new growth surge reminiscent of its WTO accession. The European Chamber appreciated the renewed commitment the EU and China made during the summit in June, 2015, during which the CAI was referred to as “one of the most important issues in EU-China bilateral economic and trade relations.”<sup>93</sup>

European business hopes that China will follow through with its commitment to conclude these

90 The United States Trade Representative (USTR) annually presents the *Report to Congress on China's WTO Compliance* to the United State Congress. The latest report for 2014 can be found here: *2014 Report to Congress on China's WTO Compliance*, USTR, 2014, viewed 9<sup>th</sup> July, 2015, <<https://ustr.gov/sites/default/files/2014-Report-to-Congress-Final.pdf>>

91 *Facts and Figures on EU-China Trade*, European Commission, March, 2014, viewed 17<sup>th</sup> June, 2015, <[http://trade.ec.europa.eu/doclib/docs/2009/september/tradoc\\_144591.pdf](http://trade.ec.europa.eu/doclib/docs/2009/september/tradoc_144591.pdf)>

92 *17<sup>th</sup> EU-China Summit Joint Statement*, European Commission, 29<sup>th</sup> June, 2015, viewed 14<sup>th</sup> July, 2015, <[http://europa.eu/rapid/press-release\\_IP-15-5279\\_en.htm](http://europa.eu/rapid/press-release_IP-15-5279_en.htm)>

93 *EU-China Summit Joint Statement: The way forward after forty years of EU-China cooperation*, Council of the European Union, 29<sup>th</sup> June, 2015, viewed 21<sup>st</sup> July, 2015, <[www.consilium.europa.eu/en/.../06/150629-eu-china-joint-statement](http://www.consilium.europa.eu/en/.../06/150629-eu-china-joint-statement)>



negotiations, as per the *Decision*.

“We will expedite the signing of investment agreements with relevant countries and regions.”

*Third Plenum Decision, Article 24*

European business hopes that the CAI will, more than anything else, secure increased market access for European companies in China. As such, any negotiated CAI will have to go substantially beyond the bilateral investment treaties that China has already signed with 27 individual EU Member States. Furthermore, European business hopes that the CAI will include an effective Investor-State Dispute Settlement mechanism with state-of-the-art investor protection, as well as a chapter dedicated specifically to SMEs. Such inclusions will be mutually beneficial for European and Chinese companies.

## 5. The Audacity to Change

The Chinese leadership is faced with the considerable challenge of mitigating the effects of a secular economic slowdown. A large part of the solution will be the successful transition to the ‘new normal’, an era in which China will embrace an economic model that can deliver sustainable, qualitative growth. This is contingent upon China giving free rein to market forces, where enterprises of all nationalities can enjoy independent management and fair competition.

This is well within the Chinese Government’s reach if it can have the courage of its convictions and stick to the bold reform pledges made in the *Decision* and not give in to the protectionist tendencies that are continuing to curtail legitimate market access, whether on the grounds of national security or other concerns. It is unfortunate that a great deal of resolve and reform momentum seems to have been lost since the *Decision* was promulgated. As many of the experiences of European business documented in this position paper demonstrate, there has been little or no progress with a large number of the policies required to set China on the road towards the ‘new normal’.

Foreign business is an important stakeholder in China’s reform process, and it both wants and needs China to sustain its economic success story. China’s economy has a reciprocal need for foreign investment in order to get its innovation drive off the ground – this will require a swift dismantling of market access barriers. As such, the European Chamber believes that the principles of the *Decision* should form the basis of China’s 13<sup>th</sup> Five-Year Plan (2016–2020).

A successful rebalancing of the Chinese economy will require an adroit sequencing of macroeconomic policies; it will require the ability to let go of the impulse to micro-manage the domestic economy; and it will require the courage to follow through with overdue, but critical, structural reforms. In short, it will require the audacity to change.



**European Chamber**  
中国欧盟商会

## **Section Two:** **Horizontal Issues**



## Horizontal Issues

The position papers in this section address the main horizontal issues affecting European businesses in China across multiple sectors. They include:

- Compliance and Business Ethics;
- Environment;
- Finance and Taxation;
- Human Resources;
- Intellectual Property Rights;
- Inter-Chamber Small and Medium-sized Enterprise;
- Legal and Competition;
- Public Procurement;
- Research and Development; and
- Standards and Conformity Assessment.

The Fourth Plenum's *Decision on Major Issues Concerning Comprehensively Advancing the Rule of Law*, issued in October 2014, set out the blueprint for the advancement of the rule of law. This commitment of the Chinese leadership was welcomed by the European business and legal community. However, quick and resolute implementation of concrete measures—especially measures to reduce 'red tape' and reform the judicial system—are still needed to establish European businesses' confidence in the Chinese legal system and address the regulatory challenges that hamper China's economic development.

Compliance and business ethics are of utmost importance to European businesses in all markets where they operate. The unpredictable legal environment in China, including a lack of clarity over the current anti-bribery legislation, continue to pose challenges to all businesses. The newly-created Compliance and Business Ethics Working Group serves as a platform for European Chamber members to discuss their experiences and challenges as well as promote further legal clarity.

China's revised Environmental Protection Law, in effect since January 2015, is perceived as the most progressive and stringent piece of legislation in the history of environmental protection in China, with unlimited penalties for environmental offences and provisions for tackling pollution and raising public awareness.

Progress was also made in specific areas with the release of the *Action Plan for Water Pollution Prevention and Control* in April 2015, an ambitious plan to clean up water pollution over the next five years. It is anticipated that the *Soil Pollution Prevention and Control Action Plan* will be published later in 2015. While it is too early to judge the effectiveness of these recent laws and regulations, the key question always remains as to whether strict regulatory enforcement and monitoring will be applied locally, regionally and nationally, a critical issue that has been addressed in the *Environment Position Paper* over the years.

Innovation remains a key priority of the Chinese Government. The Research and Development (R&D) Working Group aims to support innovation in China by promoting dialogue and transparency

in the field of R&D policy, including the financial incentives framework and equal participation in the standards-definition process. Innovation can only succeed if the intellectual property that is created is adequately protected and transfer of technology happens on a voluntary basis. While there have been improvements, many issues around the protection of trademarks, copyrights and patents remain, especially as far as enforcement is concerned.

In the context of innovation, mobility of young researchers and R&D managers remains an issue. Pollution and high individual income tax rates remain hurdles in hiring and retaining foreign talent, while a lack of flexibility in labour regulations hinders retention of local talent.

In the area of conformity assessment, the last year saw new regulations driving forward three major reforms: the reform of the standardisation system; the reform of the China Compulsory Certification (CCC) Scheme; and the reform of the China Testing and Inspection System. While this progress is welcome, efforts need to be stepped up to bring China's practices in line with World Trade Organisation Technical Barriers to Trade (WTO/TBT) principles, ensure equal market access for all players and guarantee transparent market surveillance.

In late December 2014, China submitted its fifth offer for entry to the Government Procurement Agreement under the WTO. While some improvements were observed compared with the fourth offer of late 2013, this latest offer only covers procurement under the umbrella of the Ministry of Finance, leaving a large procurement market currently dominated by state-owned enterprises unmentioned.

The *Implementation Rules to the Government Procurement Law* (order no. 658) (*Implementation Rules*), released by the State Council in late 2014, was welcome as it doesn't distinguish between local and foreign suppliers and states that all bidders should be treated equally. However, the prevailing Government Procurement Law (GPL) still requires that government agencies favour local Chinese products, yet at the same time neither the GPL nor the *Implementation Rules* provide a definition of 'Chinese products'.

## Compliance and Business Ethics Working Group

### Key Recommendations

- 1. Ensure an International and Uniform Approach to Anti-Bribery Legislation and Enforcement**
  - Refer to the United Kingdom (UK) Bribery Act and the Foreign Corrupt Practices Act (FCPA) for best practices and guidance.
  - Increase cooperation with foreign investigation agencies such as the UK Serious Fraud Office or the United States (US) Department of Justice and conduct joint enforcement actions.
- 2. Increase Clarity of Anti-Bribery Legislation Including the Establishment of Clear Criteria to Determine Whether a Certain Act Constitutes Commercial Bribery or a Legitimate Business Practice**
  - Clarify and simplify anti-bribery legislation in China, preferably to a single criminal law regime and a single civil law regime, with clear and consistent definitions of 'bribery' and 'commercial bribery' and official interpretations of key terms.
  - Simplify and limit the number of institutions responsible for anti-bribery investigation, prosecution and enforcement and clearly specify their authority, including guidance on the processes to be followed in the event of an investigation, in order to ensure fair and uniform enforcement.
  - Grant access to legal representation and an adequate right to self-defence.
- 3. Raise Compliance Standards in Collaboration With Companies**
  - Introduce the principle of Adequate Procedures, in addition to a willingness to cooperate and admit to mistakes, whereby companies can secure reduced or even no punishment as a reward for doing their best to prevent corruption.
  - Provide guidance to companies on what is meant by 'good compliance' through case studies to illustrate examples of what is expected of companies in terms of policies and procedures, and how they should respond.
  - Reinforce awareness of anti-bribery regulations within the business community and encourage all companies to adopt modern and sophisticated compliance systems and policies.

### Introduction to the Working Group

Created in 2015, the Compliance and Business Ethics Working Group aims to create a trusted environment for European Chamber members to discuss their experiences and the challenges they face with respect to compliance and business ethics, as well as to promote greater clarity on anti-bribery legislation. By sharing their experiences, the working group aims to

foster the learning and development of its members and thereby enhance the quality of compliance among Chamber member companies operating in the People's Republic of China (PRC). The working group is active in Shanghai and Beijing and membership is open only to industry representatives, including: (i) in-house counsels; (ii) Compliance officers; and (iii) internal auditors.



## Recent Developments

### Decision on Some Major Issues Concerning Comprehensively Deepening the Reform (the Decision) (Third Plenum)<sup>1</sup>

Since he took office back in 2012, President Xi Jinping made a pledge to crack down on corruption, an endemic problem in China that is putting long-term sustainable economic development at risk.

This campaign has become an even higher priority since the Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee (CPCCC) in November 2013. In the *Decision* the fight against corruption was identified as one of the current main government goals, and since then the number of investigations has increased at an unprecedented rate.

A main consequence of the focus on anti-graft in China is the increased significance that compliance programmes have for business operating here. It has helped to accelerate the adoption of internal compliance practices among companies and has facilitated the acceptance of compliance protocols by third parties, especially state-owned enterprises (SOEs). Although further improvement is needed—particularly with regard to the enforcement of laws—the Compliance and Business Ethics Working Group welcomes these developments as a positive step in the reform process.

## Key Recommendations

### 1. Ensure an International and Uniform Approach to Anti-Bribery Legislation and Enforcement

#### Concern

Anti-Bribery legislation in China diverges in many respects from international standards.

#### Assessment

With the enactment of the United Kingdom (UK) Bribery Act in 2010, and the increased enforcement of the Foreign Corrupt Practices Act (FCPA) from the United States (US), as well as other relevant international regulations, companies are further focusing on the creation/improvement of their compliance programmes

worldwide. The fact that anti-bribery legislation in China diverges in many aspects from international standards places additional strain on their daily activities as globally-implemented compliance programmes need to be significantly modified to adapt to local circumstances and regulations. The Compliance and Business Ethics Working Group encourages the Chinese authorities to introduce and implement regulations that follow international standards as much as possible. Replicating good practices and guidance provided by foreign laws and rules will not only contribute to the clarity of processes and investigations, it will also contribute to international trade. A legislative and regulatory environment that is more recognisable, predictable and transparent would promote foreign investment in China, including raising the levels of trust in Chinese companies. It would also facilitate Chinese investment abroad as Chinese companies would recognise and be able to prepare for many of the expectations of foreign stakeholders.

A good dialogue between the Chinese anti-bribery authorities and foreign anti-bribery authorities, as well as between these authorities and companies, will create a healthy dynamic that will contribute to the development of a better level of compliance to the benefit of all. Good compliance could become a competitive advantage for both Chinese and foreign companies alike.

#### Recommendations

- Refer to the UK Bribery Act and the FCPA for best practices and guidance.
- Increase cooperation with foreign investigation agencies such as the UK Serious Fraud Office or the US Department of Justice and conduct joint enforcement actions.

### 2. Increase Clarity of Anti-Bribery Legislation Including Establishing Clear Criteria to Determine Whether an Act Constitutes Commercial Bribery or a Legitimate Business Practice

#### Concern

Legislation and enforcement in China lack clear criteria to distinguish commercial bribery from a legitimate business practice; clarification is also required regarding the implementation of laws and the process and sanctions that accompany them.

<sup>1</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.







### Assessment

The Compliance and Business Ethics Working Group is pleased that comprehensively advancing the rule of law in China was adopted as a central topic of the Fourth Plenum of CCCPC and that China has placed even greater emphasis on its campaign against graft and corruption since. The working group acknowledges the significant efforts made by various government authorities over the years to: (i) define ‘commercial bribery’ in the *Provisional Rules on Prohibition of Commercial Bribery Activities*<sup>2</sup> (the *1996 State Administration for Industry and Commerce (SAIC) Rules*) (*1996 SAIC Rules*); (ii) provide policy guidelines in the *Opinions Concerning Correctly Mastering Policy Lines in the Special Tasks for Handling Commercial Bribery Cases*; <sup>3</sup> and (iii) clarify acts of corruption in the *Interpretations of Several Issues Concerning the Specific Applications of the Law in the Handling of Criminal Bribery Cases*.<sup>4</sup>

The PRC Anti-unfair Competition Law (AUCL)<sup>5</sup> provides that a business operator is prohibited from “giving bribes in the form of property or other means for the purpose of selling or purchasing products”, but may expressly offer discounts to the counterparty or pay commissions to the middlemen, provided that such discounts or commissions are faithfully recorded in their respective accounts. The *1996 SAIC Rules* define ‘commercial bribery’ as an activity by which a business operator bribes the other party to the transaction in the form of property, or other means, for the purpose of selling or purchasing products. The ‘property’ means cash and/or physical property that is falsely reported as promotional costs, advertising expenses, donations, research costs, service fees, consultation fees or commission. Together, the 1993 AUCL and the *1996 SAIC Rules* provide some concrete criteria for what can be considered ‘expressly and on the book’ and ‘secret and off the book’ to distinguish legitimate discounts or commissions from kickbacks or commercial bribes. However, existing published laws and regulations do not offer any clear and consistent criteria to distinguish

legitimate business costs such as promotion, research, consultation and donations from allegedly false ones. An example would be an incentive trip for dealers. While in general a company can organise incentive trips for its dealers, there is a lack of uniform criteria to determine when an incentive trip becomes commercial bribery. This uncertainty impairs business operators’ ability to formulate and enforce their policy against commercial bribery.

The Compliance and Business Ethics Working Group also acknowledges the authorities’ determination and significant progress in combatting corruption and creating a level playing field with respect to enforcement against both domestic and foreign businesses. However, there is a lack of clarity with respect to the mandate of the different authorities involved in anti-bribery enforcement. In some respects their authority overlaps and their objectives differ while involved in the same investigation, as is the case when the SAIC transfer potential criminal cases to the Public Security Bureau (PSB). Furthermore, the variety in local practice makes this issue more complicated. Consequently, companies operating nationwide very often find no regulation or precedent on which they can rely.

With consistency in enforcement there comes a greater willingness and ability to cooperate to the satisfaction of all involved. Today, it remains unclear what the rights of companies and employees are in the event of an investigation by the authorities in China. Even without adopting basic principles of due process and right to counsel, as applied in Europe and the US, the authorities and companies should be assisted with more details on rights and obligations in an investigation, the time lines and what the expectations are in practical terms. The working group holds the view that the interests of both the authorities and the companies are best served with access to legal representation and an adequate right to defend oneself, e.g. being afforded access to advice and time to respond to or refute allegations.

### Recommendations

- Clarify and simplify anti-bribery legislation in China, preferably to a single criminal law regime and a single civil law regime, with clear and consistent definitions of ‘bribery’ and ‘commercial bribery’ and official interpretations of key terms.
- Simplify and limit the number of institutions

2 State Administration for Industry and Commerce (SAIC), 15<sup>th</sup> November, 1996, viewed 25<sup>th</sup> June, 2015, <[http://www.saic.gov.cn/zcfg/xzgzjgfwj/199611/t119961115\\_46580.html](http://www.saic.gov.cn/zcfg/xzgzjgfwj/199611/t119961115_46580.html)>

3 State Council’s (SC’s) Leadership Team on Handling Commercial Bribery, 28<sup>th</sup> May, 2007, viewed 25<sup>th</sup> June, 2015, <[http://govinfo.nlc.gov.cn/jxsfz/xxgk/jxsgsxzgj/201206/t20120613\\_2013893.shtml](http://govinfo.nlc.gov.cn/jxsfz/xxgk/jxsgsxzgj/201206/t20120613_2013893.shtml)>

4 Jointly promulgated by the Supreme People’s Court (SPC) and the Supreme People’s Procuratorate (SPP) on 26<sup>th</sup> December, 2012, viewed 25<sup>th</sup> June, 2015, <[http://www.spp.gov.cn/fifg/sfjs/201301/t20130101\\_52307.shtml](http://www.spp.gov.cn/fifg/sfjs/201301/t20130101_52307.shtml)>

5 National People’s Congress (NPC), 2<sup>nd</sup> September, 1993, viewed 25<sup>th</sup> June, 2015, <[http://www.npc.gov.cn/wxzl/gongbao/2000-12/05/content\\_5004600.htm](http://www.npc.gov.cn/wxzl/gongbao/2000-12/05/content_5004600.htm)>





responsible for anti-bribery investigation, prosecution and enforcement and clearly specify their authority, including guidance on the processes to be followed in the event of an investigation in order to ensure fair and uniform enforcement.

- Grant access to legal representation and an adequate right to self-defence.

### 3. Raise Compliance Standards in Collaboration With Companies

#### Concern

Companies setting high compliance standards are not rewarded with milder treatment by the authorities and/or lower fines when a bribery issue arises.

#### Assessment

At present the UK Bribery Act 2010 is recognised as the gold standard in anti-bribery legislation. Under both UK and Chinese legislation companies can be held liable for the acts of their employees. However, it is recognised that no bribery prevention regime is capable of preventing bribery at all times. Therefore UK legislation recognises the defence of Adequate Procedures, which means that if companies can show they took certain actions to prevent bribery they may be 'rewarded' with a partial or full defence. Other factors remain relevant, such as the willingness to cooperate with the authorities.

The defence of Adequate Procedures will depend on specific circumstances including the nature, scale and complexity of the organisation and the risks it is exposed to. Procedures are expected to be proportionate to risk.

This approach also promotes greater transparency and commitment to a strong compliance framework as companies are encouraged to continue to work on better controls and compliance, and may provide guidance for other companies on what to follow in terms of best practices. Consequently, it leads to continuous improvement to the benefit of the authorities, companies, their shareholders and society as a whole thereby contributing to a further reduction in bribery risk. Adequate Procedures covers the following six principles:

#### 1. Proportionate procedures

Companies need to put in place policies and

procedures that are clear, practical, accessible, effectively implemented and enforced. These measures will help to maintain an anti-bribery stance and create an anti-bribery culture. Such procedures can address a wide range of subjects, such as due diligence, gifts and hospitality, authority schedules, different third-party relationships, disclosure of information, enforcement, whistle blowing procedures, communication, training and monitoring.

#### 2. Top Level Commitment

Top level management should foster a culture in which bribery is never acceptable. Management should be involved in key decisions or communication on the subject of bribery in order for the anti-bribery policy to be effective, including explaining why it is so important, what the benefits of being compliant are to the company and the consequences of not abiding by the rules (e.g. zero tolerance). Furthermore, top-level management should be committed to applying the resources necessary to make the stated policies effective.

#### 3. Risk Assessment

Depending on its nature and size, each organisation will need to introduce a form of risk assessment, which covers bribery risk, in order to understand the possible exposure and identify effective measures to reduce that risk. Such assessments should include both external risks (e.g. country, market, transaction, business opportunity and business partnership risk) as well as internal risks (e.g. deficiencies in training, incentives, governance or financial controls).

Risk assessments will need to be carried out on a regular basis in order to address the challenges of new markets and a changing environment. Accurate and appropriate documentation of the risk assessment and its conclusions forms an important element in this process and contributes to the transparency of the organisation on its journey of continuous compliance improvement.

#### 4. Due Diligence

Due diligence plays an important role in mitigating bribery risk. This effort could encompass the process of the selection of third-party agents and distributors, but also understanding the risks associated with a joint venture partner or business which will be acquired. Depending on the risk, and keeping in mind that employees represent the company, recruitment





processes may also include a form of due diligence.

### 5. Communication

Training increases the awareness and understanding of both employees and third parties. It also provides the knowledge and skills required to apply the company's policies and procedures, and deal with any compliance matters which may arise. Training should meet the specific risks and needs of the different parts of the organisation.

While internal communications should emphasise the tone from the top, external communications provide reassurance to third parties of what the company stands for. Typically an annual report will include a chapter on compliance. Internal communications and processes must include a whistle blower procedure which should be easily accessible to all employees.

### 6. Monitoring and Review

Companies should monitor and evaluate the effectiveness of their anti-bribery policies and procedures and amend them where necessary to meet the demands of changes inside and outside the company. This monitoring can be done, for example, through staff questionnaires, compliance audits, information from and practices at other companies as well as through external verification.

Further to the adoption of this approach, providing guidance to companies on what is meant by 'good compliance' is required in order for them to know what to do in terms of policies and procedures, and how they should respond. This guidance could be granted through case studies, providing examples to companies that would reinforce their awareness of anti-bribery regulations, resulting in better compliance systems within the company.

### Recommendations

- Introduce the principle of Adequate Procedures, in addition to a willingness to cooperate and admit to mistakes, whereby companies can secure reduced or even no punishment as a reward for doing their best to prevent corruption.
- Provide guidance to companies on what is meant by 'good compliance' through case studies to illustrate examples of what is expected of companies in terms of policies and procedures, and how they should respond.
- Reinforce awareness of anti-bribery regulations

within the business community and encourage all companies to adopt modern and sophisticated compliance systems and policies.

## Abbreviations

AUCL	Anti-unfair Competition Law
CPCCC	Communist Party of China Central Committee
FCPA	Foreign Corrupt Practices Act
NPC	National People's Congress
PRC	People's Republic of China
PSB	Public Security Bureau
SAIC	State Administration for Industry and Commerce
SOE	State-Owned Enterprise
UK	United Kingdom
US	United States



## Environment Working Group

### Key Recommendations

#### 1. Improve Solid Waste Management Practices in China

- Adjust the number of licences to operate hazardous waste treatment facilities in cities.
- Enable the transfer of hazardous waste between provinces.
- Consider international references in the pre-qualification stage for waste-to-energy projects; do not limit references to facilities located in China.
- Enforce waste laws and regulations in a more even and transparent manner.

#### 2. Promote More Aggressively the Use of Unconventional Water and Develop Sponge Cities to Solve China's Water Scarcity Problem and Avoid Floods

- Implement a pricing mechanism to encourage the use of unconventional water.
- Increase investment in infrastructure for reusable wastewater.
- Develop rainwater collection and utilisation systems.
- Carry out seawater desalination in coastal areas.

#### 3. Strengthen Research and Development (R&D) and Innovation of Sludge Treatment and Disposal Technologies to Better Meet the Demands of the Chinese Market

- Enhance R&D of sludge dewatering technology to further increase the sludge dewatering rate.
- Include foreign experiences and technology to improve local management of sludge digestion projects.
- Develop innovative technology to solve the problems of high heavy-metal content in sludge.
- Find appropriate sludge disposal technology specific to projects.

#### 4. Develop a Comprehensive Regulatory Framework for the Management of Contaminated Land

- Clarify the liability chain of who, out of the polluter and the past, current and future land owners, will pay for clean-up.
- Enforce the use of risk assessment methods in the management of each contaminated site.
- Promote policies to integrate urban planning and redevelopment strategies with the implementation of on-site soil and groundwater remediation.
- Encourage the involvement of international technology and service providers in the remediation and redevelopment of contaminated sites.
- Conduct pilot projects in select regions to demonstrate the application of proven site characterisation and remediation technologies as well as innovative planning, management and redevelopment strategies.

#### 5. Improve Sustainable Forestry Management Practices in China

- Increase investment into the research and promotion of sustainable forest management practices in China.
- Promote the thinking that eucalyptus plantations can be sustainably managed within drinking water catchments.
- Train local government authorities and law enforcement agencies to understand the environmental benefits of eucalyptus plantations.





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Reinforce environment-related market access standards.	<p>Foreign professional companies are unable to invest in developing proper infrastructure due to the limited number of licences available, most of which are allocated to Chinese companies.</p> <p>Recent tenders that opened in some cities in China for municipal solid waste incineration plants have set prequalification criteria, which limit access to the Chinese market for foreign waste treatment companies with a global track record.</p>	
<p>Accelerate pricing reform for natural resources and their products to give full expression to their market supply and demand.</p> <p>Establish a market-oriented mechanism to attract private capital to ecological and environmental protection, and implement third-party treatment of environmental pollution.</p>	<p>Under the pressure of the consumer price index, local governments tend to delay or reduce any increase of the price of drinking water. This puts pressure on water suppliers who, in response, have to manage their service quality to a lower level to off-set the additional loss.</p> <p>Hence, more related laws and regulations are required to ensure a genuine public-private partnership, in which contracts must be obeyed and both parties must carry equal responsibility.</p>	
Change the current environmental protection fee to an environment tax	The Environmental Tax Law has yet to take effect.	

## Introduction to the Working Group

The Environment Working Group was established in 2006, and currently consists of more than 150 member companies involved in engineering, manufacturing, construction and certification services. The members represent a diversity of industry sectors, such as waste, water, smart grid, chemicals and pharmaceuticals, and logistics. Environmental technology service providers, environmental consultants and lawyers are also active members of the working group.

The working group serves as a channel to engage government stakeholders, particularly the Ministry of Environmental Protection (MEP) and its local bureaus, and provides regular feedback on environmental regulations, standards and technologies in China. Additionally, it provides a platform for companies to share best practices, experiences, solutions and recommendations on environmental protection.

## Recent Developments

China's newly revised Environmental Protection Law, in effect since 1<sup>st</sup> January 2015, is the single most important environment-related legislation that has been published to date. It is perceived as the most progressive and stringent piece of legislation in the history of environmental protection in China, with unlimited penalties for environmental offences, and provisions for tackling pollution and raising public awareness. The law places a much higher degree of responsibility and accountability on local governments, and sets higher standards for industry.<sup>1</sup>

In the area of water, China's State Council released the *Action Plan for Water Pollution Prevention and Control* in April 2015, an ambitious action plan to clean up

<sup>1</sup> Bo, Zhang & Cong, Cao, *Four Gaps in China's New Environmental Law*, *Nature International Journal of Science*, 21<sup>st</sup> January, 2015, viewed 29<sup>th</sup> April 2015, <<http://www.nature.com/news/policy-four-gaps-in-china-s-new-environmental-law-1.16736>>



water pollution over the next five years.<sup>2</sup> The document follows a 2014 pledge by the MEP that the Chinese Government will spend more than Chinese Yuan (CNY) 70 billion to tackle the country's water issues. It promises pollution reduction, strict controls on extraction of underground water and continual improvements in drinking water quality by 2020.<sup>3</sup>

Regarding soil, the *Soil Pollution Prevention and Control Action Plan*<sup>4</sup> is expected to be published later in 2015, with a series of measures to contain the trend of worsening soil pollution in the years ahead.<sup>5</sup> It is of the highest urgency to address the lack of related laws and regulations and upgrade relevant standards to introduce innovative soil technology and enforce soil quality evaluation and monitoring to enhance soil protection in China.

While it is perhaps too early to judge the effectiveness of the recently released laws and regulations discussed above, the key question is whether strict regulatory enforcement and monitoring will be applied locally, regionally and nationally, a critical issue that has previously been addressed in the *Environment Position Paper* over the years.

## Key Recommendations

### 1. Improve Solid Waste Management Practices in China

#### Concern

China's waste management policies and practices do not properly address the waste treatment capacity available versus the waste generated, and do not provide sufficient and equal opportunities for foreign companies specialised in waste management.

#### Assessment

China lacks proper infrastructure to treat hazardous

waste in compliance with its own national environmental standards. The infrastructure developed over the last decade is insufficient in size, with a number of provinces lacking sufficient treatment capacity, and the technology is often not suitable for hazardous waste treatment. As a result most of the waste treatment facilities are not able to treat the volume of waste generated in China's cities and are therefore often not compliant with national emission standards.

Foreign professional companies are keen to invest in developing proper infrastructure but are not authorised to do so due to the limited number of licences available per province and per city in China, most of which having been allocated to local Chinese companies that are not hazardous waste treatment specialists. Chinese regulators should be more flexible in terms of licence allocation, close underperforming facilities and transfer waste treatment licences to professional companies. This will allow each province and city to build new infrastructure, increase the waste capacity available and ensure compliance with national emission standards.

In addition, hazardous waste transfer from one province to another is not authorised in China. Some provinces have already reached overcapacity, while others are operating under capacity. A proper balance between waste treatment capacity and hazardous waste generated needs to be established to ensure that all hazardous waste is treated properly and that the market price is at an equilibrium, offering a competitive price and a reasonable profit to investors. Chinese regulators should authorise the transfer of waste from one province to another in cases of overcapacity.

Recent tenders that opened in some cities in China for municipal solid waste incineration plants have set prequalification criteria, such as a minimum number of plants in operation in China. These criteria limit access to the Chinese market for foreign waste treatment companies by requiring in-China experience and disregarding their global track record. Chinese cities could benefit from foreign experiences in terms of operational skills and technologies, and foreign companies specialised in waste treatment with international experience should be invited to build and operate new infrastructure.

Moreover, law enforcement needs to be more transparent and apply evenly to local Chinese

2 State Council Notice on Action Plan for Water Pollution Prevention and Control, 2<sup>nd</sup> April, 2015, viewed 16<sup>th</sup> June 2015, <[http://www.gov.cn/zhengce/content/2015-04/16/content\\_9613.htm](http://www.gov.cn/zhengce/content/2015-04/16/content_9613.htm)>

3 Hewitt, Duncan, *China Announces Ambitious Plan to Clean Up its Water, Close Down Polluting Factories*, *International Business Times*, 17<sup>th</sup> April 2015, viewed 29<sup>th</sup> April 2015, <<http://www.ibtimes.com/china-announces-ambitious-plan-clean-its-water-close-down-polluting-factories-1886320>>

4 Ministry of Environmental Protection Approves Soil Pollution Prevention and Control Action Plan, Beijing Municipal Bureau of Agriculture, 21<sup>st</sup> March 2015, viewed 16<sup>th</sup> June 2015, <<http://www.bjny.gov.cn/njj/231595/603501/603544/520012/index.html>>

5 Xiao, Lixin, *Law to Combat Soil Pollution Expected this Year*, *China Daily*, 9<sup>th</sup> March 2015, viewed 6<sup>th</sup> May, 2015, <[http://www.chinadaily.com.cn/china/2015twosession/2015-03/09/content\\_19760818.htm](http://www.chinadaily.com.cn/china/2015twosession/2015-03/09/content_19760818.htm)>



and foreign companies, with foreign companies being treated fairly in accordance with prevailing environmental regulations. Recent cases have highlighted that while foreign companies operating waste treatment plants have been publicly listed by the MEP for regulatory non-conformity, most local Chinese companies that do not comply with national regulations are not listed.

### Recommendation

- Adjust the number of licences to operate hazardous waste treatment facilities in cities.
- Enable the transfer of hazardous waste between provinces.
- Consider international references in the pre-qualification stage for waste-to-energy projects; do not limit references to facilities located in China.
- Enforce waste laws and regulations in a more even and transparent manner.

## 2. Promote More Aggressively the Use of Unconventional Water and Develop Sponge Cities to Solve China's Water Scarcity Problem and Avoid Floods

### Concern

Rapid urbanisation and industrialisation in China have put a massive strain on natural resources: the total amount of available freshwater will not grow to match national demand and many Chinese cities, particularly in the north, are facing severe water shortages.

### Assessment

According to the World Bank, renewable internal freshwater resources per capita in China stood at just over 2,000m<sup>3</sup>, as per measurements taken in 2011,<sup>6</sup> less than 30 per cent of the world average. Two thirds of Chinese cities suffer water shortages and one quarter of them are facing severe water shortages, according to the National Development and Reform Commission (NDRC).<sup>7</sup>

The reform roadmap passed at the Third Plenum mentions that China should draw redlines for ecological protection and carry out restriction measures in

resource-overloaded areas.<sup>8</sup> This means that the central government plans to tighten regulations on seizing freshwater sources, especially in areas where resources have already been exhausted.

Besides improving water efficiency China should utilise unconventional water resources, which has proved in many countries to be an effective way to deal with water challenges.

### Wastewater reuse

According to the statistics of the Ministry of Housing and Urban-Rural Development, 45 billion m<sup>3</sup> of wastewater was treated in wastewater plants across China in 2013,<sup>9</sup> most of which has not been reused. According to the plan of the Ministry of Water Resources (MWR), wastewater reuse rate will be increased to 10 per cent by the end of 2015,<sup>10</sup> which is still at a relatively low level compared with many developed countries.

If China raises its wastewater reuse rate to 30 per cent, it will have 9.02 billion m<sup>3</sup> of additional fresh water supply every year. In 2013, the country's total water supply was 64.12 billion m<sup>3</sup>.<sup>11</sup>

### Sponge cities

The idea of a sponge city is to collect and store rainwater and use it as a supplementary water resource. It can mitigate floods caused by heavy rain and can also add fresh water resources to Chinese cities.

In April 2015, the Ministry of Finance (MOF) released a list of 16 cities to take part in the pilot project on sponge cities, most of which are located in the southern part of the country.<sup>12</sup> This initiative has already proved effective in preventing floods in a number of cities, including Beijing, Shanghai, Shenzhen and Urumqi.

### Seawater desalination

A large number of coastal cities face fresh water

6 *Renewable Internal Freshwater Resources Per Capita (Cubic Meters) in China*, Trading Economics, viewed 17<sup>th</sup> April, 2015, <[www.tradingeconomics.com/china/renewable-internal-freshwater-resources-per-capita-cubic-meters-wb-data.html](http://www.tradingeconomics.com/china/renewable-internal-freshwater-resources-per-capita-cubic-meters-wb-data.html)>

7 NDRC: *China's Per Capita Fresh Water Resources Account for Only 28% of World Level*, china.com, 13<sup>th</sup> February, 2012, viewed 20<sup>th</sup> April, 2015, <[finance.china.com.cn/news/gnjj/20120213/530417.shtml](http://finance.china.com.cn/news/gnjj/20120213/530417.shtml)>

8 *CPC Central Committee Notice on Comprehensive Deepening Reform on Major Issues*, Xinhua News, 15<sup>th</sup> November, 2013, viewed 20<sup>th</sup> April, 2015, <[news.xinhuanet.com/politics/2013-11/15/c\\_118164235.htm](http://news.xinhuanet.com/politics/2013-11/15/c_118164235.htm)>

9 *Water Article 10: Can It Change Water Imbalance?*, China Environment, 9<sup>th</sup> December, 2014, viewed 20<sup>th</sup> April, 2015, <[www.cenews.com.cn/qy/qygc/201412/t20141209\\_784763.html](http://www.cenews.com.cn/qy/qygc/201412/t20141209_784763.html)>

10 *Re-Use Wastewater in Water Resources Development Areas*, YiCai News, 6<sup>th</sup> April, 2010, viewed 20<sup>th</sup> April, 2015, <[www.yicai.com/news/2010/04/332036.html](http://www.yicai.com/news/2010/04/332036.html)>

11 *2013 Urban Construction Statistics*, Ministry of Housing and Urban-Rural Development, 5<sup>th</sup> August, 2014, viewed 20<sup>th</sup> April, 2015, <[www.mohurd.gov.cn/zcfg/jsbwj\\_0jsbjwjcw/201408/t20140805\\_218642.html](http://www.mohurd.gov.cn/zcfg/jsbwj_0jsbjwjcw/201408/t20140805_218642.html)>

12 *2015 List of Pilot Sponge Cities*, China State Finance, 3<sup>rd</sup> April, 2015, viewed 20<sup>th</sup> April, 2015, <[czzz.mof.gov.cn/caijingzixun/difangdongtai/201504/t20150403\\_1212859.html](http://czzz.mof.gov.cn/caijingzixun/difangdongtai/201504/t20150403_1212859.html)>



shortages, however, China's long coast means the country has great potential to develop desalination.

According to the NDRC's plan, China's total seawater desalination capacity will increase to 2.2 million m<sup>3</sup> per day.<sup>13</sup> Seawater desalination currently only accounts for a very small part of the country's water supply, with a large number of desalination facilities not in full operation due to high processing costs.

#### Price: a key obstacle to the utilisation of unconventional water

At present, the high cost of unconventional water and the low tap water tariff in China are key obstacles that keep investors and users away from unconventional water.

Taking seawater desalination as an example, according to the NDRC's calculation, the cost of producing 1 m<sup>3</sup> of desalinated seawater is CNY 5-6, and the fixed asset investment, excluding distribution pipeline investment, per cubic metre of desalination capacity ranges from CNY 6,000 to 8,000.<sup>14</sup> This is much higher than traditional freshwater resources in most parts of the country.

Both central and local governments in China need to carry out more attractive price policies to encourage the utilisation of unconventional water, and subsidise plants that process unconventional water, when necessary.

#### Recommendations

- Implement a pricing mechanism to encourage the use of unconventional water.
- Increase investment in infrastructure for reusable wastewater.
- Develop rainwater collection and utilisation systems.
- Carry out seawater desalination in coastal areas.

### 3. Strengthen Research and Development (R&D) and Innovation of Sludge Treatment and Disposal Technologies to Better Meet the Demands of the Chinese Market

#### Concern

While currently there is strong policy support and a strict regulatory system in place for sludge treatment and disposal in China, the technology to treat and dispose sludge remains limited.

#### Assessment

Sludge is the solid or semi-solid matter produced during wastewater treatment. Since the content of hazardous substances in sludge is high, if treated improperly it will cause heavy environmental pollution. The sludge quantity from municipal wastewater treatment plants is expected to be 33.59 million tonnes by the end of 2015,<sup>15</sup> and the harmless treatment rate is only 25.1 per cent.<sup>16</sup>

China needs to urgently solve the sludge problems that have accumulated over time – this remains a key environmental challenge for local governments. Although the Chinese Government has issued policies and regulations to enforce sludge treatment, there are still some technical problems in sludge treatment and disposal that need to be solved.

Current dewatering efficiency is low, which renders subsequent treatment and disposal difficult and costly.<sup>17</sup> At present, the majority of sludge dewatering equipment in China includes centrifuges and belt pressure filters—the design of which is outdated—which has a low dewatering efficiency.

In addition, the level of sludge stabilisation treatment is low. Although alternative methods, such as anaerobic digestion, which introduces microorganisms to help break down the waste into methane and other biogases, have been funded and explored, only a fraction of China's treatment facilities capable of applying this methodology are in operation.<sup>18</sup>

According to an investigation in 2013, there were 2,600 wastewater treatment plants across China, but only 60 are equipped with anaerobic digestion facilities, and, of these, only 10 to 30 were operational, resulting in

<sup>15</sup> *Sludge's Long-Term Existence to Injure People and Ruin Land*, *People's Daily*, 3<sup>rd</sup> August, 2014, viewed 25<sup>th</sup> April, 2015, <politics.people.com.cn/n/2014/0803/c70731-25390701.html>

<sup>16</sup> *War on Sludge*, *China Water*, 19<sup>th</sup> August, 2014, viewed 25<sup>th</sup> April, 2015, <news.h2o-china.com/html/2014/08/130241\_1.shtml>

<sup>17</sup> Dewatering is one of the core processes of sludge treatment, and the effect of dewatering will impact the final expense and results of sludge disposal.

<sup>18</sup> *Urgent Investment Needed for Treatment of China's Sewage Sludge*, *China Science Review*, 13<sup>th</sup> April, 2015, viewed 25<sup>th</sup> April, 2015, <chinasciencereview.com/2015/04/13/urgent-investment-needed-for-treatment-of-chinas-sewage-sludge/>

<sup>13</sup> *National Development and Reform Commission's Notice on 12<sup>th</sup> Five-Year-Plan for Desalination Industry*, National Development and Reform Commission, 9<sup>th</sup> December, 2012, viewed 20<sup>th</sup> April, 2015, <www.ndrc.gov.cn/fzgggz/hjhb/hjjsjyxsh/201212/120121225\_520021.html>

<sup>14</sup> *Ibid*, viewed 20<sup>th</sup> April, 2015





wasted infrastructure and treatment facilities.<sup>19</sup> The main reasons for improper plant operation are the differences in sludge quality and management as well as the lack of supervision and appraisal.

Sludge contains a high content of toxic pollutants like heavy metals. Due to the lack of efficient supervision of chemical enterprises, heavy metal discharge often does not meet national sludge treatment standards, resulting in sludge that contains a high concentration of heavy metals. This has an adverse effect on sludge compost and farming. Local governments in China need to apply effective supervision standards to ensure the proper treatment of sludge.

The many different technical solutions for resourceful utilisation of sludge means that it is impossible for the Chinese Government to issue clear guidelines. Solutions are chosen on a case-by-case basis, which poses a burden to companies.

Also, due to immature technology and the difficulty of integrating the sludge treatment and disposal industry with the industry focused on the utilisation of treated sludge as a resource, most sludge resource utilisation projects—such as sludge compost and building material re-utilisation projects—are not successful in the early stages.

Although some companies have the capability to turn the sludge into a resource, it is difficult to find companies to use this resource. This results in the producer having to extend its own business line to utilise the sludge that it produced, which places yet another burden on the industry.

#### Recommendations

- Enhance R&D of sludge dewatering technology to further increase the sludge dewater rate.
- Include foreign experiences and technology to improve local management of sludge digestion projects.
- Develop innovative technology to solve the problems of high heavy-metal content in sludge.
- Find appropriate sludge disposal technology specific to projects.

## 4. Develop a Comprehensive Regulatory Framework for the Management of Contaminated Land

<sup>19</sup> Ibid

### Concern

Widespread soil and groundwater contamination poses an imminent threat to the environment, food safety and the health of China's population, and limits the redevelopment value of brownfield sites. The regulatory framework is not mature enough to facilitate effective management and clean-up of contaminated sites.

### Assessment

Pressure from clean-up and redevelopment of contaminated sites (including decommissioned industrial facilities, legacy mining sites and impacted farmlands) for real estate development, along with health and food safety concerns, has led to a significant growth of the remediation industry in China in recent years. With the April 2015 release of the *Action Plan for Water Pollution Prevention and Clean-up*<sup>20</sup> and another action plan for soil to be published in late 2015, more efforts and support at the national and local levels are anticipated for soil and groundwater remediation in China.

However, there are still a multitude of challenges for most of the ongoing and planned remediation projects in China, mainly due to the lack of a practical and implementable regulatory framework, relevant technical standards and guidance. This usually results in inadequate site characterisation, risk assessment, and poor selection and application of the most cost-effective remedies.

Inexperienced site owners, developers and regulators sometimes have unrealistic expectations of the objective, cost and timeframe of remediation, which makes it difficult for a remediation project to be properly designed and implemented, particularly for large, complex sites. In addition, risk management and remediation implementation are seldom integrated into the planning and redevelopment of contaminated sites across China.

A clearer framework for the assignment of liabilities and responsibilities for remediation work, and a risk-based approach to assessing the required standards—as well as the costs of reaching these—is required, together with systematic monitoring and investigation of sites for the specification of works. There needs to be effective

<sup>20</sup> Hewitt, Duncan, *China Announces Ambitious Plan to Clean Up its Water, Close Down Polluting Factories*, *International Business Times*, 17<sup>th</sup> April, 2015, viewed 25<sup>th</sup> April, 2015, <[www.ibtimes.com/china-announces-ambitious-plan-clean-its-water-close-down-polluting-factories-1886320](http://www.ibtimes.com/china-announces-ambitious-plan-clean-its-water-close-down-polluting-factories-1886320)>



on-site treatment of contamination, which requires the implementation of different technologies and a minimisation of movement of hazardous material and dumping in new locations.

In addition to the introduction and localisation of soil and groundwater treatment technologies, the development of professional services in the planning and project management stages, as well as the integration of multiple contractors is necessary to deliver solutions. Experienced foreign professionals can provide related training and know-how, and work with national and local government regulators, and domestic Chinese companies to develop the knowledge and capacity to address this problem in the coming years.

#### Recommendations

- Clarify the liability chain of who, out of the polluter and the past, current and future land owners, will pay for clean-up.
- Enforce the use of risk assessment methods in the management of each contaminated site.
- Promote policies to integrate urban planning and redevelopment strategies with the implementation of on-site soil and groundwater remediation.
- Encourage the involvement of international technology and service providers in the remediation and redevelopment of contaminated sites.
- Conduct pilot projects in select regions to demonstrate the application of proven site characterisation and remediation technologies as well as innovative planning, management and redevelopment strategies.

## 5. Improve Sustainable Forestry Management Practices in China

#### Concern

Unsustainable forestry practices that can still be found in many parts of China contribute to inefficient land use, and sustain existing prejudices regarding the negative impact of eucalyptus on groundwater resources.

#### Assessment

Today, China has the world's third-largest eucalyptus plantation estate, estimated at over four million hectares in 2013. The market for eucalyptus wood is very strong, following the development of the rotary veneering and plywood industries as well as the increasing use of eucalyptus as pulpwood. Eucalyptus plantations also

contribute to carbon absorption at a rate of 6.6 tonnes of carbon per square hectometre (tC/hm<sup>2</sup>) for medium age plantations and 5.6 tC/hm<sup>2</sup> for mature plantations.

A majority of eucalyptus plantations in China are located in the southern provinces, where the landscape is hilly, and plantations are often located on steep slopes, where soil is shallow and, therefore, might have low water holdings.<sup>21</sup> Burning to clear the previous vegetation before planting remains common practice, which creates the risk of soil erosion and the loss of important nutrients, as ash is blown or washed away during rainy periods.

Poor forest management practices lead to lower productivity and, at the same time, might have a negative impact on stream water quantity, quality and biodiversity. It is therefore important to further teach, research and promote the correct usage of the terrain and soil processes in order to achieve a more cost effective and sustainable use of land.

One of the major concerns of communities living in close proximity to eucalyptus plantations is the potential impact that the fertiliser has on water reservoirs. Most growers today apply high amounts of fertiliser based on prescriptions developed in the 1980s.<sup>22</sup> While these have been useful in the past, a lot has happened since then and they may no longer be applicable in relation to the developments that have been made with faster growing and more resistant eucalyptus clones.

In order for eucalyptus plantations, and the forestry industry in general, to reach their full potential there is a need to move away from potentially unsustainable management practices and increase investment in promoting and researching sustainable forestry practices. This will not only increase the productivity of the forestry sector in China, it will also help address existing prejudices regarding the negative impact of eucalyptus to biodiversity and groundwater resources.

Sustainably-managed eucalyptus plantations have significant environmental benefits over other forms of land use, such as agriculture, given the longer rotation lengths, sequestration of greenhouse gases and less

21 Harwood, C.E. & Nambiar, E.K.S., *Sustainable Plantation Forestry in Southeast Asia*, Australian Centre for International Agricultural Research, 18<sup>th</sup> December, 2014, viewed 13<sup>th</sup> May, 2015, <[http://aci-ar.gov.au/files/tr\\_84\\_web.pdf](http://aci-ar.gov.au/files/tr_84_web.pdf)>

22 Ibid



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intensive management. Too often, plantation forestry is unfairly discriminated against. In particular, eucalyptus plantations are often frowned upon or, even worse, legislated against in drinking water catchments. The reality is that well managed plantations can either maintain or enhance drinking water quality, and there is no scientific justification for the banning of eucalyptus plantations in water catchments.

### Recommendations

- Increase investment into the research and promotion of sustainable forest management practices in China.
- Promote the thinking that eucalyptus plantations can be sustainably managed within drinking water catchments.
- Train local government authorities and law enforcement agencies to understand the environmental benefits of eucalyptus plantations.

## Abbreviations

CNY	Chinese Yuan
MEP	Ministry of Environmental Protection
NDRC	National Development and Reform Commission
R&D	Research and Development
tC/hm <sup>2</sup>	Tonne of carbon per square hectometre





# Finance and Taxation Working Group

## Key Recommendations

### 1. Improve the Overall Legislative Process

- Conduct more public consultations prior to introducing new regulations that would have a significant impact on resident and non-resident taxpayers, involving professional tax specialists, academics and industry experts, and allowing reasonable time to comment.
- Upgrade the major indirect tax rules to the highest level of legislation so that taxpayers can enjoy more stability and certainty with respect to major tax treatment.
- Provide nationwide implementation regulations with a specific timeframe, when applicable, to ensure enforcement at the local level is consistently in accordance with central-level laws and regulations.
- Provide more lead time to taxpayers so that they can fully understand and prepare for the implementation of significant changes to tax compliance requirements.
- Set up an effective mechanism to harmonise the assessment/treatment by the tax authorities and customs authorities in terms of transfer pricing / valuation position in relation to import activities.
- Provide information about the status of tax treaties being negotiated or ratified and important court cases on the official State Administration for Taxation (SAT) website as is done by other tax authorities.
- Ensure a timely ratification of tax treaties which are finalised and signed by both parties.
- Provide a more comfortable and friendly environment for taxpayers to exercise their legal rights to raise any tax-related disputes to the courts.

### 2. Modernise Corporate Restructuring Rules

- Explicitly include upstream, downstream and sidestream mergers of Chinese entities into the scope of tax-neutral mergers if preconditions are met.
- Explicitly include the merger of two foreign-invested enterprises (FIEs) under a foreign shareholder into the scope of tax-neutral mergers if preconditions are met.
- Expand the scope of 'cross-border transactions' to cover different types of share transfers if preconditions are met.
- Allocate a clear division of responsibilities to the relevant authorities, combined with a clear administrative process and deadlines for the decision and formal notification of the tax payer.
- Provide more guidance as to how 'proper commercial reasons' shall be understood and assessed in practice.

### 3. Set up an Advance Tax Ruling System at a Local Level in Order to Create Certainty for Investors

- Establish an advance ruling system that is transparently administered by the SAT.
- Ensure local tax bureaus review advance ruling applications first before referring them to the SAT for a final ruling and determination, to ensure that the SAT's resources are not exhausted.
- Publish all rulings on the SAT's website providing a summary of the facts, the taxpayer's views, the SAT's ruling/final decision and the legal basis and reasons for their conclusion, while protecting the taxpayer's information.
- Ensure that when the SAT issues an advance ruling over a tax-related matter submitted by a



taxpayer, all Chinese tax authorities abide by the ruling, with the tax ruling ceasing to be binding in the event of a change in the law or if any material errors are discovered in the information upon which the advance ruling was given.

- Allow both prospective and past transactions to fall within the scope of matters to be covered by the advance ruling system.
- Provide tax rulings to taxpayers free of charge.
- Respond to taxpayers' advance ruling requests within a specified timeframe depending on the circumstances and urgency of the situation.

#### 4. Issue Clear and Comprehensive Guidelines for the Implementation of Permanent Establishment (PE) Taxation in China

- Issue a new circular to provide clear and comprehensive guidelines as to the implementation of, as well as application procedures and required documentation pertaining to, PE tax regulations.

#### 5. Update Consumption Tax Regulations

- Review the scope of consumption tax and update it according to economic growth and the evolution of consumption habits.
- Exempt luxury consumer goods and items which are not harmful to the environment.
- Allow tax credit on consumption tax paid on raw materials.
- Review and balance the various tax rates among the different categories of goods to incentivise new consumption habits.
- Harmonise the interpretation of consumption tax between tax authorities and customs authorities.
- Update taxation methods based on international best practices regarding taxpayers, taxing basis and tax collection channels.

## Introduction to the Working Group

The Finance and Taxation Working Group consists of member firms from multinational companies (MNCs), international professional services firms and law firms operating in China. The objective of the working group is to engage in an effective dialogue with regulators to develop a more workable, coherent and integrated set of taxation, finance and accounting rules, in line with international best practices. The working group's recommendations are not sector specific but represent the interests of all member companies of the European Chamber.

## Recent Developments

The Finance and Taxation Working Group was active in 2015. Business tax to value-added tax (VAT) reform, the VAT Pilot, offshore indirect equity transfer rules and the Taxation Collection Administration Law were all in the spotlight. As China works to build a financial system

worthy of its economic status the reforms outlined in this paper will play a key part in upgrading the country's business regulatory and legal environment in line with international best practices.

The business tax to VAT reform should be completed in 2015, as originally planned. This year is a key period for expanding the scope of the VAT Pilot to all service industries, including the hotel, financial services, insurance and real estate industries. These sectors will face challenges including business arrangements, accounting treatments, upstream and downstream administration, and system improvement.

In February 2015, the State Administration of Taxation (SAT) released *Public Notice [2015] No.7 (Public Notice 7)*<sup>1</sup> to supersede the current Chinese tax rules in

<sup>1</sup> *Public Notice [2015] No.7 (Public Notice 7)*, State Administration of Taxation, 3<sup>rd</sup> February, 2015, viewed 16<sup>th</sup> June, 2015, <<http://www.chinatax.gov.cn/n810341/n810755/c1491377/content.html>>





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
We will promote the reform of value-added tax, and simplify tax rates appropriately.	Reform of VAT is in progress and should reach completion in 2015. The tax rate has been simplified.	
We will adjust the collection scope, procedures and rates of consumption tax, and impose this tax on products that consume too much energy and cause serious pollution as well as some high-end consumer goods.	Consumption tax reform has taken the first step by extending the taxable scope to paint and coatings, which are energy intensive and create large volumes of pollution.	
We will establish an individual income tax system in which taxable income is defined in both comprehensive and categorised ways.	No notable developments.	
All preferential tax policies will be made clear in taxation laws and regulations.	Insufficient progress. The European Chamber recommends the overall improvement of the legislative process with regard to the tax system in order to satisfy this promise.	
We will improve the regulatory mechanism of income redistribution mainly by the means of taxation, social security and transfer payment and enhance the regulatory role of taxation.	No notable developments.	
We will accelerate resource tax reform and change the current environmental protection fee into an environment tax.	Adjustments made to the resource tax based on a newly issued tax circular came into effect from 1 <sup>st</sup> May, 2015. The revised resource tax covers rare earth, tungsten and molybdenum, including raw ore and the concentrate processed from mining ores, and is levied on the basis of value rather than volume.  The draft of the environment tax has been released for public comments.	

relation to offshore indirect equity transfer. It opens the China tax net wider to capture not only offshore indirect equity transfer transactions addressed under Circular 698,<sup>2</sup> but also transactions involving the transfer of immovable property in China, and assets held by a foreign entity's establishment through offshore transfer using a foreign intermediate holding company. *Public Notice 7* presents a totally different tax landscape for foreign investors with a foreign intermediate holding company structure holding Chinese taxable properties.

State Council released the *Discussion Draft of Taxation Collection Administration Law (TCAL)* (the *Discussion Draft*)<sup>3</sup> for public comment. The *Discussion Draft* made considerable changes to the previous TCAL,<sup>4</sup> including key changes in terms of late payment interest, statute of limitation and additional obligations for information disclosure. The *Discussion Draft* achieves exciting breakthroughs in some crucial areas such as the introduction of an advance ruling mechanism, improving the mechanism for resolving tax disputes

On 5<sup>th</sup> January, 2015, the Legislative Affairs Office of the

<sup>2</sup> Circular 698, State Administration of Taxation, 10<sup>th</sup> December, 2010, viewed 16<sup>th</sup> June, 2015, <[http://www.chinaacc.com/new/63\\_67\\_/2010\\_1\\_6\\_wa6995621716101025642.shtml](http://www.chinaacc.com/new/63_67_/2010_1_6_wa6995621716101025642.shtml)>

<sup>3</sup> *Discussion Draft of Taxation Collection Administration Law (TCAL)*, the State Council, 5<sup>th</sup> January, 2015, viewed 16<sup>th</sup> June, 2015, <[http://www.gov.cn/xinwen/2015-01/05/content\\_2800208.htm](http://www.gov.cn/xinwen/2015-01/05/content_2800208.htm)>

<sup>4</sup> Taxation Collection Administration Law, National People's Congress (NPC), 28<sup>th</sup> April, 2001, viewed, 16<sup>th</sup> June, 2015, <[http://www.gov.cn/banshi/2005-08/31/content\\_146791.htm](http://www.gov.cn/banshi/2005-08/31/content_146791.htm)>



and enhancing consistency with other relevant laws. In particular, the government has demonstrated its intent to strengthen the protection of taxpayers' rights. These changes are welcomed by the member companies of the European Chamber.

The SAT plans to improve its international taxation policies and modernise its international taxation system in line with the G20 tax reforms. Economic globalisation is contributing to increased competition among jurisdictions surrounding the internationalisation of tax sources and the protection of taxing rights. China is facing increased pressure from both inbound and outbound investment entities to liberalise their international tax administrative environment.

The working group appreciates the continuous efforts made by the authorities in promulgating new regulations and reinforcing tax administration. However, there have been a number of practical and administrative issues surrounding these legislative efforts. In light of this, the working group offers constructive recommendations in a bid to help provide a favourable tax environment for foreign-invested and domestic enterprises.

## Key Recommendations

### 1. Improve the Overall Legislative Process

#### Concern

Companies were given tight deadlines or unclear instructions on how to comply with important changes in tax regulations that were implemented recently, and there is a concern over inconsistent interpretations of these regulations by different provincial tax authorities.

#### Assessment

Generally, higher compliance rates for important new regulations will only happen if:

- stakeholders are fully consulted prior to the introduction of the regulations;
- issuance of the final regulations, including detailed implementation rules, is carried out in a timely manner; and
- these regulations are interpreted and implemented consistently nationwide.

The Finance and Taxation Working Group appreciate the SAT's efforts to modernise the taxation regulatory framework and harmonise rules for foreign and

domestic enterprises.

This includes the release of *Guoshuifa [2012] No. 14 (Guidelines on Replies to Specific Tax Matters)*<sup>5</sup> on 10<sup>th</sup> February, 2012. This regulation provides guidelines on internal procedures for tax offices on how to deal with replies on specific tax matters, which aims to increase the transparency and standardisation of tax officials' replies to taxpayers. A more recent example of the SAT's efforts in improving the tax legislation process is the introduction of the public consultation prior to the Taxation Collection Administration Law amendment.<sup>6</sup> It provides opportunities for stakeholders to raise their concerns and constructive recommendations and will serve to enhance the enforcement of the new Tax Administration Law. The working group has also seen other examples of the SAT's efforts to simplify the tax administration process and reduce taxpayers' compliance costs.

These measures have boosted companies' confidence in the Chinese Government to provide a more internationally competitive tax environment in China.

However, a number of areas of concern remain regarding the continuous improvement of the overall legislative process in China:

#### a. Clarify the taxation of foreign-invested partnerships (FIPs)

The relevance of this topic has been stated in previous years' position papers.

The Chinese State Council released *the Administrative Measures for Foreign Corporations and Individuals to Establish Partnerships in China (Measures)*<sup>7</sup> on 25<sup>th</sup> November, 2009. The *Measures* set forth the administrative rules and procedures for foreign investors establishing partnerships in China, effective from 1<sup>st</sup> March, 2010. Although the *Measures* have left all rules in relation to finance, accounting, foreign exchange, customs—and especially taxation—to be dealt with by the relevant departments, no circulars or

<sup>5</sup> *Guidelines on Replies to Specific Tax Matters*, State Administration of Taxation, 10<sup>th</sup> February, 2012, viewed 16<sup>th</sup> June, 2015, <<http://www.shui5.cn/article/34/53239.html>>

<sup>6</sup> *Discussion Draft of Taxation Collection Administration Law (TCAL) (Discussion Draft)*, State Council, 5<sup>th</sup> January, 2015, viewed 16<sup>th</sup> June, 2015, <[http://www.gov.cn/xinwen/2015-01/05/content\\_2800208.htm](http://www.gov.cn/xinwen/2015-01/05/content_2800208.htm)>

<sup>7</sup> *Administrative Measures for Foreign Corporations and Individuals to Establish Partnerships in China*, State Council, 25<sup>th</sup> November, 2009, viewed 16<sup>th</sup> June, 2015, <[http://www.gov.cn/jfjg/2009-12/02/content\\_1480066.htm](http://www.gov.cn/jfjg/2009-12/02/content_1480066.htm)>





guidelines clarifying uncertain issues have been issued in the interim period, creating significant uncertainties for foreign investors.

While a number of FIPs are already established, there is still no guidance on taxation. Thus, investors have to rely on local authorities' practice, which creates considerable uncertainty with regard to their tax position.

#### **b. Unratified Double Tax Agreement (DTA)**

At present, the DTA with Germany,<sup>8</sup> which was signed in early 2014, is still pending ratification.

Pending ratification of DTAs creates uncertainty for investors, both for inbound foreign investment into China and for Chinese outbound investment. It would therefore be helpful to accelerate the ratification process.

#### **c. Public consultation**

Some of the issues usually seen in the implementation of new regulations are caused by the asymmetry of information available to the policy-makers and to the public. Such issues may be prevented by, prior to the introduction of new regulations, conducting proper public consultations with relevant stakeholders including industry experts, academic specialists and professional tax advisers who, through their working knowledge of industry issues, may assist in the drafting of new regulations that are more transparent and implementable.

Furthermore, important court cases and information regarding the ratification process of tax treaties should be published on the SAT's website to improve transparency.

As mentioned above, the government has made encouraging progress in this regard by introducing public consultations when making or amending significant tax laws such as the Corporate Income Tax Law,<sup>9</sup> the Individual Income Tax Law<sup>10</sup> and the

Taxation Collection Administration Law.<sup>11</sup> As the tax laws are usually quite general and only provide high-level principles, public consultations are expected to cover detailed implementation rules or tax circulars that usually provide more important details that may have a significant impact on the taxpayers.

#### **d. Indirect tax legislation**

Currently, the collection of major indirect taxes (e.g. VAT and consumption tax) in China is still based on the relevant provisional rules issued by the State Council. In recent years, as part of the indirect tax reform, the government frequently introduced regulatory changes to the VAT and consumption tax regime. In some cases the regulatory changes were not systematic and clearly defined.

Since VAT and consumption tax are within the top four tax types by value levied in China, it is suggested the VAT and consumption tax rules should be upgraded to the highest level of legislation (i.e. tax laws legislated by the National People's Congress (NPC)). This would help to make the indirect tax regime more mature and stable, which would provide more certainty for the industry and taxpayers when planning their economic activities. As the State Council is the administrative authority responsible for tax collection, upgrading the tax rules into congressional laws would also be helpful for establishing fair tax treatment, governing administrative power and protecting the rights and interests of the taxpayers.

#### **e. Disharmony between the transfer pricing and customs valuation assessments**

Currently, if either the China tax authorities or customs carry out an assessment of a taxpayer's import transactions with related parties, the other authority is not obliged to make a corresponding adjustment (i.e. refund) of customs duties or corporate tax. This has resulted in double taxation.

This issue may be prevented or solved through: 1) the implementation an effective mechanism to allow the exchange of information between the tax authorities and the customs authorities when assessing certain import-related transfer pricing or valuation cases; and 2) the creation of a Pricing Adjustment Decision Committee—

8 Agreement Between the People's Republic of China and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, 28<sup>th</sup> March, 2014, viewed 16<sup>th</sup> June, 2015, <<http://www.chinatax.gov.cn/n810341/n810770/c1152685/part/1152686.pdf>>

9 Corporate Income Tax Law, National People's Congress, 16<sup>th</sup> March, 2007, viewed 16<sup>th</sup> June, 2015, <[http://www.gov.cn/jffg/2007-03/19/content\\_554243.htm](http://www.gov.cn/jffg/2007-03/19/content_554243.htm)>

10 Individual Income Tax Law, National People's Congress, 30<sup>th</sup> June, 2011, viewed 16<sup>th</sup> June, 2015, <[http://www.gov.cn/jffg/2011-06/30/content\\_1897108.htm](http://www.gov.cn/jffg/2011-06/30/content_1897108.htm)>

11 Taxation Collection Administration Law, National People's Congress, 28<sup>th</sup> April, 2001, viewed 16<sup>th</sup> June, 2015, <[http://www.gov.cn/banshi/2005-08/31/content\\_146791.htm](http://www.gov.cn/banshi/2005-08/31/content_146791.htm)>





jointly established by the tax and customs authorities—to which the taxpayers can make an appeal or ask for rulings where transfer prices and customs value in a related party transaction are determined differently.

#### f. Tax litigation

Currently, in the event of a tax dispute with the tax authorities regarding tax treatment, a taxpayer must first pay the tax (including late payment interest) and a penalty in accordance with the decisions made by the tax authorities. Only then may they apply for an administrative review. Taxpayers may lodge administrative litigation before people's courts if they are dissatisfied with the decisions of an administrative review. However, in practice, taxpayers rarely win the litigation when the dispute surrounds the tax treatment itself as opposed to the tax administration process. This is mainly because the people's courts lack technical expertise in taxation theories or tax regulations issues. Instead, they must rely on the arguments of the tax authorities when judging tax treatment. As a result, taxpayers are discouraged from using litigation as a means of protecting their interests. This has the additional negative effect of giving China an international reputation of having no effective tax litigation mechanism.

The issue may be resolved by setting up special tax courts in certain locations with independent tax professionals designated as the judges so that tax lawsuits between taxpayers and the authorities can be handled in a more professional and fair manner. It is important to encourage tax courts to protect the legal rights and interests of taxpayers and supervise the tax authorities' administrative power, in order to improve the global reputation of the Chinese tax system.

#### Recommendations

- Conduct more public consultations prior to introducing new regulations that would have a significant impact on resident and non-resident taxpayers, involving professional tax specialists, academics and industry experts, and allowing reasonable time to comment.
- Upgrade the major indirect tax rules to the highest level of legislation so that taxpayers can enjoy more stability and certainty with respect to major tax treatment.
- Provide nationwide implementation regulations with a specific timeframe, when applicable, to ensure

enforcement at the local level is consistently in accordance with central-level laws and regulations.

- Provide more lead time to taxpayers so that they can fully understand and prepare for the implementation of significant changes to tax compliance requirements.
- Set up an effective mechanism to harmonise the assessment/treatment by the tax authorities and customs authorities in terms of transfer pricing / valuation position in relation to import activities.
- Provide information about the status of tax treaties being negotiated or ratified and important court cases on the official State Administration for Taxation (SAT) website as is done by other tax authorities.
- Ensure a timely ratification of tax treaties which are finalised and signed by both parties.
- Provide a more comfortable and friendly environment for taxpayers to exercise their legal rights to raise any tax-related disputes to the courts.

## 2. Modernise Corporate Restructuring Rules

### Concern

Tax-neutral, intra-group restructuring transactions for proper business reasons, such as mergers, splits, asset and share transfers, are subject to tight restrictions, which prevents the formation of efficient corporate structures and the maximisation of taxable profits.

### Assessment

#### a. Scope of tax neutral restructurings

*Caishui [2009] No. 59 (Circular 59)*<sup>12</sup> and *Caishui [2014] No. 109 (Circular 109)*<sup>13</sup> stipulate a specified number of restructuring scenarios, such as mergers, splits, and asset and share transfers within the group, where tax neutrality can be achieved. The scenarios given in both circulars focus largely on transactions within China, whereas overseas transactions mainly consist of transfers of Chinese shares by overseas shareholders to direct subsidiaries:

- With reference to *Circular 59*, mergers are sometimes interpreted as mergers of a Chinese entity into another Chinese entity where both are

<sup>12</sup> *Caishui [2009] No. 59*, Ministry of Finance, 30<sup>th</sup> April, 2009, viewed 15<sup>th</sup> June, 2015, <[http://www.chinaacc.com/new/63\\_67\\_/2009\\_5\\_7\\_ha4164794017590021750.shtml](http://www.chinaacc.com/new/63_67_/2009_5_7_ha4164794017590021750.shtml)>

<sup>13</sup> *Caishui [2014] No. 109*, Ministry of Finance, 25<sup>th</sup> December, 2009, viewed 15<sup>th</sup> June, 2015, <<http://www.chinatax.gov.cn/n810341/n810755/c1451490/content.html>>





wholly owned by the same shareholder. Mergers of parent companies into their subsidiaries (downstream), subsidiaries into their parent companies (upstream) or between entities within the same company group but with different direct shareholders (sidestream) are sometimes excluded from tax-neutral treatment according to *Circular 59*, by way of interpretation. Given these merger options may also serve proper commercial reasons, there is no reason in principle why they should be excluded from tax-neutral treatment. Therefore, an improved regulation should clearly include the aforementioned scenarios in its scope for tax neutral treatment if the standard preconditions are met.

- Sidestream mergers of a foreign-invested enterprise (FIE) to its direct sister company within China (both directly owned by the same overseas shareholder) may face the challenge that the merger is qualified as a cross-border transaction due to the fact that shareholder of both entities is foreign. Accordingly, tax-neutral treatment based on *Circular 59* is not applicable because the allowable cases for cross-border transactions defined within it do not cover mergers unless there is a proper commercial reason for the merger. Therefore, an improved regulation should either clearly qualify this merger as 'domestic', or expand the scope of 'cross-border transactions' to cover all kinds of mergers.
- Intra-group restructurings of overseas entities through mergers, splits or liquidations, which are conducted overseas in a tax-neutral way due to proper commercial reasons, may lead to a nominal change of shareholder for a Chinese subsidiary. This change of shareholder may be viewed as a share transfer in China, yet it does not fulfil the tight Chinese preconditions for tax-neutral group restructuring. This can be because the merger or transfer is not downstream towards a 100 per cent direct subsidiary but is in fact upstream or sidestream. As a result, the overseas restructuring may result in the same tax burden as a traditional share transfer between two entities, which in effect discourages the necessary inter-group restructuring. An improved regulation should expand the scope of 'cross-border transactions' to include such overseas transactions accordingly.

## b. Implementation of tax neutral restructurings

With regard to implementation, taxpayers in China often feel uncertainty over whether or not their restructuring case would receive approval for tax-neutral treatment, even if all technical requirements for tax neutrality as per *Circular 59* are met. As a result, taxpayers may shy away from the transaction, in particular when significant values and potential tax costs are involved. The main reasons for this uncertainty are differing local interpretations of the same national regulations and a lack of clear and detailed technical guidance issued by the national regulator:

- While mergers within the jurisdiction of a single tax authority may be possible with a reasonable level of administrative effort by the companies involved, mergers across district or province borders often fall under the jurisdiction of multiple authorities. This results in an administrative burden that is prohibitive to the companies involved. Applications for tax-neutral treatment may not be properly processed and approval may not be confirmed by the provincial-level tax authorities in charge because of a conflicting understanding of responsibilities. In practice, merger transactions often get stuck at this stage. Therefore, an improved regulation should allocate clear responsibilities for the tax authorities involved, combined with a clear administrative process including deadlines for the decision and formal notification of the taxpayer.
- Mergers of profitable entities into loss-making entities may face the challenge that the merger would lack a proper commercial reason given that the netting of profits of the profitable entity against the losses of the loss-making entity creates a reduction of overall tax liability in China. As a consequence, a tax-neutral merger may not be realised. This scenario doesn't take into account the fact that a potential tax benefit may not be the only criteria to assess the precondition of 'proper commercial reasons' for a transaction. Therefore, to provide more guidance to taxpayers and tax authorities, an improved regulation should clearly define the meaning of 'proper commercial reasons' and how it is assessed in actual situations, similar to what has been provided in the SAT's *Public Notice [2015] No. 7*<sup>14</sup> with regard to indirect transfers.

<sup>14</sup> *Public Notice [2015] No. 7*, SAT, 3<sup>rd</sup> February, 2015, viewed 16<sup>th</sup> June, 2015, <<http://www.chinatax.gov.cn/n810341/n810765/n1465977/n1466002/c1676726/content.html>>





### Recommendations

- Explicitly include upstream, downstream and sidestream mergers of Chinese entities into the scope of tax-neutral mergers if preconditions are met.
- Explicitly include the merger of two FIEs under a foreign shareholder into the scope of tax-neutral mergers if preconditions are met.
- Expand the scope of 'cross-border transactions' to cover different types of share transfers if preconditions are met.
- Allocate a clear division of responsibilities to the relevant authorities, combined with a clear administrative process and deadlines for the decision and formal notification of the tax payer.
- Provide more guidance as to how 'proper commercial reasons' shall be understood and assessed in practice.

## 3. Set up an Advance Tax Ruling System in Order to Create Certainty for Investors

### Concern

Due to the considerable scope for uncertainties over China's tax laws, there is a clear need for an advance tax ruling system and to provide enhanced taxpayer services, such as guiding taxpayers to comply with tax regulations on their own, helping taxpayers to manage tax risks, and providing taxpayers with more customised assistance.

### Assessment

The introduction by China of a system of advance rulings would benefit both taxpayers and the tax authorities. The opportunity to obtain advance rulings is seen as a key component of facilitating the management of tax risks and enhanced voluntary compliance. Taxpayers would benefit by obtaining certainty before entering into transactions and the tax authority would benefit from enhanced levels of voluntary compliance by taxpayers.

The working group appreciates the SAT's efforts to modernise the taxation and regulatory framework and to provide more enhanced taxpayer services. This includes providing companies with the ability—via China's Advance Pricing Arrangement system—to apply in advance to negotiate and reach an agreement with the tax authorities in respect of the transfer pricing methods and corresponding calculation methods to

be applied to their related party transactions for future years, in accordance with the 'arm's length' principle. The working group also appreciates the SAT's efforts in providing a framework through which taxpayers may enter into tax compliance agreements (TCAs) with the tax authorities, which has modernised the nature of the relationship between taxpayers and tax authorities and has allowed taxpayers to receive enhanced services so they can better manage tax risks.

However, an advance ruling system is an important step in further modernising and developing the Chinese tax system, both for the benefit of taxpayers and tax authorities.

An advance ruling is a tax authority's interpretation of how the tax laws should be applied to a given set of facts submitted by a taxpayer. A tax ruling is addressed to a taxpayer and is intended to have the same legal force as tax circulars. The advance ruling is generally issued by the highest tax authority in the jurisdiction (i.e. the SAT) and is binding over all other tax authorities.

The most significant benefit that an advance ruling system will provide taxpayers is certainty regarding the tax consequences of particular transactions so that decisions can be made with the knowledge of their full costs.

Certainty is particularly difficult to achieve in China due to a number of reasons:

- Tax regulations in China are relatively light on substantive detail and sometimes general in their application. The tax regulations are supplemented by a number of quasi-legislative materials such as circulars, which are often basic in their operation and can be readily replaced and updated. In some cases different circulars conflict with one another.
- Tax administration in China is still in a developmental phase. Businesses can encounter challenges due to inconsistencies in decisions made by different tax officials on the same issue, as well as a misunderstanding of complex transactions. While the SAT has made enormous progress in a short period of time, new policies and procedures will take some time to be understood and implemented in full.
- There is a lack of case law and so it is not possible to look to this for clarification of how certain tax laws must be interpreted and applied.





For companies doing business in China, a combination of the above factors can create a tax environment which is difficult to manage and has unacceptable levels of risk. A large volume of surveys on tax risk management regularly highlight the fact that the primary objective for businesses in managing tax risks is to limit unwelcome tax surprises. In addition to this, according to the European Chamber's *Business Confidence Survey 2015*,<sup>15</sup> 76 per cent of European businesses surveyed stated that China's difficult regulatory environment had a strong or average impact on their net profit margin. As a result, only 29 per cent of the surveyed companies expressed an optimistic outlook in terms of profitability

As touched on by Li Keqiang during the Fourth Plenum, it is important that China's regulatory environment is simplified so that business confidence is restored. Should the framework for managing tax risks in China develop in such a way that facilitates and encourages effective control over tax risks, this will be a positive step towards making China's legal and regulatory environment simpler and easier for foreign companies to comply with. These measures are in line with the government's commitment to simplify the legal and regulatory environment across all areas, as outlined in the Fourth Plenum in October 2014.

From the tax authorities' perspective, an advance ruling system would provide a number of benefits – primarily enhanced tax compliance and improved tax administration. An advance ruling system could also foster a good working relationship between the tax authorities and taxpayers and provide tax authorities with an opportunity to preview the type of transactions taxpayers are contemplating, which would allow early detection of taxpayers' issues in applying laws as well as exposing defects and unintended consequences in legislation.

In addition to the benefits from both the taxpayers' and tax authorities' perspectives, support for the introduction of an advance ruling system in China can be obtained by observing how widespread this type of system is used internationally. According to statistics released by the Organisation for Economic Cooperation and Development (OECD), 28 out of 30 OECD countries,

including Australia, Canada, France, Germany and the United States (US), have implemented advance ruling systems.<sup>16</sup> With respect to non-OECD countries, 12 out of the 13 major non-OECD countries, such as Singapore, South Africa and Argentina, have also adopted some form of advance ruling system.

The Finance and Taxation Working Group appreciates that the SAT may be concerned that it will not have sufficient resources available to establish and administer an advance ruling programme. However, in practice, the resources required should not be too dissimilar from the amount currently being used by the China tax authorities in the traditional 'audit-adjustment-penalty' approach.

Under the traditional approach, a taxpayer generally files a tax return and then, based on the facts and circumstances, the tax authority may decide to perform an audit. If the tax authority believes the position adopted by the taxpayer to be incorrect and not in accordance with the current laws and regulations, an adjustment will be required and any penalties resulting from the incorrect position taken will also be imposed. Therefore the time and resources spent by both the taxpayer and tax authority throughout this traditional process can be significant.

However, if an advance ruling system was introduced that allowed taxpayers to disclose to the tax authority details of a transaction as well as their understanding of the associated tax treatment for confirmation by the tax authority before the transaction was undertaken, the time and resources involved would not be too dissimilar to the traditional approach described above. This new approach would also allow the tax authority to work with taxpayers on a transparent basis to solve problems, and would further encourage taxpayers to disclose material transactions voluntarily.

The advance ruling system could also be designed in such a way to minimise the amount of resources required for it to function efficiently and effectively. That said, if the advance ruling could be granted at the SAT level, it would be helpful to ensure consistency and a binding effect of the ruling throughout all regions. In addition, the ruling may also be helpful for the SAT

<sup>15</sup> *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, 10<sup>th</sup> June, 2015, viewed 16<sup>th</sup> June, 2015, <[http://www.europeanchamber.com.cn/en/publications-archive/334/Business\\_Confidence\\_Survey\\_2015](http://www.europeanchamber.com.cn/en/publications-archive/334/Business_Confidence_Survey_2015) >

<sup>16</sup> *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series 2008*, OECD, 28<sup>th</sup> January, 2009, viewed 16<sup>th</sup> June, 2015, <<http://www.oecd.org/ctp/administration/CIS-2008.pdf>>





to study and devise new policies for new situations/cases which could apply to all taxpayers, which could also further relieve SAT's administrative resources. Therefore, the following should help the ruling to function more efficiently and effectively:

- 1) Authorities at the provincial level need to understand and examine the fact patterns and provide recommendations to the SAT in terms of the application of policy; and then
- 2) Relevant SAT functional departments should study the application of existing policies or offer a 'new' tax treatment to the case under examination and, where necessary, the SAT could devise a totally new policy by itself, jointly with Ministry of Finance (MOF) or even passing a new law via the NPC.

Further, to avoid duplication of existing processes, the SAT could decline to issue rulings on transactions which are already the subject of an audit, which involve questions of fact, contain issues already directly covered by existing circulars or are not material in amount. This would ensure that the SAT's resources are dedicated to resolving real issues of interpretive difficulty and cases where the tax amounts of transactions are significant and material.

#### Recommendations

- Establish an advance ruling system that is transparently administered by the SAT.
- Ensure local tax bureaus review advance ruling applications first before referring them to the SAT for a final ruling and determination, to ensure that the SAT's resources are not exhausted.
- Publish all rulings on the SAT's website providing a summary of the facts, the taxpayer's views, the SAT's ruling/final decision and the legal basis and reasons for their conclusion, while protecting the taxpayer's information.
- Ensure that when the SAT issues an advance ruling over a tax-related matter submitted by a taxpayer, all Chinese tax authorities abide by the ruling, with the tax ruling ceasing to be binding in the event of a change in the law or if any material errors are discovered in the information upon which the advance ruling was given.
- Allow both prospective and past transactions to fall within the scope of matters to be covered by the advance ruling system.
- Provide tax rulings to taxpayers free of charge.

- Respond to taxpayers' advance ruling requests within a specified timeframe depending on the circumstances and urgency of the situation.

#### 4. Issue Comprehensive Guidelines for the Implementation of Permanent Establishment (PE) Taxation in China

##### Concern

As a non-resident constitutes a PE in China, the non-resident would need to establish accounting books to calculate Enterprise Income Tax on the profits attributable to it in order to apply the actual profit method, or they must alternatively apply the deemed profit method.

##### Assessment

In practice, most PEs will be deemed a profit rate on the gross income derived to calculate its 'taxable income'. While this approach is practical and simple to compute the 'taxable income' of the PE, it assumes that the PE did indeed make actual taxable income which is therefore subject to tax; in some other cases where there is no actual taxable income made by the PE, applying the same approach would not be equitable to the taxpayer. Under such circumstances, the actual profit method can be used as available under the regulations. However, the actual profit method only provides general principles without further elaboration on detailed implementation guidance in terms of the application procedures and required documentation. As such, it is difficult for non-resident taxpayers to rely on the rules to compute their PE income attributed on an actual basis. Furthermore, it may also be difficult to persuade local tax bureaus to agree to the use of actual profit method due to a lack of detailed guidance.

Therefore, it would be helpful for the SAT to release a new circular to address such issues, introducing practical and workable guidelines without unduly creating heavy compliance business costs. It would help both non-resident taxpayers and local tax bureaus regarding the use of the actual profit method to compute the income attributable to the PE, should this actual profit method be used.

##### Recommendation

- Issue a new circular to provide clear and comprehensive guidelines as to the implementation of, as well as application procedures and required documentation





pertaining to, PE tax regulations.

## 5. Update Consumption Tax Regulations

### Concern

The *Consumption Tax Regulation*, which was launched in China 20 years ago, is no longer suitable for China's current level of economic development and changes in modern consumer habits, therefore consumption tax reform needs to be accelerated.

### Assessment

#### a. Scope of consumption tax

The purpose of consumption tax is to reshape the direction of consumption. Its scope normally covers environmentally-harmful goods, unhealthy products and luxury items.

The definition of 'environmentally harmful', 'unhealthy' and 'luxury' has evolved with economic growth and technological developments. The scope of China's consumption tax should be updated accordingly in order that it not hinder the development of certain industries in the mass market and discourage private consumption, which drives increased job opportunities and tax contributions. It is understood that there were two major updates to the scope in 1999 and 2006. However, some products, which do not belong to any category of consumption tax, are still included in the scope.

#### Case Study: Cosmetic Products Subject to Consumption Tax

Cosmetic products have been included in the scope of China's consumption tax since 1994, as they are perceived as unnecessary for daily life. After 20 years, consumers habits have largely evolved and using cosmetic products has become a daily habit for people of different ages and various social demographics.

The average price for a cosmetic product is currently Chinese Yuan (CNY) 60 in China, which does not qualify as a 'luxury item'. From an environmental-protection perspective, the cosmetics industry does not consume natural resources and is not harmful to the environment, and the benefits for consumers' psychological state are recognised. Furthermore, very few European countries impose consumption tax on cosmetics products.

This case study<sup>17</sup> shows that the inclusion of certain kinds of goods in the scope of China's consumption tax is no longer appropriate. The removal of such products from the consumption tax scope would create more benefits to both consumers and authorities:

- Savings from tax reductions could be reinvested into the market (e.g. advertising and promotion).
- Reduced costs could increase private consumption.
- Additional indirect taxes such as VAT may be triggered.
- More job opportunities could be created.

#### b. Consumption tax credit mechanism

Consumption tax reform has finally taken its first step this year. The MOF and the SAT promulgated the *Notice of Imposing Consumption Tax (CT) on Battery and Coating Products [2015] No.16*<sup>18</sup> to extend the taxable scope to paint and coating (涂料) products. Effective from 1<sup>st</sup> February, 2015, paint and coating products are now subject to consumption tax at a rate of four per cent. Consumption tax is levied on the stage of manufacturing, subcontract processing and import and as such forms part of the respective consumer goods price.

Theoretically, consumption tax can be levied twice during a production process. Once, as part of the feedstock/raw material price, and second on finished goods. To avoid this, a credit mechanism is applicable, which in principle credits the consumption tax paid on the feedstock/raw material against the consumption tax payable on the finished goods. Ideally double taxation is avoided, however, it is not applicable to paint and coating products.

#### c. Harmonise the interpretation of consumption tax between tax authorities and customs authorities

The SAT issued the *Announcement of Taxation on Supplementary Provisions on Issues Relating to Consumption Tax Policies*<sup>19</sup> in October 2013, which partly clarified the definition and separation between oil and chemicals. The General Administration of Customs (GAC) issued the *Announcement of Taxation on*

<sup>17</sup> See the *Cosmetics Position Paper* for more information.

<sup>18</sup> *Notice of Imposing Consumption Tax (CT) on Battery and Coating Products*, SAT, 18<sup>th</sup> March, 2015, viewed 16<sup>th</sup> June, 2015, <[http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201501/t20150127\\_1184863.html](http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201501/t20150127_1184863.html)>

<sup>19</sup> *Announcement of Taxation on Supplementary Provisions on Issues Relating to Consumption Tax Policies*, SAT, 9<sup>th</sup> September, 2013, viewed 16<sup>th</sup> June, 2015, <<http://www.chinatax.gov.cn/n810341/n810765/n812146/n812323/c1080871/content.html>>



*Imported Product Oil*<sup>20</sup> in July 2010, and the *Clarification of Announcement of Taxation on Imported Product Oil*<sup>21</sup> in December 2013, which is not completely compatible with the SAT's *Announcement of Taxation on Supplementary Provisions on Issues Relating to Consumption Tax Policies*. Thus, consumption tax has been mistakenly imposed on some chemicals imported by foreign companies.

Due to different approaches in categorisation, e.g. the SAT's *Inventory of Existing Chemical Substances Produced or Imported in China* (IECSC) and the GAC's Harmonised System code, some imported chemicals are subject to consumption tax by mistake. It is recommended that the SAT coordinate with the GAC to add some new sub-categories, so that imported chemicals can be added to these two sub-categories and exempted from consumption tax. In addition, the SAT should coordinate with the technology and quality supervision authorities and further clarify the procedure and format for certification of chemicals based on the SAT's *Regulation of Taxation on the Announcement on Issues Relating to Consumption Tax Policies*<sup>22</sup> and the *Announcement of Taxation on Supplementary Provisions on Issues Relating to Consumption Tax Policies*.

#### **d. Update the taxation method based on international best practices regarding taxpayers, taxing basis and tax collection channels**

The current rate of consumption tax applicable to naphtha is CNY 1.52 /litre (effective from 13<sup>th</sup> January, 2015), on top of which a local surcharge of 12 per cent is levied.

After a thorough review of the *Circular of Taxation on Increasing the Consumption Tax Rate for Product Oil* (Caishui 167)<sup>23</sup> issued in 2008, the *Regulation of Taxation on the Announcement on Issues Relating to Consumption Tax Policies* (Circular 47),<sup>24</sup> issued in 2012,

20 *Announcement of Taxation on Imported Product Oil*, General Administration of Customs (GAC), 19<sup>th</sup> July, 2010, viewed 16<sup>th</sup> June, 2015, <<http://www.customs.gov.cn/publish/portal99/tab4744/info233982.htm>>

21 *Clarification of Announcement of Taxation on Imported Product Oil*, General Administration of Customs (GAC), 31<sup>st</sup> December, 2013, viewed 16<sup>th</sup> June, 2015, <<http://www.customs.gov.cn/publish/portal0/tab49564/info688839.htm>>

22 *Regulation of Taxation on the Announcement on Issues Relating to Consumption Tax Policies*, SAT, 6<sup>th</sup> November, 2010, viewed 16<sup>th</sup> June, 2015, <[http://www.csj.sh.gov.cn/pub/xxgk/zcfg/xfs/201211/t20121116\\_400936.html](http://www.csj.sh.gov.cn/pub/xxgk/zcfg/xfs/201211/t20121116_400936.html)>

23 *Circular of Taxation on Increasing the Consumption Tax Rate for Product Oil*, Ministry of Finance and the State Administration of Taxation, 19<sup>th</sup> December, 2008, viewed 16<sup>th</sup> June, 2015, <[http://www.gov.cn/gzdt/2008-12/20/content\\_1183214.htm](http://www.gov.cn/gzdt/2008-12/20/content_1183214.htm)>

24 *Regulation of Taxation on the Announcement on Issues Relating to Consumption Tax Policies*, SAT, 6<sup>th</sup> November, 2012, viewed 16<sup>th</sup> June, 2015, <[http://www.csj.sh.gov.cn/pub/xxgk/zcfg/xfs/201211/t20121116\\_400936.html](http://www.csj.sh.gov.cn/pub/xxgk/zcfg/xfs/201211/t20121116_400936.html)>

and the *Announcement of Taxation on Supplementary Provisions on Issues Relating to Consumption Tax Policies* (Circular 50),<sup>25</sup> issued in 2013, the members of the Taxation Working Group and the Petrochemical, Chemicals and Refining Working Group<sup>26</sup> of the European Chamber understand and support the purpose of levying consumption tax on refined oil. However, the above regulations define the term 'naphtha' in a broad way that makes nearly all oil-based finished products or refined oil-related finished products (including some petrochemical products) taxable. Such an approach is likely to have negative impact on the development of the petrochemical industry in China and cripple its international competitiveness. Therefore, it is necessary to clarify the fundamental principles of consumption tax on 'refined oil', i.e. that consumption tax should be payable on 'refined oil' only when it is used for heating or burning purposes and not as a raw material used in the production of petrochemical products.

As we know, it is an internationally common practice that hydrocarbons (including naphtha) used as feedstock in the production of petrochemical products are exempted from the consumption tax. For example, the European Energy Tax Regime provides consumption tax exemption to hydrocarbons (including naphtha) used as feedstock in petrochemical industry within the European Union. The US and Japan have similar regulations that exempt products used in a continuing chemical production from consumption tax liabilities.

#### **e. Effective tax rates**

The tax rate for consumption tax ranges from one per cent to 45 per cent based on the manufacturing and importation price. On 13<sup>th</sup> January, 2015, consumption tax rates on refined oil products, such as gasoline, diesel and naphtha, were increased for the third time within two months. For exemption, after the increase, the effective tax rate of gasoline became 40 per cent, which is significantly higher than that of US (11 per cent), Japan (39 per cent) and China Taiwan (26 per cent).

25 *Announcement of Taxation on Supplementary Provisions on Issues Relating to Consumption Tax Policies*, SAT, 9<sup>th</sup> September, 2013, viewed 16<sup>th</sup> June, 2015, <<http://www.chinatax.gov.cn/n810341/n810765/n812146/n812323/c1080871/content.html>>

26 See the *Petrochemical, Chemical and Refining Working Group Position Paper* for more information.





The Finance and Taxation Working Group believes that the rate for some products is unreasonably high. Since the consumption tax is included in the final price, the effective tax cost can represent up to around 43 per cent of the manufacturing or importation cost. This is an unreasonably high tax burden for fast moving commodity industries.

#### Recommendations

- Review the scope of consumption tax and update it according to economic growth and the evolution of consumption habits.
- Exempt luxury consumer goods and items which are not harmful to the environment.
- Allow tax credit on consumption tax paid on raw materials
- Review and balance the various tax rates among the different categories of goods to incentivise new consumption habits.
- Harmonise the interpretation of consumption tax between tax authorities and customs authorities.
- Update taxation methods based on international best practices regarding taxpayers, taxing basis and tax collection channels.

## Abbreviations

SAT	State Administration for Taxation
CNY	Chinese Yuan
DTA	Double Taxation Agreement
FIE	Foreign-invested Enterprise
FIP	Foreign-Invested Partnership
GAC	General Administration of Customs
IECSC	Inventory of Existing Chemical Substances
	Produced or Imported in China
MNC	Multinational Company
MOF	Ministry of Finance
NPC	National People's Congress
OECD	Organisation for Economic Cooperation and Development
PE	Permanent Establishment
TCAL	Taxation Collection Administration Law
TCAAs	Tax Compliance Agreement
VAT	Value Added Tax



## Human Resources Working Group

### Key Recommendations

#### 1. Improve Education Programmes

- Improve education programmes to ensure graduates acquire competitive skills needed by the market, such as critical thinking, problem solving, business communication and an understanding of company processes.
- Encourage more internships and private vocational training initiatives.

#### 2. Improve Workforce Flexibility by Clarifying How Work-load (Including Part-time) or Project-based Contracts with Employees can be used

- Take a more flexible approach to human resources (HR) outsourcing by allowing the percentage applicable for each company to be based on a realistic evaluation of the industry sector, regional location and actual workforce demand.
- Improve workforce flexibility by clarifying how work-load (including part-time) or project-based contracts with employees can be used.

#### 3. Implement More Flexible Visa and Work Permit Regulations

- Clarify university and internship visa access in China.
- Lower the threshold for Green Card applications.
- Simplify work permit procedures for female foreign employees over 55 years of age and male employees over 60 years of age.

#### 4. Improve the Attractiveness of China in Order to Attract and Retain Top-class, Distinctive Talent From China and From Abroad

- 4.1 Lower Individual Income Tax (IIT) Pressure to Avoid Losing Top Talent to Other Regional Hubs.
- 4.2 Ensure China's Environmental Standards for Air, Water and Soil Quality, as Well as Food Safety, are Meeting International Standards.
- 4.3 Ensure Internet Speed and Accessibility Reach International Standards.
- 4.4 Speed up Bilateral Social Security Agreements to Avoid Double Payments for Pensions and Health Insurance Contributions.


 Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.

### Introduction to the Working Group

The European Chamber's Human Resources (HR) Working Group is currently active in five European Chamber Chapters—Beijing, Nanjing, Shanghai, South China and Southwest China. The group is composed of a wide range of HR professionals from European multinational corporations (MNCs) and small

and medium-sized enterprises (SMEs) involved in a variety of industries. The group represents European companies employing hundreds of thousands of people who contribute to social security funds and tax receipts, as well as HR service providers across China. The working group aims to provide a platform to exchange information, experiences and best practices among



Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
XII. 42. We will quicken steps in the development of a modern vocational education system, deepen the integration of production and cooperation between schools and enterprises and train high-calibre workers and technical talents.	A number of initiatives have been implemented (see examples in Key Recommendation 1), however, they are not yet sufficient to provide the pool of skilled candidates needed by businesses, by a long way.	

member companies, as well as promote awareness of HR and labour-related issues across industries. The HR group regularly organises seminars and conferences and facilitates training sessions aimed at sharing knowledge and experience among members.

## Recent Developments

The ongoing economic reform in China, as well as rapidly changing demographics, requires an adaptation of the workforce. Working group members welcome the government's efforts to reform the education system to match market demands, especially its support for vocational education as an important part of both the national education system, and developing a skilled labour force. See Key Recommendations 1 and 2 for more details.

Air, soil and water pollution levels continue to concern top international and local talent, who are reconsidering working and living in China with their families. The Human Resources Working Group strongly supports the agenda of the Chinese Government with regard to improving environmental protection. In the meantime, intensified Internet restrictions continue to adversely impact communication between companies as well as access to information in general, making China a less attractive employment destination. See Key Recommendation 4 for more details.

Rising labour costs were the most significant factor impacting European companies' China net profit margins in 2014, ahead of competition from foreign companies and slower economic growth in China. Margin pressure is leading companies to reduce headcount. Sixty-one per cent of respondents to the European Chamber's *Business Confidence Survey 2015* indicated that they have cost reduction plans.<sup>1</sup> At

<sup>1</sup> *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, 2015, p. 12, <[http://www.eurochamber.com.cn/en/publications-archive/334/Business\\_Confidence\\_Survey\\_2015](http://www.eurochamber.com.cn/en/publications-archive/334/Business_Confidence_Survey_2015)>

the same time, workforce flexibility is critical to remaining competitive.<sup>2</sup> See Key Recommendation 2 for more details.

Working group members are encouraged by the statements made during The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee (CPCCC) held in November 2013, and the resulting *Decision on Some Major Issues Concerning Comprehensively Deepening the Reform (Decision)*,<sup>3</sup> to establish an individual income tax (IIT) system in which taxable income is defined in both comprehensive and categorised ways. It is hoped the new system will result in lowering IIT pressure for top talent, both from China and abroad. See Key Recommendation 4.1 for more details.

▶ In January 2014, China and the European Union (EU) commenced negotiations for a Comprehensive Agreement on Investment (CAI). In this agreement the EU aims to facilitate the temporary entry and stay of natural persons for business purposes. The Human Resources Working Group encourages both parties to reach an agreement in 2015.

## Key Recommendations

### 1. Improve Education Programmes

#### Concern

A significant number of fresh graduates entering the workforce are not equipped with competitive skills such as critical thinking, problem solving, business communication and an understanding of company processes.

<sup>2</sup> *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, 2015, p. 24, <[http://www.eurochamber.com.cn/en/publications-archive/334/Business\\_Confidence\\_Survey\\_2015](http://www.eurochamber.com.cn/en/publications-archive/334/Business_Confidence_Survey_2015)>

<sup>3</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.



## Assessment

In 2014, a record number of 7.3 million graduates joined the labour force in China, up from 6.99 million in 2013.<sup>4</sup>

Slowing economic growth in China and steadily increasing HR costs has led to more restrictive hiring policies. At the same time, when hiring fresh graduates companies need to invest heavily in practical work skills training, such as critical thinking, problem solving, business communication and understanding of company processes. Employees requiring a long training period to become fully efficient was the number-four key HR challenge for European companies in China, according to the European Chamber's *Business Confidence Survey 2014*.<sup>5</sup>

Both, government-funded and private initiatives are being experimented with to encourage companies to offer internships and help students to acquire necessary business skills at an early stage or provide vocational training in cooperation between schools and companies. Such initiatives include, for example, the internship programme funded by the Pudong Government in Shanghai for students who are permanent residents of the city,<sup>6</sup> or private companies' and other organisations' initiatives like the vocational training programme provided by the Delegations of German Industry and Commerce.<sup>7</sup> Initiatives that help young graduates to become familiar with companies' business culture and processes should be further encouraged.

## Recommendations

- Improve education programmes to ensure graduates acquire competitive skills needed by the market, such as critical thinking, problem solving, business communication and an understanding of company processes.
- Encourage more internships and private vocational training initiatives.

4 *Li visit hints at future policy*, *Shanghai Daily*, 6<sup>th</sup> July, 2014, viewed 9<sup>th</sup> July, 2014, <<http://www.shanghaidaily.com/national/Li-visit-hints-at-future-policy/shdaily.shtml>>

5 *European Business in China Business Confidence Survey 2014*, European Chamber of Commerce in China, 2014, p. 17, <[www.europeanchamber.com.cn/en/publications-archive/256/Business\\_Confidence\\_Survey\\_2014](http://www.europeanchamber.com.cn/en/publications-archive/256/Business_Confidence_Survey_2014)>

6 *Opinions on Further Promoting Internship for the Youth in Shanghai*, Shanghai Municipal Human Resources and Social Security Bureau, 7<sup>th</sup> March, 2007, viewed 25<sup>th</sup> March, 2015, <[http://www.12333sh.gov.cn/201412333/xxgk/ffg/gfxwj/jygl/jn/201405/t20140506\\_1181188.shtml](http://www.12333sh.gov.cn/201412333/xxgk/ffg/gfxwj/jygl/jn/201405/t20140506_1181188.shtml)>

7 *Vocational Training Mainland China*, Delegations of German Industry and Commerce, viewed 22<sup>nd</sup> July, 2015, <<http://china.ahk.de/services/recruitment-training-vocational-training/voctrain/>>

## 2. Improve Workforce Flexibility by Clarifying How Work-load (Including Part-time) or Project-based Contracts with Employees can be used

### Concern

The *Interim Revisions on Labour Dispatch* issued by the Ministry of Human Resources and Social Security (MHORSS) on 26<sup>th</sup> January, 2014, make labour dispatch management more challenging, especially for companies with peak production seasons, who need to work with seasonal staff. In addition, labour legislation is not flexible enough to address the challenges of a rapidly ageing population and workforce shortage.

### Assessment

The working group acknowledges the intention of the MOHRSS to promote fair treatment of the dispatched workforce. However, with the 10 per cent limit now enforced across the board, and only for so-called "temporary, auxiliary or replaceable functions", the new regulation allows no flexibility.<sup>8</sup> This is especially challenging for companies with peak production times who depend on seasonal workers. In terms of how to define the three aforementioned job categories, this could cause employee relationship conflicts and eventually lead to a worsening of labour relations.

At the same time the Chinese population is ageing rapidly. The number of people over 60 in 2014 had increased over the last year by 10 million. They amount to 15.5 per cent of the total population. It is predicted that by 2030, the number of people over the age of 60 will reach 350 million, or 25 per cent of the total population.<sup>9</sup> At the same time, 2014 witnessed a decrease in the workforce by 3.71 million over the previous year and this has been the third consecutive year of such a decrease.<sup>10</sup>

To deal with the impact of an ageing population and declining workforce, in the third session of China's 12<sup>th</sup> National People's Congress, the Minister for Human Resources and Social Security indicated that the retirement age extension scheme is expected to be

8 *Interim Revisions on Labour Dispatch*, MHORSS, 26<sup>th</sup> January, 2014, viewed 14<sup>th</sup> May, 2015, <[http://www.mohrss.gov.cn/gkml/xxgk/201401/t20140126\\_123297.htm](http://www.mohrss.gov.cn/gkml/xxgk/201401/t20140126_123297.htm)>

9 *China 2030*, The World Bank, 2015, p. 277, <<http://www.worldbank.org/content/dam/Worldbank/document/China-2030-complete.pdf>>

10 *State Council Press Office press conference on 2014 national economic operation*, State Council, 20<sup>th</sup> January, 2015, viewed on 3<sup>rd</sup> June, 2015, <<http://www.scio.gov.cn/xwfbh/xwfbh/wqfbh/2015/20150120/index.htm>>



formulated next year and implemented gradually over the next five years. The current retirement age in China for men is 60, while the retirement age for women depends on the work they do: the retirement age for female blue-collar workers is 50, and 55 for female white collar workers. It is anticipated that the scheme will increase the retirement age to 65 for both men and women, irrespective of the work they carry out.

Because elderly people need comparatively more care from family members and fewer of them support economic development, it may be a pragmatic option for people to work on a more flexible basis which would allow them to look after elderly family members. Time-based contracts could be supplemented by work-load (including part-time) or project-based contracts where needed. Additionally, the rapid development of mobile Internet, big data and cloud computing has led to an increase in mobile working or working from home.<sup>11</sup> According to statistics from Iresearch, 2013 saw an increase of the mobile Internet market volume in China by 81.2 per cent amounting to Chinese Yuan (CNY) 105 billion. It is predicted that the market volume will increase by 4.5 times, to approximately CNY 600 billion by 2017.<sup>12</sup> This indicates that there will be an increasing trend of mobile offices, which may offer an ideal solution for those who need to work as well as take care of elderly family members, while addressing the workforce shortage.

#### Recommendations

- Take a more flexible approach to HR outsourcing by allowing the percentage applicable for each company to be based on a realistic evaluation of the industry sector, regional location and actual work force demand.
- Improve workforce flexibility by clarifying how work-load (including part-time) or project-based contracts with employees can be used.

### 3. Implement More Flexible Visa and Work Permit Regulations

#### Concern

Strict immigration policies have a negative impact on

talent attraction, retention and development, and at the end of their career, experienced employees in many cases are denied a work visa if they have surpassed the Chinese retirement age of 55 for women and 60 for men.

#### Assessment

Regulations stipulating the number of required years of work experience deters fresh graduates from moving to China and young European talent from gaining experience in China through internships. Companies have experienced increasing difficulties obtaining visas for foreign interns since the enactment of the *Regulations on the Entry and Exit Administration of Foreigners*, effective 1<sup>st</sup> September, 2013.<sup>13</sup> European companies employ a large number of Chinese employees but also a number of foreign employees to facilitate know-how transfer and best practice-sharing. Given the continuing importance of China in European companies' global strategy, European Chamber member companies wish to give exposure to young European talent to the Chinese market by offering internships in their China operations. Young foreign interns contribute as much to an internationalised business environment, as young Chinese interns contribute when undertaking corresponding internships in Europe.

The Human Resources Working Group understands that the regulations and administrative practices do not provide for a specific visa-type for foreign interns anymore.<sup>14</sup> At the moment, at most embassies/consulates abroad business visas are not granted for internship purposes anymore. Even if still granted, these visas are not accepted by most local Public Security Bureaus (PSBs) in China. Companies have faced claims by the PSB that interns holding M-visas are now viewed as 'illegal employees' by the PSB with fines being issued. However, due to the lack of prior two-year work experience, it is impossible to apply for a work permit for such interns. The working group understands that the regulations further allow foreign students holding residence permits for study purposes to complement their studies with an internship or off-campus job if the relevant school gives permission and the local PSB indicates this in the residence

11 *Ten Trends of 2015 China Internet development: the Internet boom of initiating business*, Hexun News, 15<sup>th</sup> January, 2015, viewed on 1<sup>st</sup> June, 2015, <<http://pe.hexun.com/2015-01-15/172416183.html>>

12 *The volume of mobile internet market in China has reached 105.98 billion yuan and has entered a pattern of rapid development*, iResearch, 14<sup>th</sup> January, 2014, viewed on 3<sup>rd</sup> June, 2015, <<http://wireless.iresearch.cn/others/20140114/224843.shtml>>

13 *The Decree of the State Council No. 637*, The Central People's Government of the People's Republic of China, 22<sup>nd</sup> July, 2013, viewed on 1<sup>st</sup> June, 2015, <[http://www.gov.cn/zwqk/2013-07/22/content\\_2452453.htm](http://www.gov.cn/zwqk/2013-07/22/content_2452453.htm)>

14 Before 1<sup>st</sup> September, 2013, the websites of the Chinese Visa Application Service Centres expressly mentioned F-visa as the appropriate visa for short-term training and internships.



permit. However, although almost two years have passed, this 'indication' is currently not being granted in practice, prohibiting companies *de facto* from offering internships to foreign students holding a residence permit for study purposes. Even though the working group is encouraged by recent announcements that the expanded China (Shanghai) Pilot Free Trade Zone (CSPFTZ or Zone) will loosen its employment policies for overseas candidates and will give international students the chance to work in the Zone, the situation is still uncertain as no implementation rules have been issued yet. Currently European Chamber member companies are confronted with a lack of clarity in the law, conflicting interpretation by various agencies, as well as a lack of implementation of already-existing regulations.

In many cases, foreign female employees of 55 years of age and male employees of 60 years of age cannot renew their work permits as they reach the Chinese retirement age. The retirement age in most EU countries is much higher. These experienced employees could still be employed by foreign-invested enterprises (FIEs) and contribute their expertise to the development of Chinese entities and their employees.

The working group is encouraged by recent reports according to which China is considering relaxing its 'Green Card' policy by lowering the application and approval threshold, in a move to attract more foreign talent. The regulation governing the approval of Green Cards for foreigners currently in force was issued in 2004 by the Ministry of Foreign Affairs and the Ministry of Public Security and stipulates high thresholds for such applications, including the position of the applicant in his company and investment threshold. Revised regulations should take into consideration the need for specific talent. Recent announcements that new policies which are to be soon piloted in the CSPFTZ will lower the threshold for certain talent are welcome.<sup>15</sup> The working group is looking forward to timely implementation and it is hoped that they will soon be rolled out nationwide.

#### Recommendations

- Clarify university and internship visa access in China.
- Lower the threshold for Green Card application.
- Simplify work permit procedures for female

<sup>15</sup> *Enlarge the scope of enterprises for allowing foreigners to apply for permanent residence in China*, Ministry of Public Security, 8<sup>th</sup> June, 2015, viewed 15<sup>th</sup> June, 2015, <<http://www.mps.gov.cn/n16/n1237/n1342/n803715/4477475.html>>

foreign employees over 55 years of age and male employees over 60 years of age.

## 4. Improve the Attractiveness of China in Order to Attract and Retain Top-class, Distinctive Talent From China and From Abroad

### 4.1 Lower Individual Income Tax (IIT) Pressure to Avoid Losing Top Talent to Other Regional Hubs

#### Concern

Top strategic talent command the highest salaries and are subject to the upper bracket for individual income tax (IIT). Individual income tax rates in China are now the highest in the region, discouraging top talent from coming to China or encouraging them to work in China but reside outside China to avoid such high tax rates.

#### Assessment

The upper tax bracket in China is 45 per cent, which is almost three times the rate in competing hubs like Hong Kong or Singapore.<sup>16</sup> This has a negative impact on efforts to attract top strategic talent who choose to either reside in other hubs in the region and conduct their China work from there, or relocate to other hubs like Hong Kong or Singapore. The competitiveness of companies in China is derived primarily from the presence of top talent at the general management level, hence a lower presence of top talent has a negative impact on the competitiveness of companies based in China. It has also a very negative impact on the global talent landscape in China because younger talent learns from direct interaction with top talent.

#### Recommendation

- Lower IIT pressure to avoid losing top talent to other regional hubs.

### 4.2 Ensure China's Environmental Standards for Air, Water and Soil Quality, as Well as Food Safety, are Meeting International Standards

#### Concern

Air, water and soil pollution, as well as food safety issues, have started to have a negative impact on the attractiveness of China for top international and local talent.

<sup>16</sup> *European Business in China Asia-Pacific Headquarters Study*, European Union Chamber of Commerce in China, 2011, p. 33, <[http://www.eurochamber.com.cn/en/publications-archive/26/Asia\\_Pacific\\_Headquarters\\_Study\\_2011](http://www.eurochamber.com.cn/en/publications-archive/26/Asia_Pacific_Headquarters_Study_2011)>



### Assessment

High levels of air, water and soil pollution, as well as repeated food safety scandals, have led to growing concerns from international and local top talent about the quality and safety of the living environment in China. Top talent is attractive to the labour market and consequently have more choices with regards to work location. When selecting a location to work, quality of life is an important part of the equation.

Since the episodes of extremely serious pollution during the winter of 2013, where pollution levels were 30 times higher than the acceptable limits set by the World Health Organisation (WHO),<sup>17</sup> companies have encountered more difficulties attracting top foreign talent to China. In the European Chamber's *Business China Confidence 2015*, air quality issues retains its position as the top HR challenge for European companies: 74 per cent of companies stated that air quality issues are one of the top three challenges when trying to attract expat talent in China; and 63 per cent reported that air quality issues are one of the top three challenges when trying to retain the right expat talent in China.<sup>18</sup>

In addition to the impact of air pollution on recruitment, almost one third (27 per cent) of European companies believe that air pollution is also contributing to higher HR costs, as companies need to compensate employees to move to polluted cities and need to take other steps to respond to employee concerns.<sup>19</sup> It has also become more common for local talent grown in China to request to be assigned to other locations to avoid health risks deriving from pollution and a lack of food safety.

### Recommendation

- Ensure China's environmental standards for air, water and soil quality, as well as food safety, are meeting international standards.

### 4.3 Ensure Internet Speed and Accessibility Reach International Standards.

#### Concern

Slow Internet speeds and restricted access to legitimate

<sup>17</sup> *Ambient (outdoor) air quality and health*, World Health Organisation, March, 2014, viewed on 7<sup>th</sup> July, 2014, <<http://www.who.int/mediacentre/factsheets/fs313/en/>>

<sup>18</sup> *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, 2015, p. 45, <[http://www.europeanchamber.com.cn/en/publications-archive/334/Business\\_Confidence\\_Survey\\_2015](http://www.europeanchamber.com.cn/en/publications-archive/334/Business_Confidence_Survey_2015)>

<sup>19</sup> *European Business in China Business Confidence Survey 2014*, European Union Chamber of Commerce in China, 2014, page 17, <[www.europeanchamber.com.cn/en/publications-archive/256/Business\\_Confidence\\_Survey\\_2014](http://www.europeanchamber.com.cn/en/publications-archive/256/Business_Confidence_Survey_2014)>

sources of information not only impede normal business functions and the globalisation of finance, trade and e-commerce, they also negatively impact communication between companies and individuals and deter world-class talent from relocating to China.

### Assessment

In a members' poll run in January 2015, the European Chamber found that China's slow Internet speed and the inability to access certain web pages in China were identified as negatively affecting business by 86 per cent of respondents. The extent of restrictions in China, and the apparatus used to carry out such censorship, massively slows Internet speed and filters out huge amounts of non-illegal content. In recent years, this has even extended to restrictions on search engines, which are necessary for research amongst almost all businesses and the public.

These restrictions on the Internet affect the ability of individuals and businesses to conduct research in China and the companies' ability to attract top researchers as they are put off by the restrictions and the difficulty to search for scholarly papers to conduct their work. Inability to get access to indispensable online tools, like Google Scholar, and database websites has greatly hindered research, not to mention news websites like Le Monde, BBC, The New York Times and Bloomberg. The breakdown of Google, the world's largest search engine, and Gmail, the world's most widely used mailbox, has hugely affected the ability to research and conduct very basic business operations. Therefore, in addition to diminishing the quality of experience of Internet users, the inaccessibility of certain websites and low Internet speeds—with China being ranked 96<sup>th</sup> in the world for average peak Internet connection speeds—also have a negative impact on talent attraction, especially research staff.

### Recommendation

- Ensure Internet speed and accessibility reach international standards.

### 4.4 Speed up Bilateral Social Security Agreements to Avoid Double Payments for Pensions and Health Insurance Contributions

#### Concern

China has developed its system for contributing to social pensions and now extends this scheme to



foreigners. However, currently China only has relevant agreements with two EU countries,<sup>20</sup> leading to a situation of double contributions, and unclear rules and benefits for expatriate talent.

### Assessment

The revised Social Insurance Law (SIL) became effective on 1<sup>st</sup> July, 2011, and extends the obligation to contribute to the Chinese Social Insurance scheme to foreigners working in China. In many cases this leads to double contributions in China and the home country of foreign work permit holders. In addition, local implementation differs in terms of rates and benefits depending on the individual's location. This usually results in inconsistency or lack of access to benefits, along with the costs of double contributions.

### Recommendation

- Speed up bilateral social security agreements to avoid double payments for pensions and health insurance contributions.

## Abbreviations

CAI	Comprehensive Agreement on Investment
CNY	Chinese Yuan
CPCCC	Communist Party of China Central Committee
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
EU	European Union
FIE	Foreign-Invested Enterprise
HR	Human Resources
IIT	Individual Income Tax
MNC	Multinational Corporation
MOHRSS	Ministry of Human Resources and Social Security
PSB	Public Security Bureau
SIL	Social Insurance Law
SME	Small and Medium-sized Enterprise
WHO	World Health Organisation

<sup>20</sup> China has only entered into bilateral social security agreements with Germany and South Korea, and most recently with Denmark, to coordinate their pension programmes. Negotiations with 12 other countries are underway.





# Intellectual Property Rights Working Group

## Key Recommendations

### 1. Trademarks

#### 1.1 Utilise the Examination Notice Procedure when Clarification on Trademark Applications is Needed

- Apply standard phonetic transliteration when adapting non-English Latin letters to standard English letters when processing international trademark applications; for domestic applications, apply the Examination Notice Procedure—rather than just rejecting the applications—where the applicant's name or address contain non-English, Latin letters.
- Apply the Examination Notice Procedure—rather than rejecting the applications—where applications contain what the Trademark Office considers to be non-standard goods and services.

#### 1.2 Implement a New Regulation that Addresses the Issue of the Unauthorised Use of Trademark Names in Enterprise Names

- Confirm that using a registered trademark as a trade name or in a company name is an act of unfair competition which violates Article 2 of the Anti Unfair Competition Law.
- When a final judgement is reached that orders the modification of a company name, stipulate a 15-day time limit to take action, failing which the name of the company will be deleted and replaced by its registration number.

#### 1.3 Explain that the Stock of Infringing Goods Detained by a Seller Who Meets the Criteria of an 'Innocent Seller', as Defined in Article 64.2 of the Trademark Law, Must be Disposed of Outside the Channels of Commerce

#### 1.4 Improve Intellectual Property Rights (IPR) Enforcement When a Registered Trademark is Altered in Use so as to Constitute an Infringing Use of Another Registered Trademark (the 'Infringed Mark')

- Clarify that the local Administration of Industry and Commerce (AIC) is authorised, at the request of the owner of the infringed mark, to conduct raid actions on the basis of trademark infringement.
- Issue a rectification order making the registrant of the trademark responsible for obtaining rectification by all the licensees or sub-licensees, failing which the trademark shall be cancelled by the Trademark Office.

### 2. Patents

#### 2.1 Introduce an Effective Patent Linkage System

- Maintain Article 19 of the *Drug Registration Regulations (DRR)*, and improve the effectiveness of the provision in the practice of the China Food and Drug Administration (CFDA).
- Clarify by an update that the Supreme People's Court's (SPC's) *Opinions on Hearing Intellectual Property Cases (Opinions)* of 2009 is no longer an obstacle to pharmaceutical companies' effectively obtaining preliminary injunctions in pharmaceutical cases to prevent illegal early market entry by generic drug companies.
- Encourage the CFDA, the State Intellectual Property Office (SIPO) and the courts to work together to introduce an effective patent linkage system in China based on the originator's patent protection.

#### 2.2 Clarify the Rules for Post-filing Submission of Supplemental Data

- Revise Part II, Chapter 10, Section 3 of the SIPO's *Patent Examination Guidelines of China (Guidelines)* and other sections of the guidelines to clarify the admissibility of the post-filing







submission of supplemental data.

- Publish specific decisions made by the Patent Re-examination Board (PRB) or the Beijing High Court to show the implementation of the clarified practice of admissibility of post-filing submissions of supplemental data.
- Provide clear guidance to patent examiners at the SIPO and the PRB, as well as patent applicants, regarding the circumstances under which, and what type of, post-filing data will be considered.

### **2.3 Introduce Adequate Protection for Biotechnology Innovations Related to DNA and Amino Acid Sequences**

- Revise the SIPO's *Patent Examination Guidelines of China* to ensure that for inventions in the field of biotechnology relating to genes and proteins the obtainable patent protection is not limited to only the specific nucleotide or amino acid sequences in the sequence listings of the embodiments.
- Allow percentage values of identity or homology related to genes and proteins in patent claims when the claims also refer to the retained innovative utility of such variants and homologues.

## **3. Copyright**

### **3.1 Clarify What is Required to Show Ownership of Copyright**

- Offer clear guidance to copyright administrative authorities as to what evidence is required to raise a presumption of ownership.
- Clarify and bring forward the point at which the burden will be passed to the defendant to demonstrate that the defendant is validly licensed

### **3.2 Improve Administrative Enforcement**

- Assign dedicated officers within the copyright administrative authorities to handle pure copyright infringement cases, strengthen their powers of investigation and provide them with clearer and more express guidance as to how complaints must be handled.

### **3.3 Finalise the Draft Amendments to the Copyright Law, Taking into Account Stakeholders' Remaining Concerns, and Then Implement Them**

- Finalise and implement the amendments to the Copyright Law as an absolute top priority in the State Council Legislative Affairs Office's (SCLAO's) legislative work plan, to ensure that the critical progress in the protection of right-holders that is required today actually takes place.

## **4. Trade Secrets**

### **4.1 Facilitate Criminal Prosecution of Trade Secret Theft and Raise Penalties Imposed on Such Infringements**

- Modify the *Interpretation of the Supreme People's Court on Several Issues Concerning the Applicable Laws in the Trial of Unfair Competition Civil Cases* to: (1) lower the burden of proof for a plaintiff to bring a trade secret misappropriation case; and (2) let judges determine when a *prima facie* case of trade secret misappropriation has been established by the plaintiff and, thus, to decide that the burden of proof should be shifted onto the defendant.
- Lower substantially the threshold damages amount needed to bring a case in the *Judicial Interpretation of Unfair Competition in Criminal Intellectual Property (IP)* cases.
- Substantially increase penalties for misappropriation of trade secrets under the Anti-Unfair Competition Law and the rules of the State Administrative for Industry and Commerce (SAIC).



## Introduction to the Working Group

The Intellectual Property Rights (IPR) Working Group represents a wide range of European interests in the intellectual property (IP) regulatory framework and IPR enforcement in China. Half of the working group's 380-plus members are from the goods sector with the other half are from the services sector. Over the last fifteen years, the Intellectual Property Rights Working Group has witnessed China's efforts to curb the dramatic increase of IPR violations that affect its economic order, China's innovation capacity and the rights of its consumers. The working group serves as a bridge between Chinese governmental agencies and judicial officials and European business. It offers its support primarily through recommendations aimed at improving the efficiency and effectiveness of China's IPR protection system.

## Recent Developments

### Trademarks

Both the Supreme People's Court (SPC) (25<sup>th</sup> March, 2014) and the State Administration for Industry and Commerce (SAIC) (15<sup>th</sup> April, 2014) issued transitional provisions (*Interpretations of the Supreme People's Court on Issues Concerning Jurisdiction Over and Application of Law to Trademark Cases After Implementation of the Decision on Amending the Trademark Law 2014 No.4; Notice of the State Administration for Industry and Commerce on Issues Relating to Implementing the Revised Trademark Law of the People's Republic of China 2014 No.81*) to clarify how the 'old' law and the 'new' law are to apply to administrative enforcement cases filed before the revised law came into force on 1<sup>st</sup> May, 2014, when the acts of infringement took place before that date. The Intellectual Property Rights Working Group welcome this clarification.

The SPC issued a call for comments on the draft *Interpretation on Several Issues Concerning the Hearing of Administrative Cases Involving the Granting and Confirmation of Trademark Rights*. The Interpretation provides, *inter alia*, for the "massive filing of trademarks"<sup>1</sup> with "no intention to use", to be considered as an indication of bad faith. The European

Chamber sent comments approving such provision, but noting that a "massive number" is hard to define and is not the only condition revealing bad faith.

### Patents

The State Intellectual Property Office (SIPO) issued a call for comments on a new draft amendment to the Patent Law on 1<sup>st</sup> April, 2015. The working group welcomes the changes that provide for more limited administrative enforcement powers compared with the earlier draft amendment published for comments in 2014. However, the working group believes that patent enforcement should remain in the hands of experienced judiciary and courts rather than be devolved to administrative authorities and that the final amendments should reflect this.

On 2<sup>nd</sup> April, 2015, the SIPO issued a call for comments on a new draft of the *Regulations on Service Inventions*. Compared with the previous draft, the working group welcomes the changes that reduce the burden on employers. However, the draft regulation arguably still allows for the invalidation of reward policies and individual agreements *ex post facto* if there is any non-compliance with other articles regarding the rights of service inventors in the draft regulation. This clause remains a substantial concern and results in risks and uncertainty for employers. In addition, it is still not clearly stated that only the employer of the inventor is liable to pay remuneration, and not the entity to whom the patent is granted (if they are not the same).

The SPC released a draft of the *Interpretations of the Supreme People's Court on Certain Issues Concerning the Application of Law in the Trial of Patent Infringement Cases (II)*, providing in Article 26 that an alleged infringer can generally raise a non-infringement defence based on a prior technical solution or prior design. However, if the alleged infringer can provide evidence to prove that: the allegedly infringing technical solution is an obvious combination of a prior technical solution and common general knowledge before the application date of the patent; or that the allegedly infringing design is an obvious combination of one prior design and customary design before the application date of the patent, the people's court may find that the defence of non-infringement raised by the alleged infringer to be valid. Regarding the aforesaid defence raised by the alleged infringer, the applicable court must assess prior art or prior design in accordance with the Patent Law

<sup>1</sup> *Interpretation on Several Issues Concerning the Hearing of Administrative Cases Involving the Granting and Confirmation of Trademark Rights*, Supreme People's Court, 14<sup>th</sup> October, 2014, viewed 2<sup>nd</sup> July, 2015, <<http://www.chinacourt.org/law/detail/2014/10/id/147963.shtml>>



in effect at the date of application of the patent. The working group will need to consider the impact of this interpretation once it has been implemented in its final form.

### Courts

The SPC issued the *Regulations of SPC on the Jurisdictions of IP courts in Beijing, Shanghai and Guangzhou 2014 No.12* in October 2014, effectively paving the way for the establishment of three IP courts in Beijing, Shanghai and Guangdong. This measure constitutes a three-year experiment for these courts. They are provided as having exclusive jurisdiction relating to: (1) patent cases (civil litigation, appeals from the Patent Re-examination Board (PRB) and administrative enforcement), new plant varieties, trade secrets and lay out of integrated circuit; (2) reviews of certain decisions made by ministries on licence fee issues; and (3) recognition of well-known trademarks. As a result, it seems that all civil litigation concerning trademarks—regardless of the amount or the existence of a foreign party—will have to be submitted in the first instance to the basic courts. This will need to be examined in view of Article 1 of the Civil Procedure Code (revised in 2012), which provides that intermediate courts shall have jurisdiction over: (1) major cases involving a foreign element; (2) cases that have a major impact in the area of its jurisdiction; and (3) cases under the jurisdiction of the intermediate court as determined by the SPC. The working group appreciates the measures and further recommends a national appellate patent court to reduce any risk of local influence and improve adjudication of patent cases.

### Copyright

The State Council Legislative Affairs Office (SCLAO) issued a call for comments on the fourth draft amendment of the Copyright Law (June, 2014). Disappointingly, the fourth draft presented no substantial further developments whatsoever compared with the third draft. Serious concerns remain regarding the amendments proposed in the fourth draft, in particular, the following:

- The limitations to the exclusive rights in Article 43 are not fit for purpose. The limitations as drafted remain overbroad and ill-defined in scope. Today, technology allows overbroad or ambiguous drafting to be ruthlessly exploited, undermining the creativity and investment of rights holders and removing the incentives for the creation of the works in the first

place. The limitations must be drafted very narrowly, extremely clearly and in strict compliance with the Three Step Test as set out in the *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPS), among other places.

- The statutory licensing provisions in Articles 47 to 50 are overbroad and unconditional, i.e. it is not possible for rights holders to 'opt out'. Rights in copyright and related rights are exclusive private rights and it is critical that any right holder be permitted to 'opt out', i.e. to declare that any or all of his works may not be used in accordance with the provisions.
- The principles on which the orphan works provision in Article 51 are to be founded are unclear. The law should expressly establish two key principles: (1) the principle of diligent search by the intended user on a work-by-work basis; and, (2) the principle of a licensing-based scheme, rather than an exception/limitation to exclusive rights or some other approach.
- The principles on which the collective management organisation provisions in Articles 61 to 67 are founded are unclear. The law should expressly establish several key principles regarding the establishment of collective management organisations (CMOs): (1) CMOs primary responsibilities must be to its members and copyright owners (not users); and, (2) CMOs must be transparent, have clear governance and be accountable to their members.

The amended Copyright Law fell into the second category of priorities in the SCLAO's legislative work plan in 2014. The working group's view remains that these amendments should fall within the first category of priorities in order to ensure that further progress is made. Given the minimal and immaterial amendments between the third and fourth drafts, there has effectively been little progress in the amendment process for more than two years, since the third draft was released in January 2013.

### Civil Procedure Law and Administrative Procedures

The Administrative Procedure law of China was revised on 11<sup>th</sup> January, 2014. An opening has been made for not only the person subject to an administrative action but also a person *with an interest* in such administrative action, to file a complaint before the court against such administrative action (Article 25). It is further stipulated that where a party to an administrative ruling on a civil dispute applies to the court for settling the civil dispute



concurrently, the court may accept the case (Article 61). The working group will need to consider the impact of this change in due course in light of experience gained with the revision.

The SPC issued the *Interpretation on the Civil Procedure Law of China (Interpretation)*, on 30<sup>th</sup> January, 2015. This *Interpretation*, which is composed of 552 articles, introduces specific jurisdiction rules concerning purchase contracts executed by means of an information network. When the goods are delivered through an information network the jurisdiction is the place where the purchaser is domiciled; if the goods are delivered by other means the jurisdiction is the place of delivery. Furthermore, when a tort is committed (which arguably includes certain types of IPR violations), the jurisdiction is the place where the tortious act was committed or the place where the defendant is domiciled (Article 28 of the Code of Civil Procedure). The SPC adds, in Article 25 of the *Interpretation*, that the place where the tort or offense in respect of the information network is committed includes the place where the information facilities (computer) are located, and the place where the results of the offense take place. It remains to be verified whether an IP owner will effectively be able to sue an Internet Service Provider before the court of its own domicile. The working group will need to consider the impact of the *Interpretation* in light of experience gained with it.

### IPR and the Anti-Monopoly Law

The SAIC issued the *Provisions on the Prohibition of the Abuse of Intellectual Property Rights to Exclude or Restrict Competition (Provisions)*, on 7<sup>th</sup> April, 2015, to become effective on 1<sup>st</sup> August, 2015.

The *Provisions* had been under discussion since 2009, and are the result of a long examination process. They address, in particular, the stipulation contained in Article 55 of the Anti-Monopoly Law that the law does not govern the business of business operators to exercise their IPR, provided that they do not abuse their rights to eliminate or restrict competition. An abuse of rights is deemed to have occurred when operators reach a monopoly agreement by way of exercising IPR. Article 5 of the *Provisions* creates a safe harbour, defining what is not a monopoly agreement (where operators are below a certain threshold in the relevant market or alternative technologies exist). However, this harbour is not absolutely safe, since Article 5 adds that the

SAIC could consider that contrary evidence indicates that the agreement in fact does exclude or restrict competition. Article 7 also raises some concerns: it prohibits the refusal of a licence to an operator where the IPR concerned is considered an "essential facility",<sup>2</sup> for manufacturing and operating activities. Again, the Intellectual Property Rights Working Group will need to consider the impact of the *Provisions* once they have been implemented and experience has been gained in their actual operation.

### EU-China IPR Cooperation

In 2015, the European Union and China are celebrating the 40<sup>th</sup> anniversary of their diplomatic relations as well as the 10<sup>th</sup> anniversary of their cooperation on IPR issues.

This cooperation has been realised through annual meetings, The IPR Dialogue, between officials on both sides, in Beijing and in Brussels, and through the bi-annual EU-China IPR Working Group meetings, in Beijing, in the presence of European industry representatives such as the European Chamber. Since 2014, follow-up meetings have allowed more in-depth discussions on certain topics of particular importance, such as the Inclusive Development Theory initiated by the SPC in 2010. The success and usefulness of these meetings has led both sides to upgrade the dialogue to the level of vice minister in order to give it more weight.

The working group appreciates the offer made by the European Commission with regards to making information services for international protection of trademarks available to all IP users, Chinese or foreign, via the TM view system proposed by the Office for Harmonisation in the Internal Market (OHIM).

The European Chamber encourages and supports such initiatives.

<sup>2</sup> *Provisions on the Prohibition of the Abuse of Intellectual Property Rights to Exclude or Restrict Competition*, SAIC, 7<sup>th</sup> April, 2015, viewed 2<sup>nd</sup> July, 2015, <[http://www.saic.gov.cn/zwgk/zyfb/zj/ftd/201504/t20150413\\_155103.html](http://www.saic.gov.cn/zwgk/zyfb/zj/ftd/201504/t20150413_155103.html)>



Third Plenum Reality Check		
What did the Third Plenum's <i>Decisions</i> say?	What is the reality?	Status
<p>13. Deepening reform of the management system for science and technology. “We will strengthen the application and protection of intellectual property rights (IPR), improve the technological innovation incentive mechanism, and explore ways to set up IPR courts.”</p>	<p>Parts of this promise are on track for implementation, namely the implementation of a separate specialised system of IPR Courts.</p>	
<p>31. Deepening reform of the administrative law-enforcement system. “We will integrate major law-enforcement bodies, relatively centralise the law-enforcement power, press ahead with comprehensive law enforcement, and do our best to resolve problems such as overlapping functions and duplicate law enforcement to establish an authoritative and efficient administrative law-enforcement system with the integration of power and responsibility. We will reduce the hierarchy of administrative law enforcement, and allocate more law-enforcement resources to the primary level in such key areas as foodstuffs and medicines, production safety, environmental protection, labour security, and coastal areas and islands. We will straighten out the urban management law enforcement system, and improve the level of law-enforcement and service quality. We will improve the procedure of administrative law enforcement, specify areas of discretion, strengthen supervision over administrative law enforcement, and comprehensively implement the responsibility system as well as government funding for administrative law enforcement, in order to promote strict, standardised, fair and civilised law enforcement. We will improve the mechanism that dovetails administrative law enforcement and criminal justice.”</p>	<p>Implementation of this promise may be reflected in the proposed/draft fourth amendment of the Patent Law as they relate to devolving enforcement powers to administrative authorities. The results/impact of this devolution will need to be assessed once the final version of the fourth amendment has been issued.</p> <p>The same applies to the Administrative Procedure Law, which came into effect on 1<sup>st</sup> May, 2015, the impact of which will likewise have to be assessed once more experience has been garnered of its operation in practice.</p>	
<p>32. Ensuring the independent exercise of the judicial and procuratorial power in accordance with the law. “We will reform the judicial administration system, unify the management of staffs, funds and properties of courts and procuratorates below the provincial level and explore ways to establish a judicial jurisdiction system that is appropriately separated from the administrative divisions to ensure that the state laws are enforced properly and uniformly. We will establish a judicial personnel management system fitting their professional characteristics, improve the system for unified recruitment, orderly exchange and level-by-level promotion of judges, procurators and the police, improve the classified management system of legal personnel, and guarantee the job security of judges, procurators and the police.”</p>	<p><i>Regulations of the SPC on the Jurisdictions of IP Courts in Beijing, Shanghai and Guangzhou(2014) No.12</i> might constitute an opportunity to implement this promise, by experiencing new specific procedures. Its impact/effect will need to be assessed when more practical experience has been garnered with the new specialist IPR court system.</p>	

## Key Recommendations

### 1. Trademarks

#### 1.1 Utilise the Examination Notice Procedure when Clarification on Trademark Applications is Needed

#### Concern

Due to the time constraints imposed in the revised Trademark Law, trademark applications are at times too easily refused, or are accepted but registered in a way that may cause problems: better use of the examination notice procedure could avoid these inconveniences.



### Assessment

Whenever an examiner finds the slightest clerical mistake (such as a typographical error) in an application, which could be very easily rectified and which does not affect the validity of the application, the trademark is flatly refused: the consequence is that the applicant loses the benefit of the application/priority date.

Or, when an international application is received where it is not clear to which Chinese sub-classes of goods or services the goods or services designated by the original registration correspond, it happens that the examiner accepts the registration without mentioning any sub-class, or with all sub-classes mentioned. This creates problems at the enforcement stage, as the local Administration for Industry and Commerce (AIC) bureaus are reluctant to enforce trademarks when no precision is given as to which goods or services should be protected.

Furthermore, when an application contains certain characters that do not exist in standard English letters ('non-English, Latin letters'), which are not accepted by Trademark Office practice, the examiner chooses *ex officio* a replacement character without asking the applicant. This can create confusion as well as making the ensuing registrations effectively un-enforceable, where, as a result, the name of the applicant is transformed into another name. For example where 'Möller' is changed to 'Moller' or the European Chamber's President 'Jörg Wuttke' becomes 'Jorg Wuttke', and the local notaries become unable to notarise the signing of the power of attorney of the proprietor of the trademark to be enforced.

### Recommendations

- Apply standard phonetic transliteration when adapting non-English Latin letters to standard English letters when processing international trademark applications; for domestic applications, apply the Examination Notice Procedure—rather than just rejecting the applications—where the applicant's name or address contain non-English, Latin letters.
- Apply the Examination Notice Procedure—rather than rejecting the applications—where applications contain what the Trademark Office considers to be non-standard goods and services.

## 1.2 Implement a New Regulation that Addresses the Issue of the Unauthorised Use of Trademark Names in Enterprise Names

### Concern

According to Article 58 of the revised Trademark Law, the unauthorised use of a registered trademark as an enterprise name, in such a way that it misleads the public, is considered as an act of unfair competition, to be handled pursuant to the law against unfair competition. However, this law does not contain any specific provisions addressing such cases, and even if a judgement orders an enterprise to change its name, the enforcement of such judgement is almost impossible.

### Assessment

The PRC Anti Unfair Competition Law dates back to 1993, and has never been revised. In the absence of any specific provision addressing the conflict between a registered trademark and an enterprise name, the only useable provision of this law is the general principle laid down in Article 2. Civil courts are sometimes reluctant to base their decision on such a broad and general principle.

Furthermore, the difficulty of enforcing a judgement ordering the change of an enterprise name was already explained in the *IPR Position Paper 2011* and *IPR Position Paper 2012*: even where the judgement is notified by the court to the relevant bureau of the AIC, such notification is often insufficient to result in any action. If the AIC is willing to enforce the judgement, it has no authority to decide which other name should replace the litigious one.

This is why it is proposed to follow the same solution as in Hong Kong, where the Company Registrar notifies the company that unless a change is made within a given period of time, the company will become identifiable on the Company's Registry by its sole registration number.

### Recommendations

- Confirm that using a registered trademark as a trade name or in a company name is an act of unfair competition which violates Article 2 of the PRC Anti Unfair Competition Law.
- When a final judgement is reached that orders the modification of a company name, stipulate a 15-day time limit to take action, failing which the name



of the company will be deleted and replaced by its registration number.

### 1.3 Explain that the Stock of Infringing Goods Detained by a Seller Who Meets the Criteria of an ‘Innocent Seller’, as Defined in Article 64.2 of the Trademark Law, Must be Disposed of Outside the Channels of Commerce

#### Concern

The combination of Article 64.2 of the new Trademark Law and Article 80 of the new *Implementing Rules* creates a loophole, whereby if a seller of infringing goods claims ignorance, that person gets to keep the infringing goods with a mere order to stop selling, opening the possibility for those goods to return to the channels of commerce without further control.

#### Assessment

Article 64.2 of the Trademark Law provides that the AIC, when it believes that an infringing act has been committed, may order to stop the infringing act, confiscate and destroy the infringing goods and the tools to manufacture the infringing goods, and impose a fine. However, the article provides for an exception in favour of the ‘innocent seller’. The seller who does not know that the goods are infringing, who can prove that he/she obtained the goods through legal channels and who discloses the name of his supplier “shall be ordered by the AIC to stop selling such goods”.<sup>3</sup> No seizure, confiscation of goods or fine is imposed. This new provision is confirmed by Article 80 of the revised *Implementing Rules*: “... the administration for industry and commerce shall order the seller to stop selling the infringing products, and report the case to the supplier’s local administration for industry and commerce”.<sup>4</sup>

In practice, when the local AIC of the infringing supplier receives such a report, it does not know how to respond and will do nothing. More worryingly, the infringing goods are then returned to the ‘innocent’ distributor, to be disposed of at his discretion without any guarantee that this will be done.

This seems to contradict Article 49 of the TRIPS, regarding administrative procedures. When such

administrative procedures are available, they must conform to principles equivalent in substance to other principles set forth in this section of the TRIPS, (such as Article 46 where it is clear that infringing goods must be disposed of outside the channels of commerce, and without compensation). Returning the goods with a simple order to stop selling is clearly insufficient to guarantee that they will not be disposed of in the channels of commerce.

In fact, the confiscation and destruction (or giving to charity etc.) of the stock already made and seized should not be considered as a penalty, but rather as a measure of protection of the social order. The ‘innocent seller’ would receive an order to stop selling similar infringing goods in the future, while not being sanctioned with a fine. However, the stock that has been seized should be dealt with according to Article 60 paragraph 2 of the Trademark Law, i.e. confiscated and destroyed.

#### Recommendation

- Explain that the stock of infringing goods detained by a seller who meets the criteria of an ‘innocent seller’, as defined in Article 64.2 of the Trademark Law, must be disposed of outside the channels of commerce.

### 1.4 Improve IPR Enforcement When a Registered Trademark is Altered in Use so as to Constitute an Infringing Use of Another Registered Trademark (the ‘Infringed Mark’)

#### Concern

The intentional transformation of registered trademarks into trademarks that infringe on previously existing trademarks has become an increasingly worrisome phenomenon in China – aside from suing before a People’s Court, which takes time and money, no direct enforcement solution is available.

#### Assessment

During the third revision of the Trademark Law, a draft was proposed by the SAIC in 2009, which provided in Article 48 that whenever “a registered trademark is altered to make it identical or similar to another party’s registered trademark in respect of the same or similar goods, which may cause confusion or misidentification, any person may apply to the Trademark Review and Adjudication Board to cancel such registered

<sup>3</sup> *Implementing Rules of the Trademark Law of the People’s Republic of China*, State Council, 9<sup>th</sup> April, 2014, viewed 2<sup>nd</sup> July, 2015, <http://www.chinalaw.gov.cn/article/fgkd/xfg/xzfg/201405/20140500395980.shtml>

<sup>4</sup> *Ibid*



trademark".<sup>5</sup>

This aimed to fill a loophole in Article 44 of the law of 2001, ("...the Trademark Office shall order the registrant to rectify the situation within a specified period or even cancel the trademark"). No procedure existed for the victim of such an alteration to file an application to the Trademark Office or the Trademark Review and Adjudication Board (TRAB); it was only an *ex officio* decision.

The most welcome 2007 draft unfortunately was not retained. On the contrary, the text finally promulgated in 2013 is even less enforceable than the original text of 2001. It provides that when a trademark registrant unilaterally alters the trademark, "the local administrative department for industry and commerce shall order him to rectify the situation within a specified period; where the situation is not rectified at the expiration of the said period, the Trademark Office may revoke the registered trademark".

This text overlooked that, in most cases, the trademark registrant and the trademark user are not the same person. There may be many different trademark users, according to the licensing arrangements made by the registrant. This means that, in principle, it should be necessary for each local AIC to order rectification. In practice, this can be almost impossible as the numbers can reach hundreds. And even if they do, the users have an easy defence: they claim that they are not using a 'transformed' trademark but a different trademark, and that this is an infringement issue, not a 'rectification' issue. If the local AIC organises a raid on the grounds of infringement, the user can claim that it is using a registered trademark, which makes the AIC very cautious. As to the trademark registrant, he can claim that he is not responsible for transformations made by the users.

Meanwhile, the owner of the prior-registered trademark is deprived of any direct action against the registrant of the transformed trademark.<sup>6</sup>

This is highly unfortunate because it allows the most

carefully-planned, bad-faith behaviour to develop without risk, which is contrary to the spirit of the new Trademark Law and its Article 7 about the principle of good faith.

### Recommendations

- Clarify that the local AIC is authorised, at the request of the owner of the infringed mark, to conduct raid actions on the basis of trademark infringement.
- Issue a rectification order making the registrant of the trademark responsible for obtaining rectification by all the licensees or sub-licensees, failing which the trademark shall be cancelled by the Trademark Office.

## 2. Patents

### 2.1 Introduce an Effective Patent Linkage System

#### Concern

The research-based pharmaceutical industry has observed that generic drug companies submit drug applications and obtain marketing approvals well before the expiry date of the innovators' valid patents, and there is a concern that they cannot be efficiently stopped from a patent-infringing, early market entry before patent expiry of the originator.

#### Assessment

This concern is based on the practice of the China Food and Drug Administration (CFDA), which grants marketing approval to generic drugs without having considered the relevant patent information of the originator. The originator's patent data is often missing from the CFDA database and the generic drug companies are not reporting on this originator's patent protection correctly as would be required by Article 18 of the *Drug Registration Regulations (DRR)*. This leads to the fact that CFDA cannot fulfil the supervision of preventing a market entry before patent expiry according to Article 19 of the *DRR*. Furthermore, the SPC has opined on scrutinising the grant of preliminary injunctions in patent cases, which are critical for pharmaceutical companies to avoid irreparable harm when an infringing product enters the market before the expiry of the patent term based on a market approval given by the CFDA.

The Bolar Exemption was introduced into the Patent Law in 2009, on the occasion of the third revision of the law. It allows—without being considered as an infringer—the use of a patented drug for the purpose of

<sup>5</sup> PRC Trademark Law 2010 revised draft (submitted for deliberation), Legislative Affairs Office, 18<sup>th</sup> November, 2009, viewed 2<sup>nd</sup> July, 2015, <[http://www.gov.cn/gzdt/2011-09/02/content\\_1939013.htm](http://www.gov.cn/gzdt/2011-09/02/content_1939013.htm)>

<sup>6</sup> Trademark Law of People's Republic of China, National People's Congress, 30<sup>th</sup> August, 2013, viewed 2<sup>nd</sup> July, 2015, <[http://www.sipo.gov.cn/zcfg/fffg/sb/fjxzfg/201309/t20130903\\_816432.html](http://www.sipo.gov.cn/zcfg/fffg/sb/fjxzfg/201309/t20130903_816432.html)>





obtaining marketing approval before the expiry date of the patent. This provision allows generic companies to prepare for the marketing of their drugs as soon as the patent protecting the original drug has expired.

However, by giving this beneficial right to the generic drug companies the Chinese laws must effectively ensure that any market entry relying on data obtained under the privilege of the Bolar Exemption is not misused for a market entry before the expiry of a valid patent. According to the current wording of Article 19 of the *DRR*, the generic applicant cannot submit the generic application earlier than two years prior to the expiry date of the patent and the authority should approve the application only after the expiry date of the patent. This hurdle, if used properly, would help to prevent misuse of the system.

However, due to insufficient information on the relevant patent protection, or due to the fact that the CFDA does not want to evaluate patent information, this provision was not utilised efficiently by the CFDA. In the February 2014 draft of the *DRR*, it was even proposed that the CFDA can grant marketing approval before the patent expiry, although it should not be effective until after patent expiry. If the draft *DRR* is passed as is, even more generic companies will get approvals for products covered by innovators' patents and will put these products on the market before the patent expiry, as patent information on valid patents is disregarded. This causes irreparable damage to the patentees. When this happens, the patentee's only recourse is to enforce its patent and seek an immediate preliminary injunction from the court before the market is finally disturbed by the patent infringing, early market entry. However, due to the scrutiny introduced by the SPC *Opinions*, there may be an obstacle to obtaining a preliminary injunction in the Chinese courts on new drug invention patents. Some companies have noted positive developments in obtaining preliminary injunctions also in pharmaceutical patent cases, but would be looking forward to guidance in the form of a judicial interpretation, especially referencing the high value of pharmaceutical patents which should allow for obtaining preliminary injunctions consistently. Certainly, commercial harm by an early illegal market entry is extremely high.

Next to being burdened with high research and development (R&D) investment costs and risks of failure during the development of new drugs, the

pharmaceutical industry's innovation cycle also faces already-shortened, effective patent protection terms due to regulatory approval procedures causing delayed market entry. This innovation cycle relies heavily on utilising the remaining effective patent term to compensate for the high risk of the investment. A well-established patent linkage system based on the effective recognition of the originators patent protection should at least safeguard the minimum term of patent protection that China is willing to guarantee in the absence of patent term extensions as granted by other countries and in view of the scrutiny to grant preliminary injunctions.

The Intellectual Property Rights Working Group understands that an effective patent linkage system involves the long-term efforts from various authorities—the CFDA, the SIPO and the courts—and that it will take time before it reaches full maturity. It is urgently requested that a balancing mechanism in the pharmaceutical field be put in place, including predictable preliminary injunctions and reasonable compensation to protect the legitimate right of patentees, so as to encourage innovation in the pharmaceutical field.

The suggested patent linkage in the *DRR* is an immediate target in the discussion process of current law reforms, but the working group would also support other law changes that guarantee an effective enforcement tool for research-based pharma companies in alternative ways. The Patent Law (in the fourth amendment process) and other laws, when revised, should also offer improved opportunities for the prevention against illegal market entries before patent expiry.

#### Recommendations

- Maintain Article 19 of the *DRR*, and improve the effectiveness of the provision in the practice of the CFDA.
- Clarify by an update that the SPC's *Opinions* of 2009 is no longer an obstacle to pharmaceutical companies' effectively obtaining preliminary injunctions in pharmaceutical cases to prevent illegal early market entry by generic drug companies.
- Encourage the CFDA, the SIPO and the courts to work together to introduce an effective patent linkage system in China based on the originator's patent protection.





## 2.2 Clarify the Rules for Post-filing Submission of Supplemental Data

### Concern

In spite of the SIPO's statements dated 4<sup>th</sup> December, 2013, and of China's public announcement made on 2<sup>nd</sup> January, 2014, confirming that the SIPO's *Patent Examination Guidelines of China (Guidelines)* allow drug patent applicants to submit supplemental data after filing, SIPO examiners are still rejecting post-filing submissions of supplemental data. It appears therefore that this clarification of the *Guidelines* regarding the Patent Law for chemical inventions is, in practice, not implemented.

### Assessment

Patent protection for new chemical entity (NCE) inventions is the basic condition for the business model of all research-based pharmaceutical companies, providing incentives for investment in new drug discovery and pre-clinical and clinical research (industry average, euro (EUR) 1.45 billion per NCE).

Examiners from the SIPO followed a flexible, practical approach of allowing post-filing data supplementation under its 1993 *Guidelines* as proof of statements made in the original application in several cases. However, in 2006, the SIPO amended its *Guidelines* to restrict examiners from considering post-filing data in support of the patentability of NCE inventions. Thereafter, numerous NCE patent applications from European and other pharmaceutical companies were rejected by SIPO examiners.

Furthermore, generic drug companies have been successful in and are still trying to invalidate NCE patents in China relying on retroactive application of the strict practice of the 2006 and 2010 *Guidelines* and the strict examiner practice, even against NCE patents filed under the 1993 *Guidelines*.

The Ministry of Commerce (MOFCOM) listed the following as an accomplishment of the 24<sup>th</sup> China-US Joint Commission on Commerce and Trade (JCCT) meetings in its public announcement on 2<sup>nd</sup> January, 2014:

“China re-affirms that the *Chinese Patent Guidelines* permit patent applicants to file additional data after filing their patent applications, and that the *Guidelines*

are subject to Article 84 of the Law on Legislation to ensure that pharmaceutical inventions receive patent protection. China affirms that this interpretation is currently in effect for patent examinations, re-examinations, and representations before the Courts. Relevant Chinese and U.S. agencies will continue to engage on specific cases.”<sup>7</sup>

This followed up on a news briefing from the SIPO of 4<sup>th</sup> December, 2013, in which it was stated that, (a) post-filing experimental data submitted by the applicant shall be considered during the patent examination, if it is evidence for originally disclosed facts, and (b) that the new version of the *Guidelines* does not have a retroactive effect on old cases.

It was however also stated that, if the technical solution can only be established upon confirmation by experimental results, then experimental data must be provided in the original description.

Currently, there are still numerous NCE patent applications of European pharmaceutical companies being rejected by SIPO examiners for lacking data in the initial patent specification and pending PRB review.

In addition, many granted NCE patents covering highly valuable pharmaceutical products still face invalidation threats by generic drug companies for lacking data in the original patent filing relying on the old strict standard. European companies are highly interested in guidance on the now established practice and its establishment in the SIPO, the PRB of SIPO and the courts, of defending their patent assets adequately and avoiding further challenges.

This guidance should also clarify whether data can be supplemented for other reasons post-filing. Several companies have observed that they are also prevented from supplementing data to overcome a rejection of a lack of inventive steps. This restrictive practice also creates barriers preventing research companies from obtaining patent protection for inventions that meet the patentability criteria, if such data is accepted and considered.

7 Joint Achievement List of the 24<sup>th</sup> China-US Joint Commission on Commerce and Trade, People's Republic of China and United States of America, 20<sup>th</sup> December, 2013, viewed 2<sup>nd</sup> July, 2015, <<https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2013/December/JCCT-outcomes>>





A highly recommended first clarification could be done by publishing relevant case decisions of the PRB and the courts and amending the wording in the *Guidelines* for more certainty.

#### Recommendations

- Revise Part II, Chapter 10, Section 3 of the SIPO's *Guidelines* and other sections of the guidelines to clarify the admissibility of the post-filing submission of supplemental data.
- Publish specific decisions made by the PRB or the Beijing High Court to show the implementation of the clarified practice of admissibility of post-filing submissions of supplemental data.
- Provide clear guidance to patent examiners at the SIPO and the PRB, as well as patent applicants, regarding the circumstances under which, and what type of, post-filing data will be considered.

### 2.3 Introduce Adequate Protection for Biotechnology Innovations Related to DNA and Amino Acid Sequences

#### Concern

If genes or proteins have been isolated or identified together with their function which has an innovative utility in the field of medicine or agriculture, the obtainable patent protection often does not allow for the inclusion of analogues of the specific genes or proteins used according to the invention. This makes the obtainable protection subject to simple circumvention of the claims by trivial changes in the DNA or amino acid sequences which maintain the same inventive functionality and utility.

#### Assessment

The SIPO's *Guidelines* explain the patentability of claims for genes or proteins. If a new function and related utility has been invented, an isolated gene or protein can be patented in the form of a specific nucleotide sequence or amino acid sequences as listed in the embodiments of the patent application. However, trivial variants such as those obtainable by substitution, deletion or addition of nucleotides or amino acids in the sequence can only be claimed if the patent application exemplifies such variants. A broader scope than for the specifically listed sequence is therefore not possible for a usual invention. However, it is trivial to use mutants or otherwise amended variants in such cases. Most patent offices outside China therefore allow the application

to define a broader scope of protection by defining the claimed genes and proteins not only by the specific sequence, but also by an additional range of identity stated as percentage of identity or homology, if it is further defined that the genes or proteins retain their function and utility or are mutants derived from the same source as the exemplified genes or proteins.

Accepting the use of percentages of identity or homology in the claims is therefore crucial for biotech innovators to obtain suitable patent protection for their invention. Most patents that are limited to specific sequences during patent prosecution are not providing meaningful protection as others can easily circumvent them with mutants and trivial variants. In the absence of such a protection scope, the encouragement to disclose innovation by patent filings and enjoy protection for the term of the patent is lacking for the innovators in this field.

#### Recommendations

- Revise the SIPO's *Guidelines* to ensure that for inventions in the field of biotechnology relating to genes and proteins the obtainable patent protection is not limited to only the specific nucleotide or amino acid sequences in the sequence listings of the embodiments.
- Allow percentage value of identity or homology related to genes and proteins in patent claims when the claims also refer to the retained innovative utility of such variants and homologues.

## 3. Copyright

### 3.1 Clarify What is Required to Provide Evidence of Ownership

#### Concern

The copyright administrative authorities and the criminal authorities often require burdensome levels of evidence to demonstrate ownership of copyright. This issue becomes particularly significant when hundreds or thousands of different works (e.g. sound recordings, journals, books) from one or more copyright owners are being infringed at the same time.

#### Assessment

To be put to task to demonstrate ownership through detailed evidence of the chain of title of each and every work being infringed can be simply unmanageable for the rights owner. Alternative methods need to be





explored as the burden on the rights owner is too great. It is also necessary to clarify and bring forward the point at which the burden will be passed to the defendant to demonstrate that he is validly licensed in relation to the works being exploited.

#### Recommendations

- Offer clear guidance to the copyright administrative authorities and the criminal authorities as to what evidence is necessary to create a presumption of ownership.
- Clarify and bring forward the point at which the burden will be passed to the defendant to demonstrate that the defendant is validly licensed.

### 3.2 Improve Administrative Enforcement

#### Concern

The experience of users of the administrative channel for copyright enforcement, including the music, software and film industries, is that the system is often ineffective, which appears to be due to a fundamental lack of resourcing and commitment to the administrative enforcement of copyright in itself.

#### Assessment

The experience of heavy users of the administrative channel for copyright enforcement is that greater commitment is given to the enforcement of illegal/unlicensed media and cultural activities (matters regulated by State Administration of Press, Publication, Radio, Film and Television (SAPPRFT) and the Ministry of Culture) at the expense of 'pure' copyright enforcement issues. This is manifested in many ways including:

- Inconsistent and burdensome filing requirements;
- Neither formal acceptance nor formal rejection of complaints, meaning that complaints are simply 'lost in the system';
- A lack of technical training, in particular regarding infringement occurring on Internet or mobile platforms; and
- Failure to enforce and/or an over reliance on mediated solutions to avoid a formal decision or associated punishment and fine.

#### Recommendation

- Assign dedicated officers within the copyright administrative authorities to handle pure copyright infringement cases, strengthen their powers of

investigation and provide them with clearer and more express guidance as to how complaints must be handled.

### 3.3 Finalise and Implement the Amendments to the Copyright Law, Taking into Account Stakeholders' Remaining Concerns, and Then Implement Them

#### Concern

The amendment of the Copyright Law has not been given the political priority that it deserves – in 2014, passing an amendment of the Copyright Law to the National People's Congress (NPC) fell into the second category of priorities in the SCLAO's legislative work plan.

#### Assessment

The Copyright Law in China first came into effect in 1990. Since then there has been no material amendment. A complete review and revision of the Copyright Law to make it fit for the 21<sup>st</sup> century is under way, but has recently stalled. The process began with some energy in 2011, with the first draft amendment produced in March 2012. A draft amended law was passed from the National Copyright Administration of China (NCAC) to the SCLAO at the end of 2012. The third draft amendment (SCLAO's first) followed swiftly in January 2013, but no material progress whatsoever has been made since then, despite a fourth draft in 2014.

#### Recommendation

- Finalise and implement the amendments to the Copyright Law as an absolute top priority in the State Council Legislative Affairs Office's (SCLAO's) legislative work plan, to ensure that the critical progress in the protection of right-holders that is required today actually takes place.

## 4. Trade Secrets

### 4.1 Facilitate Criminal Prosecution of Trade Secret Theft and Raise Penalties Imposed on Such Infringements

#### Concern

Public awareness of the concept and proprietary nature of trade secrets among China's technology labour force and IPR enforcement agencies has not progressed at the same positive pace as for patents and trademarks – updating laws and regulations with regard to trade secret protection and enforcement is therefore highly recommended.





### Assessment

The burden of proof in many trade secret civil cases acts as an undue hurdle for plaintiffs. The *Interpretation of the Supreme People's Court on Several Issues Concerning the Applicable Laws in the Trial of Unfair Competition Civil Cases (JI on Unfair Competition Civil Cases)* does not clearly define when that burden should shift to the defendant to show how it has acquired the knowledge alleged to have been a misappropriated trade secret. It would be helpful to clarify the judge's discretion in determining when a reasonable account of the facts is sufficient to shift that burden.

In essence, the stealing of a trade secret is no different than stealing a car. However, criminal enforcement of the latter against an identified perpetrator is far easier than enforcement of the former. The reluctance of the Public Security Bureau (PSB) to engage in trade secret theft cases might be due to the sometimes highly technical nature of the criminal allegation, which the PSB might find itself ill-equipped to handle. The PSB is certainly dissuaded from pursuing such cases because the *Interpretations of the Supreme People's Court and the Supreme People's Procuratorate on Several Issues Relating to Specific Laws Applicable to Handling of Criminal Cases of Intellectual Property Infringement (JI on Criminal IP Cases)* requires that the victim needs to show at least Chinese Yuan (CNY) 500,000 in damages. In addition, it is not always easy for a victim to access the investigation documents or reports held by the PSB, documents which may aid the victim in pursuing non-criminal avenues of justice, for example if the PSB find trade secret misappropriation in an investigation but decide not to pursue the case because it doesn't reach the criminal threshold. If so few cases are brought successfully and publicised, that merely emboldens would-be thieves to do wrong.

What further emboldens wrongdoers is the relatively low fine for a company found to have misappropriated another's trade secret, currently at CNY 10,000 to 200,000 under the Anti-Unfair Competition Law and *Several Rules on Prohibiting Trade Secret Infringement* enacted by State Administration for Industry and Commerce (*Rules of the SAIC*).

### Recommendations

- Modify the *Interpretation of the Supreme People's Court on Several Issues Concerning the Applicable Laws in the Trial of Unfair Competition Civil Cases*

to: (1) lower the burden of proof for a plaintiff to bring a trade secret misappropriation case; and (2) let judges determine when a *prima facie* case of trade secret misappropriation has been established by the plaintiff and, thus, to decide that the burden of proof should be shifted onto the defendant.

- Lower substantially the threshold damages amount needed to bring a case in the *Judicial Interpretation of Unfair Competition in Criminal Intellectual Property (IP) cases*.
- Substantially increase penalties for misappropriation of trade secrets under the Anti-Unfair Competition Law and the rules of the SAIC.

### Abbreviations

CFDA	China Food and Drug Administration
CTMO	China Trademark Office
EU	European Union
EPO	European Patent Office
IPR	Intellectual Property Rights
JCCT	Joint Commission for Commerce and Trade
KIPO	Korea Intellectual Property Office
MOFCOM	Ministry of Commerce
NCE	New Chemical Entity
PRB	Patent Re-examination Board
PSB	Public Security Bureau
R&D	Research and Development
SAIC	State Administration for Industry and Commerce
SAPPRFT	State Administration of Press, Publication, Radio, Film and Television
SCLAO	State Council Legislative Affairs Office
SIPO	State Intellectual Property Office
SPC	Supreme People's Court
TRAB	Trademark Review and Adjudication Board
WTO	World Trade Organisation





# Inter-Chamber Small and Medium-sized Enterprise Working Group

## Key Recommendations

### 1. Provide European Small and Medium-sized Enterprises (SMEs) in China with Better Access to Financing

- Develop and implement a SME lending strategy to assist all SMEs operating in China (including European and Chinese companies), taking into account the following considerations:
  - Provide incentives to encourage banks to grant short-term banking overdrafts for SMEs facing temporary cash shortages.
  - Develop focused credit risk assessment procedures/systems suitable for the provision of SME loans.
  - Implement Key Performance Indicators (KPIs) to encourage banks to issue loans to SMEs.
  - Encourage China to establish a dedicated fund for financing partnerships between European and Chinese SMEs.
  - Remove regulatory obstacles that limit foreign-invested enterprises' (FIEs') access to credit financing by relaxing the foreign exchange debt quota requirements ('borrowing gap').

### 2. Streamline and Increase the Transparency of Regulatory and Administrative Requirements for SMEs in China

- Expand the 'one-stop-service' system to support all SMEs in China in fulfilling their multiple registration and regulatory obligations, and provide authorised and accessible helplines of relevant authorities where SME investors can receive clarification of policies with regards to investments.
- Provide more business hubs for foreign SMEs in China at reasonable prices.

### 3. Establish Rule of Payment to Alleviate Cash Flow Burdens of SMEs in China

- Encourage relevant government bodies to review commercial terms written in bidding documents to allow state-owned enterprises (SOEs) to sign contracts with negotiable payment terms with SMEs.
- Encourage China to issue guidelines similar to those being implemented by European Union (EU) Member States to ensure that government and state-associated institutions, including SOEs, respect contractual payment terms.
- Offer equal treatment to foreign SMEs when there is no legislative basis for differences between domestic companies and FIEs in the bidding process.

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.





## Introduction to the Working Group

The Inter-Chamber Small and Medium-sized Enterprise (SME) Working Group was established in 2014 as a new advocacy element of the European Union (EU) SME Centre Phase 2,<sup>1</sup> with the objective of strengthening advocacy for EU SMEs. The Inter-chamber SME Working Group is based on the existing Small and Medium-sized Enterprise (SME) Forum of the European Union Chamber of Commerce in China, bringing together European SMEs and creating a strong channel to express concerns and report challenges they face in conducting business in China. The Inter-chamber SME Working Group's recommendations represent the concerns and interests of SMEs from all EU Member States.<sup>2</sup>

The official EU definition of SMEs limits them to a maximum size of 250 employees and a maximum annual turnover of euro (EUR) 50 million or total assets of EUR 43 million.<sup>3</sup> European SMEs play an important role in the European economy as they represent 99 per cent of the businesses, hire two in every three employees and contribute 58 cents in every euro of value added.<sup>4</sup>

In China, the definition of a SME varies by industry.<sup>5</sup> They represent 99.7 per cent of the total number of companies, contribute 60 per cent of gross domestic product (GDP) and 50 per cent of tax revenue.<sup>6</sup>

The EU SME Centre (Phase 2) runs from July 2014 to July 2018. Its main objectives are: assisting European SMEs to establish and develop a commercial presence in the Chinese market (through exports and/or investments) by providing EU added-value support services; improving synergies and increasing best practice sharing at the national and regional EU business association levels, with the ultimate goal of benefitting EU SMEs intending to do business in China; and strengthening advocacy efforts on behalf of the EU business community to help create a better business environment.

In addition to the EU SME Centre, the China Intellectual Property Rights (IPR) SME Helpdesk is another EU-funded project supporting SMEs in China with the objective of protecting and enforcing their IPR in or relating to China, through the provision of free information and services.

## Recent Developments

On 16<sup>th</sup> April, 2015, the Ministry of Industry and Information Technology (MIIT), the Ministry of Finance (MOF), the Ministry of Commerce (MOFCOM), the Ministry of Science and Technology (MOST), and the State Administration for Industry and Commerce (SAIC) released a joint notice on a decision to support exemplary SME start-ups and innovation base cities in an effort to support SME innovation, create a healthy business environment and promote fair market competition. A total of Chinese Yuan (CNY) 0.9 billion will be granted to the exemplary capital cities by the central government.<sup>7</sup>

On 13<sup>th</sup> March, 2015, the State Administration of Taxation (SAT) issued *Caishui [2015] No. 34*<sup>8</sup> to further support small and micro-sized enterprises' development. The notice provides preferential tax incentives to enterprises with an annual taxable income equal to or less than CNY 200 thousand from 1<sup>st</sup> January, 2015, to 31<sup>st</sup> December, 2017.

1 The EU SME Centre is a EU funded initiative helping SMEs get ready to do business in China. Located in Beijing, the Centre provides practical information, confidential advice, and training in the areas of business development, legal issues, standards and HR to facilitate market access for European SMEs. The Centre also acts as a platform to facilitate coordination among Member States and European public and private sector service providers to SMEs. The EU SME Centre is managed by six implementing partners who through their knowledge and experience of the China market guide the strategic development and management of the Centre. The six implementing partners are: the Benelux Chamber of Commerce in China, the China-Britain Business Council, the China-Italy Chamber of Commerce, Eurochambres, the European Union Chamber of Commerce in China, and the French Chamber of Commerce in China.  
2 The *Inter-Chamber SME Working Group Position Paper* represents recommendations of SMEs from all EU Member States regardless of their membership to the European Chamber.  
3 *What is an SME?*, European Commission, viewed 18<sup>th</sup> May, 2015, <[http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm)>  
4 *A Partial and Fragile Recovery, EU SME Annual Report 2013-2014*, European Commission, July 2014, viewed 18<sup>th</sup> May, 2015, <[http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting\\_documents/2014/annual-report-smes-2014\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting_documents/2014/annual-report-smes-2014_en.pdf)>  
5 *Notice on types and standards of small and medium-sized enterprises*, The Central People's Government of the People's Republic of China, 18<sup>th</sup> June, 2011, viewed 27<sup>th</sup> April, 2015, <[http://www.gov.cn/jzwgk/2011-07/04/content\\_1898747.htm](http://www.gov.cn/jzwgk/2011-07/04/content_1898747.htm)>  
6 *Promote Small and Medium-sized Enterprises Development*, Ministry of Industry and Information Technology of the People's Republic of China (MIIT), 22<sup>nd</sup> May, 2015, viewed 27<sup>th</sup> April, 2015, <<http://qys.miit.gov.cn/n11293472/n11295074/n11298763/16604190.html>>

7 *Notice on Supporting Exemplary SME Start-up and Innovation Base Cities*, Caijian [2015] No. 114, Ministry of Finance, 16<sup>th</sup> April, 2015, viewed 18<sup>th</sup> May, 2015, <[http://jjs.mof.gov.cn/zhengwuxinxi/tongzhigonggao/201504/t20150422\\_1221621.html](http://jjs.mof.gov.cn/zhengwuxinxi/tongzhigonggao/201504/t20150422_1221621.html)>  
8 *Notice on small low-profit enterprises income tax preferential policies*, Caishui [2015] 34, State Administration of Taxation, 13<sup>th</sup> March, 2015, viewed 18<sup>th</sup> May, 2015, <<http://www.chinatax.gov.cn/n810219/n810744/n1530987/n1531031/c1517141/content.html>>





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> <sup>13</sup> say?	What is the reality?	Status
Support the healthy development of the non-public sector.	Access to financing is still a major challenge to carrying out businesses in China, particularly for SMEs.	
Deepen reform of the management system for science and technology.	The Central Government SME Development Fund will be used to support SME development in innovation to promote a healthy business environment and fair market competition. The Inter-Chamber SME Working Group hopes foreign SMEs will benefit from this positive development.	

Foreign SMEs who meet the definition<sup>9</sup> are eligible for these incentives. The Inter-Chamber SME Working Group appreciates the continuous efforts by the authorities to carry out the State Council's decision on supporting SMEs. However, EU SMEs are still facing challenges due to issues related to access to financing, late payments from clients, market access barriers, application of legislation, IPR protection<sup>10</sup> and attracting and retaining talent.<sup>11</sup>

According to the European Chamber's *Business Confidence Survey (BCS) 2015*, among the top ten challenges for future business in China are the Chinese economic slowdown, rising labour costs, market access barriers and investment restrictions, competition from Chinese privately-owned enterprises (POEs), ambiguous rules and regulations, and talent attraction and retention.<sup>12</sup>

## Key Recommendations

### 1. Provide European SMEs in China with Better Access to Financing

#### Concern

European SMEs operating in China still experience

difficulties in gaining access to financing.

#### Assessment

The Chinese economy is currently experiencing a slow-down, so companies are facing a more fierce competition, thus financing plays a bigger role in business operations.

A series of regulations and policies were released in 2015 to assist with SME financing. However, it is still a major challenge for SMEs. Key reasons for this are that SMEs are considered as being high-risk and low-return clients and local SMEs are preferred because of their better relationships with local banks.

European SMEs rely on several sources for financing. The main sources are internal profit-based financing or internal financing provided by related parties such as shareholders (capital or shareholder loans), management and employees, as well as external financing by non-banking financial institutions (e.g. financial leasing companies, credit guarantee companies and micro-loan companies) whose financing costs are extremely high for SMEs. Other types of financing include equity financing through business angles, venture capital and private equity funds.

Bank loans for foreign-invested enterprises (FIEs) can also be obtained against guarantees from banks outside of China, which typically require further risk assessment of European headquarter entities. Foreign exchange loans, which theoretically should be easier to be accessed by FIEs, are limited by the so-called 'borrowing gap', which is the difference between the total investment and the minimum required capital corresponding to the amount invested.

<sup>9</sup> Notice on types and standards of small and medium-sized enterprises, The Central People's Government of the People's Republic of China, 18<sup>th</sup> June, 2011, viewed 10<sup>th</sup> June, 2015, <[http://www.gov.cn/zwqk/2011-07/04/content\\_1898747.htm](http://www.gov.cn/zwqk/2011-07/04/content_1898747.htm)>

<sup>10</sup> Examples of the importance of IPR protection can be found in the European Chamber's *Rail Position Paper*.

<sup>11</sup> For more information on HR challenges, please refer to European Chamber's *Human Resources Position Paper*.

<sup>12</sup> *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, 10<sup>th</sup> June, 2015, viewed 24<sup>th</sup> June, 2015, p17, <[http://www.eurochamber.com.cn/en/publications-archive/334/Business\\_Confidence\\_Survey\\_2015](http://www.eurochamber.com.cn/en/publications-archive/334/Business_Confidence_Survey_2015)>

<sup>13</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.





Table 1: Ratio between total investment and registered capital<sup>14</sup>

Total Investment	Ratio of minimum registered capital of total investment
Up to USD 3 million	70%
USD 3-10 million	50% or USD 2.1 million, whichever is the larger
USD 10-30 million	40% or USD 5 million, whichever is the larger
>USD 30 million	33.3% or USD 12 million, whichever is the larger

#### Recommendations

- Develop and implement a SME lending strategy to assist all SMEs operating in China (including European and Chinese companies), taking into account the following considerations:
  - Provide incentives to encourage banks to grant short-term banking overdrafts for SMEs facing temporary cash shortages.
  - Develop focused credit risk assessment procedures/systems suitable for the provision of SME loans.
  - Implement KPIs to encourage banks to issue loans to SMEs.
  - Encourage China to establish a dedicated fund for financing partnerships between European and Chinese SMEs.
- Remove regulatory obstacles that limit FIEs' access to credit financing by relaxing the foreign exchange debt quota requirements ('borrowing gap').

## 2. Streamline and Increase the Transparency of Regulatory and Administrative requirements for SMEs in China

#### Concern

The relatively fragmented nature of China's regulatory system makes it difficult for foreign companies in China to: (1) access relevant regulatory information for their business; (2) understand the frequent changes in the regulations; and (3) manage the high volume of administration work set by multiple regulating agencies. This is a particular burden for SMEs who often do not have the resources and expertise to effectively deal

<sup>14</sup> *Interim Regulation on Joint Venture Proportion of Registration Capital and Total Investment*, State Administration for Industry and Commerce, 21<sup>st</sup> May, 2007, viewed 10<sup>th</sup> June, 2015, <[http://www.saic.gov.cn/fldyfbzdzj/zcfcg/200705/t20070523\\_57448.html](http://www.saic.gov.cn/fldyfbzdzj/zcfcg/200705/t20070523_57448.html)>

with such processes.

#### Assessment

##### a. Regulatory requirements of registration and availability of government authorities for explanations on policies

After receiving approval to establish a FIE by the local government, it is necessary to get additional permits/registrations/filings from several different government agencies before a SME becomes operational, usually requiring a waiting period of several months, during which office rents and other expenses are incurred. In addition, annual re-registrations must be done at several government agencies, requiring considerable resources from SMEs.

Besides lengthy administrative procedures, SMEs often need to consult with government authorities for clarification on certain regulations through designated helplines, which sometimes are unreachable in major investment cities such as Beijing, Shanghai and Guangzhou due to the fact that the line is busy or no one is answering. Different explanations are sometimes provided by different branches and offices from the same government authority, making the situation more confusing for SME investors who are seeking a clear picture of the feasibility of their proposed investments.

##### b. Establishment of FIEs

Foreign investors are required to submit relevant materials to apply for establishing FIEs to the competent department and then make registrations upon receiving the approval certificate to obtain the correct licence to do business and start operations. Foreign investors shall also get other approvals depending on the business scope.

In accordance with the revisions of the *Rules for the Implementation of the Law of the People's Republic of China on Foreign-capital Enterprises*,<sup>15</sup> the new changes (please see Table 2) help to greatly ease market access controls for companies. However, in practice, SMEs are still required to submit minimum registered capital by some authorities. It is nonetheless guaranteed that applications submitted upon requirements are sufficient.

<sup>15</sup> *Rules for the Implementation of the Law of the People's Republic of China on Foreign-capital Enterprises* (revision) 1<sup>st</sup> March, 2014, viewed 1<sup>st</sup> June, 2015, <[http://www.fdi.gov.cn/1800000121\\_23\\_71637\\_0\\_7.html](http://www.fdi.gov.cn/1800000121_23_71637_0_7.html)>



Table 2: The main changes of Corporate Law<sup>16</sup>

	Approval Certificate received before 1 <sup>st</sup> March, 2014	Approval Certificate received after 1 <sup>st</sup> March, 2014 (including the date)
1	Minimum required amount of registered capital: Limited liability company: CNY 30,000 One-person limited liability company: CNY 100,000 Joint-stock limited company: CNY 5 million	Cancelled
2	Registered capital shall be consistent with the scale of operation	Cancelled
3	Submission of capital verification certificates	Cancelled
4	Annual inspection by the relevant Administration for Industry and Commerce	Cancelled

#### Recommendations

- Expand the 'one-stop-service' system<sup>17</sup> to support all SMEs in China in fulfilling their multiple registration and regulatory obligations and provide authorised and accessible helplines of relevant authorities where SME investors can receive clarification on policies in regards to investments.
- Provide more business hubs for foreign SMEs in China at reasonable prices.

### 3. Establish Rule of Payment to Alleviate Cash Flow Burdens of SMEs in China

#### Concern

Non-negotiable payment terms with SOEs and late payments from clients result in liquidity problems for SMEs.

#### Assessment

As access to bank loans is limited for SMEs in general and foreign SMEs in particular, substantial reserve assets are a prerequisite for business operations in China. When dealing with SOEs, there are a number of obstacles that limit the overall chances of success for SMEs. For example, SMEs in the industrial sector are paid a 20 per cent down payment, receive 30 per cent at delivery on site, 40 per cent at commissioning and the remaining 10 per cent at the end of the warranty period (24 months). This means that only 20 per cent of the total payment is secured while the remaining 80 per cent is fully dependent on the clients' willingness to

comply with their payment obligations.

Unlike doing business with international companies or Chinese POEs, SMEs who conduct businesses with SOEs have limited negotiation powers over payment terms as payment terms are generally considered as non-negotiable by SOEs. At the same time, SMEs are required to pay a 30 per cent down payment and 70 per cent prior to delivery of the goods necessary for production to suppliers.

By definition, SMEs are small entities that need to deal with clients who often do not respect contractual payment terms and who, on account of their larger size, usually have more leverage in negotiations. The reality negatively impacts SMEs' overall business operations in China.

#### Recommendations

- Encourage relevant government bodies to review commercial terms written in bidding documents to allow SOEs to sign contracts with negotiable payment terms with SMEs.
- Encourage China to issue guidelines similar to those being implemented by EU Member States to ensure that government and state-associated institutions, including SOEs, respect contractual payment terms.
- Offer equal treatment to foreign SMEs when there is no legislative basis for differences between domestic companies and FIEs in the bidding process.

<sup>16</sup> Comparison of the Corporate Law before and after revision, 2014, China Gongsi Fa, viewed 10<sup>th</sup> June, 2015, <<http://www.cngsf.com/duibi.htm>>

<sup>17</sup> Dong, Bishui, *The First 5-in-1 Policy to be Introduced in Zhejiang*, people.cn, 23<sup>rd</sup> June, 2015, viewed 29<sup>th</sup> June, 2015, <<http://politics.people.com.cn/n/2015/0623/c1001-27192306.html>>





European Chamber  
中国欧盟商会

## Abbreviations

BCS	Business Confidence Survey
CNY	Chinese Yuan (Currency)
EU	European Union
FIE	Foreign-Invested Enterprise
GDP	Gross Domestic Product
KPI	Key Performance Indicator
MIIT	Ministry of Industry and Information Technology
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOST	Ministry of Science and Technology
POE	Privately-Owned Enterprise
SAIC	State Administration for Industry and Commerce
SAT	State Administration of Taxation
SME	Small and Medium-sized Enterprise
SOE	State-Owned Enterprise
USD	United States Dollars (Currency)





## Legal and Competition Working Group

### Key Recommendations

#### 1. Eliminate Restrictions for Foreign Legal Services

- Allow foreign law firms to practice People's Republic of China (PRC) law through the employment of individuals who are qualified under PRC law.
- Allow lawyers in foreign law firms to represent their clients before Chinese government authorities.
- Roll out more breakthroughs under the *Pilot Work Plan of Establishing a Close Cooperation Mechanism Between Chinese and Foreign Law Firms* in the China Shanghai Pilot Free Trade Zone (CSPFTZ) (*Pilot Work Plan*) (Ministry of Justice (MOJ), 27<sup>th</sup> January, 2014), in particular to permit the establishment of real Sino-foreign joint law ventures (JLVs) to practise in their own name both Chinese law and foreign law.

#### 2. Adopt Regulations That Encourage Fair Enforcement of the Anti-Monopoly Law (AML)

##### Rules and transparency

- Issue comprehensive rules and guidelines on all remaining key aspects of the AML promptly in order to promote fuller understanding and compliance by businesses, and to offer them greater legal certainty; where such rules or guidelines are not available, the Anti-Monopoly Enforcement Authority (AMEA) bodies should take this lack of clarity into account in their enforcement of the AML.
- Amend existing rules and guidelines where appropriate to reflect the evolving case law and practice of the enforcement authorities as well as judicial interpretations adopted by the Supreme People's Court (SPC), in order to ensure that businesses better understand the AML and related implementing regulations and remain in compliance.

##### Fair enforcement

- Utilise external experts and make available to parties and their advisers the reports on which the AMEA bodies rely.
- Support the efforts of the SPC in promoting cases brought under the AML as well as consistent interpretation, application and enforcement of the AML by China's enforcement authorities.
- Adopt standard publication channels, such as websites, for all information relevant to AML enforcement, including new measures, decisions and consultations.

##### Concentrations

- Publish notices online on non-simple cases identifying the notifying parties and the sector involved in the transaction.
- Apply and enforce the AML transparently, publishing detailed and reasoned decisions in all non-simple cases in order to increase understanding of the review process and standards of the AMEA bodies.
- Ensure that external elements do not obstruct the swift and prompt decision-making process of notified concentrations.
- Enable notifying parties to engage with external consultants appointed by the Ministry of Commerce (MOFCOM) to advise on notified transactions.

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.



- Notify the parties in a formal way of any competition concerns during the assessment process at least 30 days before the end of the second-phase review.

#### International Standards

- Ensure that the implementation and enforcement of the AML does not unfairly discriminate between domestic companies and foreign-owned enterprises (FIEs), in particular in light of Article 7 of the AML.
- Contribute to the development of International Competition Law (ICL) policy through participation in the International Competition Network (ICN), and other international bodies.
- Ensure that the application and enforcement of the AML is consistent with ICL policy and practice, while adopting policies and approaches suited to the Chinese context.

### 3. Continue Working Towards Greater Transparency and Strengthening the Rule of Law

- Standardise the public consultation process, allow for at least eight weeks for comments on drafts of laws and regulations and publish stakeholders' comments and regulators' feedback.
- Publish all laws and regulations prior to implementation, improve the online publication of laws and regulations and provide official English translations of important rules and regulations.
- Enforce only those laws and regulations that have been previously published in official journals or through other media.
- Ensure that the *Regulation Concerning the Publication of People's Courts Judgements and Rulings on the Internet (2013 Regulation)* (SPC, 21<sup>st</sup> November, 2013) requiring the publication of court judgements on the SPC's designated official website will be implemented by individual people's courts, including cases involving local government interests.
- Ensure that all judgements issued by a court can be accessed and reviewed by any interested party, not only the litigants or their counsels.
- Permit foreigners to attend civil and commercial hearings in the People's Courts.
- Further define the scope of state secrets.
- Continue to focus on the advancement of the rule of law and quickly implement the blueprint set out in the *Decision on Major Issues Concerning Comprehensively Advancing the Rule of Law (the Decision)* (Fourth Plenum, 23<sup>rd</sup> October, 2014).

## Introduction to the Working Group

Created in 2000, the Legal and Competition Working Group aims to foster greater legal transparency and awareness of legal developments affecting foreign investment and trade in China and advocates for better access to the legal market for foreign law firms in China. It now comprises around 500 individuals representing over 200 member companies and is active in the Beijing, Shanghai and South China chapters of the European Chamber. These individuals are: (i) lawyers from European-based law firms registered with the Ministry of Justice (MOJ); (ii) European lawyers working in other foreign law firms registered with the MOJ or in Chinese law firms; and (iii) in-house counsels for European corporate entities with a presence within China.

## Recent Developments

The working group highlights the following significant developments in the Chinese legal system during the past year:

### The Closer Economic Partnership Arrangement (CEPA)

On 18<sup>th</sup> December, 2014, a new agreement was signed between the Hong Kong Special Administrative Region Government (HKSARG) and the Ministry of Commerce (MOFCOM) under the framework of the Mainland China<sup>1</sup> and Hong Kong CEPA. This agreement, aiming to achieve basic liberalisation of trade in services between Guangdong and Hong Kong, ensures that Hong Kong

<sup>1</sup> For the purposes of this paper 'Mainland China' is defined as the geographical area known as the People's Republic of China, excluding the special administrative regions of Hong Kong and Macau but including Hainan.





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> <sup>3</sup> say?	What is the reality?	Status
24. <b>Relaxing control over investment access.</b> "We will promote the orderly opening up of finance, education, culture, healthcare and other service sectors."	Legal services have been moved from the 'restricted' to the 'prohibited' category.	
	Foreign law firms cannot practice PRC law through the employment of individuals qualified in PRC law.	
9. <b>Enacting market rules that are fair, open and transparent.</b>	Many aspects of the application of the AML remain unclear, detailed reasoning in important cases remains unpublished and an increasing number of transactions approved by the MOFCOM are subject to remedies which can be far reaching.	
IX. <b>Promoting of the Rule of Law.</b>	Lack of transparency in the promulgation, elaboration and implementation of laws and regulations by legislative, judiciary and administrative bodies remains an issue.	

will continue enjoying the most preferential liberalisation measures. For example Hong Kong legal service suppliers who have acquired Mainland China legal professional qualifications are allowed to act as agents in civil litigation cases relating to Hong Kong residents and juridical persons, according to the specific scope of permitted business.

The working group notes that this agreement, implemented on 1<sup>st</sup> March, 2015, will still improve business opportunities for Hong Kong law firms in Mainland China and allow them to have further and better access to Mainland China's legal market than non-Hong Kong law firms.

**China (Shanghai) Pilot Free Trade Zone (CSPFTZ)**

a) *Notice on Forwarding the Implementation Measures for Mutual Assignment of Lawyers to Serve as Legal Consultants by Chinese and Foreign Law Firms in the CSPFTZ and the Implementation Measures for Economic Association Between Chinese and Foreign Law Firms in the CSPFTZ (Implementation Measures)* (General Office of the People's Government of Shanghai Municipality developed by the Shanghai Municipal Bureau of Justice (SHBOJ), 18<sup>th</sup> November, 2014).

The Legal and Competition Working Group welcomes the creation of the CSPFTZ and is encouraged by the fact that it aims to explore cooperative mechanisms

between Chinese and foreign law firms. The *Implementation Measures* brought into effect the MOJ's policy<sup>2</sup> to allow deeper collaboration in the CSPFTZ between mainland Chinese and foreign firms. The main developments of this new regulation are:

1. If a foreign firm has a representative office in the CSPFTZ, it is allowed to enter into an agreement with a Chinese firm to second lawyers to each other's offices. The People's Republic of China (PRC) lawyers working in the foreign firm's CSPFTZ representative office can provide PRC legal advice while the foreign counsel working in Chinese firms can provide legal advice on foreign law.
2. Within the CSPFTZ, foreign firms and Chinese firms are allowed to enter into an association on a contractual basis. In this way, the two firms remain financially independent and separate entities, but can join forces to provide legal services to clients. The PRC legal advice can only be provided by the Chinese firm in the association.

2 *Pilot Work Plan of Establishing a Close Cooperation Mechanism Between Chinese and Foreign Law Firms in the CSPFTZ*, MOJ, 27<sup>th</sup> January, 2014, viewed 29<sup>th</sup> June, 2015, <[http://www.moj.gov.cn/lsgzgzds/content/2015-04/21/content\\_6052539.htm?node=278](http://www.moj.gov.cn/lsgzgzds/content/2015-04/21/content_6052539.htm?node=278)>

3 The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.



## Updates on the Anti-Monopoly Law (AML)

a) *Provisions on Imposing Additional Restrictive Conditions on Concentrations of Business Operators (Provisions)* (Trial) (MOFCOM, 4<sup>th</sup> December, 2014).

The *Provisions* identifies three types of restrictive conditions, which are: (i) structural conditions, such as divesting tangible assets, intangible assets (e.g. intellectual property rights (IPR)) and other related interests; (ii) behavioural conditions, such as the licensing of key technologies (including patents, know-how or other IPR); and (iii) hybrid conditions combining both structural and behavioural conditions. The *Provisions* also identifies the range, procedure of divesting and all the obligations and responsibilities of the MOFCOM, divestiture obligor and assignee.

b) *Rules on the Prohibition of Abuses of IPR for the Purposes of Eliminating or Restricting Competition (Rules)* (State Administration for Industry and Commerce (SAIC), 7<sup>th</sup> April, 2015).

The *Rules*' essential goal is that of prohibiting business operators from restricting and eliminating competition by exercising IPR and to address two categories of IPR-related anticompetitive conduct: monopolistic agreements and abuse of market dominance. It expressly indicates that it will not apply to any price-related monopolistic conduct.

## Key Recommendations

### 1. Eliminate Restrictions for Foreign Legal Services

#### Concern

The working group is concerned about the continuing restrictions placed on foreign lawyers and foreign law firms operating in China, including professional assistance with regards to PRC law and cooperation with PRC firms and lawyers.

#### Assessment

The Legal and Competition Working Group welcomes the registration and control of foreign law firms and lawyers by appointed authorities, as this happens in most foreign jurisdictions. However, the elimination of restrictions on the provision of legal services by them is an area of increasing importance in fostering economic progress and working relationships between the

European Union (EU) Member States and China. The working group is concerned about the latest update of the *Foreign Investment Industry Guidance Catalogue*<sup>4</sup> (*Foreign Investment Catalogue*) which moved the provision of legal services from the 'restricted' to the 'prohibited' category in what has been seen as a step backwards in the opening process.

Chinese law firms are allowed to offer local legal services when establishing their offices in Europe as they face no restrictions to access the European legal services market. In light of this, the Legal and Competition Working Group would like to draw this to the attention of the EU negotiating team so that it can be discussed within the framework of The EU-China Comprehensive Agreement on Investment (CAI), in order to call for equal market access for European law firms in China.

Further opening up of the legal services sector would allow clients of Mainland Chinese companies to have better access to guidance on the impact of international laws and practice, and would simultaneously provide foreign investors with better access to Chinese legal advice in an international environment for operating or doing business in China. The working group would welcome progress in the following three segments:

#### Employment of Chinese-qualified lawyers by EU law firms

European law firms should be allowed to hire PRC qualified lawyers without affecting those individuals' qualification to practice PRC law. Allowing Chinese-qualified lawyers to practice as PRC-qualified lawyers in foreign law firms will give those law firms' clients—both Chinese and foreign—faster, more cost-effective and more efficient access to PRC law and foreign law advice. It will also broaden the career prospects of PRC-qualified lawyers, allowing them to grow and gain expertise in an international environment, which will also benefit Chinese investors abroad.

#### Participation of lawyers from foreign law firms in meetings with the Chinese Government

Appearance, participation and representation by lawyers of foreign law firms (including PRC-qualified lawyers) before Chinese government authorities and

<sup>4</sup> *Foreign Investment Industry Guidance Catalogue*, MOFCOM and NDRC, 10<sup>th</sup> March, 2015, viewed on 29<sup>th</sup> June, 2015, <[http://www.sdpc.gov.cn/zcfbl/201503/t20150313\\_667332.html](http://www.sdpc.gov.cn/zcfbl/201503/t20150313_667332.html)>



other public, non-judicial, authorities on behalf of their clients is permitted occasionally and only on a case-by-case basis. In cross border-transactions, or where an investment is being made by a foreign investor into China, both foreign investors and their Chinese partners are prevented from determining the choice and composition of their own legal teams. This lack of a transparent and consistently-enforced right of access and representation for lawyers working in foreign law firms often reduces the quality of the information exchange with the Chinese authorities and can sometimes result in misunderstandings between the Chinese government authorities and the investors. As a result, foreign investors' ability to understand Chinese government proceedings in their international context is impaired.

#### Foreign firms' access to joint law ventures (JLVs)

The signing of *Supplement X* in 2013, and the new agreement signed in December 2014, under the framework of the Mainland and Hong Kong CEPA clearly indicates that China is committed to opening part of its legal market to Hong Kong law firms.

A further step has been taken with the *Pilot Work Plan of Establishing a Close Cooperation Mechanism Between Chinese and Foreign Law Firm in the CSPFTZ (Pilot Work Plan)* (27<sup>th</sup> January, 2014), already brought into effect through the *Implementation Measures*. It may additionally be extended to the other (at the time of writing) announced free trade zones (FTZs). Under such regulation the secondment of lawyers and contractual associations between foreign and PRC firms with offices within the FTZs would be permitted. However, further developments under the *Pilot Work Plan* still appear very much restricted since it does not permit foreign firms to establish joint ventures (JVs) with domestic counterparts that can independently practise both Chinese and foreign law.

#### Recommendations

- Allow foreign law firms to practice PRC law through the employment of individuals who are qualified under PRC law.
- Allow lawyers in foreign law firms to represent their clients before Chinese government authorities.
- Roll out more breakthroughs under the *Pilot Work Plan*, in particular to permit the establishment of real Sino-foreign JLVs to practise in their own name both Chinese law and foreign laws.

## 2. Adopt More Regulations and Guidelines on Implementing the AML

### Concern

Many aspects of the application of the AML remain unclear, detailed reasoning in important cases remains unpublished and an increasing number of transactions approved by the MOFCOM are subject to remedies which can be far reaching and create long-term administrative burdens and costs.

### Assessment

The Legal and Competition Working Group welcomes the increased enforcement of the AML across a number of sectors as it sends a strong message from the Chinese authorities about their intention to promote market-oriented reform and safeguard fair competition. This is in line with China's reform agenda as laid down in the Third and Fourth Plenums. Some of these enforcement cases are high-profile ones that can provide China with an opportunity to demonstrate investigations are carried out fully in accordance with the rule of law, one of the central themes of the Fourth Plenum. However, for this to happen, legal best practices must be embraced in order to ensure that administrative law enforcement is carried out impartially, transparently and consistently. The working group regrets these principles, essential to any competition regime, are still not generally applied.

Examples of this increase in enforcement levels include: (i) Glencore/Xstrata,<sup>5</sup> the largest merger in mining history, was subjected to structural and behavioural remedies imposed by the MOFCOM; (ii) Marubeni/Gavilon,<sup>6</sup> where the MOFCOM ruled that Marubeni had to establish, within six months from the merger clearance date, two separate and independent legal entities and operation teams in charge of the export and sales of soybeans to China; and (iii) the P3 Network Alliance,<sup>7</sup> prohibited by the MOFCOM. Other examples

5 *Announcement No. 20 of 2013 on Decisions of Anti-monopoly Review against Concentration of Undertakings in the Acquisition of Xstrata plc by Glencore International Plc with Additional Restrictive Conditions*, MOFCOM, 2013, viewed on 24<sup>th</sup> June, 2015, <<http://fldj.mofcom.gov.cn/article/ztxx/201304/20130400091222.shtml>>

6 *Announcement No. 22 of 2013 on Decisions of Anti-monopoly Review against Concentration of Undertakings in the Acquisition of Gavilon Holdings by Marubeni Corp with Additional Restrictive Conditions*, MOFCOM, 2013, viewed on 24<sup>th</sup> June, 2015, <<http://fldj.mofcom.gov.cn/article/ztxx/201304/20130400100376.shtml>>

7 *Announcement No. 46 of 2014 on Decisions of Anti-monopoly Review against Concentration of Undertakings by Prohibiting Maersk, MSC and CMA CGM from*





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are the vertical agreements that have attracted the National Development and Reform Commission's (NDRC's) interest in recent years, such as: (i) the Chinese Yuan (CNY) 350 million resale price fine the NDRC imposed on Mercedes in April 2015; or (ii) the CNY 975 million fine the NDRC imposed on Qualcomm in February 2015, the highest fine to date.

However, despite the fact that the Anti-Monopoly Enforcement Authority (AMEA) bodies are becoming more savvy and experienced and, therefore, some progress on the implementation process has been made during the recent years, there is still uncertainty among businesses regarding the AML enforcement processes. This uncertainty derives from the lack of clarity with regards, but not limited, to: (i) the rights to confidentiality; (ii) standards, fairness and proportionality of the proceedings; (iii) deadlines that apply to notified parties; and (iv) the number and type of additional implementing regulations/guidance that can be expected from the AMEA bodies. As a result, business operators in China keen to comply with the law continue to face challenges and more and more companies step up their demands for clarity and transparency. The absence of such clarification may eliminate or reduce the positive economic benefits that an effective competition law affords companies and consumers (as set out in Article 1 of the AML).

More specifically, regarding the process, transparency should be granted. Inspections should not prejudge the outcome of the investigation and full rights of defence must be afforded to the companies in question.

In relation to merger control, the working group encourages the MOFCOM to publish notice of filings for non-simple cases—immediately upon acceptance—including basic information on the merging parties, the sector concerned and the indicative deadline for the MOFCOM's decision. The working group further encourages them to publish these decisions as soon as possible after clearance, with more detailed information, e.g. the involved relevant markets. Clarification will enhance the quality of any filings and thus create more effective proceedings for the MOFCOM. An example of this lack of transparency and detailed information on the decision process is the MOFCOM's decision of

17<sup>th</sup> June, 2014, prohibiting the P3 Network Alliance between three container shipping liners, Maersk Line, Mediterranean Shipping Company and CMA CGM.

The European business community welcomes the publication of courts' judgements, provided that the confidentiality of the proceeding itself is respected, as a positive development. In this respect, it would be helpful if the AMEA bodies created websites on which all AML-related documentation can be published, including a comprehensive and up-to-date copy of the AML, implementing regulations, fully-reasoned decisions, notices, guidance, a summary of filings received, an indication of the sector involved in the transaction and so on. Many other competition authorities have created such websites, in particular the European Commission (EC) and national competition authorities. The publication of such information encourages compliance with the AML by businesses, by enhancing awareness of obligations. It is also important to ensure that any communication with the press does not undermine the individual rights of defendants, while ensuring appropriate publicity of a case at the same time.

The working group remains keen to work with relevant EU and Chinese government bodies such as the Directorate General (DG) for Competition, the EU Delegation to China and Mongolia and the AMEA bodies, in order to develop more frequent and structured dialogue between EU businesses in China and the three bodies entrusted by the State Council with AML enforcement, namely the MOFCOM, the SAIC and the NDRC.

#### Examples of issues where further guidance is needed include:

- Concentrations, in particular the notion of control;
  - The P3 Network Alliance has created a degree of ambiguity as to when control by contract arises. Guidance in this regard would be welcomed in view of the number of different forms of alliances that currently exist in certain industries (e.g. the airline industry, the shipping industry).
- The notion of 'JVs';
  - A significant number of notified transactions involve JVs. The broad definitions under the AML mean that fully-functional and non-fully functional JVs require notification. The challenge is determining which, if any, kind of JVs should not qualify as a concentration.
- Merger remedies;

*Establishing a Network Center*, MOFCOM, 2014, viewed on 24<sup>th</sup> June, 2015, <<http://fdj.mofcom.gov.cn/article/zbxx/201406/20140600628586.shtml>>





- Timelines for the submission of remedies and negotiations, including the protection of third party rights.
- Hold-separate remedies, a concern to companies given the potentially indefinite timeframe of such remedies.
- Criteria on assessing competition impact of concentrations;
  - The circumstances in which the MOFCOM will determine that a transaction merits expedited review outside the context of a simple case.
  - Detailed guidance on how the MOFCOM interprets the assessment criteria in Article 27 of the AML, including by reference to market share thresholds and indicative of the Herfindahl–Hirschman Index (HHI) and the concentration ratio (CRn) measures.
- The circumstances in which the MOFCOM may intervene if the filing thresholds are not met;
- The application of the AML to the exercise of IPR;
  - Determination of the circumstances in which price-related conduct with respect to the exercise of IPR will be considered problematic.
- The calculation of fines in the context of conduct investigations by the NDRC and the SAIC as well as the MOFCOM investigations for failure to notify;
- The market share threshold under which agreements will not be considered as monopoly agreement (*de minimis* rules);
- Automatic exemption for some types of agreements (block exemption);
- The inconsistency of the leniency programmes between the SAIC and the NDRC;
- Consistent application and enforcement of the AML by the AMEA bodies, as well as consistency in law enforcement and rule making between private litigation and administrative enforcement of the AML; and
- The MOFCOM's review procedure, especially during the pre-consultation phase fostering the development of a predictable review timetable and limiting the instances where merging parties are forced to withdraw and re-file their notification.

## Recommendations

### Rules and Transparency

- Issue comprehensive rules and guidelines on all remaining key aspects of the AML promptly in order to promote fuller understanding and compliance by businesses, and to offer them greater legal certainty; where such rules or guidelines are not available, the AMEA bodies should take this lack of clarity into account in their enforcement of the AML.

- Amend existing rules and guidelines where appropriate to reflect the evolving case law and practice of the enforcement authorities as well as judicial interpretations adopted by the SPC, in order to ensure that businesses better understand the AML and related implementing regulations and remain in compliance.

### Fair Enforcement

- Utilise external experts and make available to parties and their advisers the reports on which the AMEA bodies rely.
- Support the efforts of the SPC in promoting cases brought under the AML as well as consistent interpretation, application and enforcement of the AML by China's enforcement authorities.
- Adopt standard publication channels, such as websites, for all information relevant to AML enforcement, including new measures, decisions and consultations.

### Concentrations

- Publish notices online in non-simple cases identifying the notifying parties and the sector involved in the transaction.
- Apply and enforce the AML transparently, publishing detailed and reasoned decisions in all non-simple cases in order to increase understanding of the review process and standards of the AMEA bodies.
- Ensure that external elements do not obstruct the swift and prompt decision-making process of notified concentrations.
- Enable notifying parties to engage with external consultants appointed by the MOFCOM to advise on notified transactions.
- Formally notify the parties of any competition concerns during the assessment process at least 30 days before the end of the second-phase review.

### International Standards

- Ensure that the implementation and enforcement of the AML does not unfairly discriminate between domestic companies and FIEs, in particular in light of Article 7 of the AML.
- Contribute to the development of ICL policy through participation in the ICN, and other international bodies.
- Ensure that the application and enforcement of the AML is consistent with ICL policy and practice, while adopting policies and approaches suited to the Chinese context.



### 3. Continue Working Towards Greater Transparency and Strengthening the Rule of Law

#### Concern

As a member of the World Trade Organisation (WTO), China is obliged to comply with the transparency requirements in its accession protocol: although significant progress has been made, and the Chinese Communist Party has recently reaffirmed its commitment to the rule of law, the lack of transparency in the elaboration, promulgation and implementation of laws and regulations by legislative, judiciary and administrative bodies remains an issue for European companies operating in the Chinese market.

#### Assessment

A key element in China's accession to the WTO relates to laws, regulations and other rules related to trade and investment. While there has been significant progress in the quality of drafting, timeliness of issuance and ease of interpretation of PRC laws and regulations since China's accession to the WTO, further attention still needs to be paid to issues of transparency, uniform application and broad administrative discretion in applying laws and regulations, and judicial review of administrative decisions.

#### Public consultation process

The working group welcomes the progress that has been made and the fruitful dialogue that has been established between some PRC legislative organs and EU stakeholders. Public consultation is a crucial element in the law-making process, as it facilitates the resolution of potential problems in the practical implementation of laws before their official promulgation and therefore enables better legislation to be promulgated.

Despite the transparency efforts of the Legislative Affairs Office of the State Council (SCLAO) to maintain their public consultation website,<sup>8</sup> many ministries and commissions still do not allow for a consultation period of at least 30 days for public consultation of draft regulations, as committed to by China in the *Interim Measures on Solicitation of Public Comments on Draft Laws and Regulations*.<sup>9</sup> In addition, this

<sup>8</sup> <<http://bmyj.chinalaw.gov.cn/>>

<sup>9</sup> *Interim Measures on Solicitation of Public Comments on Draft Laws and Regulations*, SCLAO, 27<sup>th</sup> April, 2012, viewed 24<sup>th</sup> June, 2015, <<http://www.chinalaw.gov.cn/article/cazjgg/201204/20120400367358.shtml>>

public consultation process should be made more transparent by publishing all contributions received from stakeholders on draft laws and regulations, together with feedback from regulators on the stakeholders' comments, in a manner similar to the EC website Your Voice in Europe.<sup>10</sup> Due to the lack of transparency in the current consultation process, it is little more than a 'black box', and foreign stakeholders may be discouraged from providing comments since no comprehensive assessment of such comments is provided when regulations are published in their final form.

#### Official publication of laws and regulations

Upon its accession to the WTO, China made a commitment to establish an official journal dedicated to the publication of all laws, regulations and other measures concerning or affecting trade in goods and services, or the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). This is achieved to some extent through the website maintained by the SCLAO.<sup>11</sup> However, this tool remains basic and insufficiently user-friendly. The working group encourages the Chinese Government to further invest in this tool by including professional search and hyperlinking features, as well as ensuring same-day publication of all laws and regulations. This would work to enhance the rule of law by providing greater accessibility and enable both foreign and domestic enterprises to obtain free and readily available access to laws and regulations, instead of relying on costly commercial offerings. The working group regrets that this website does not offer links to essential laws and regulations in any of the languages of the officially recognised ethnic groups of China (Mongolian, Tibetan, Uyghur and Zhuang).

#### State and commercial secrets

The foreign business community continues to be concerned about PRC laws on state and commercial secrets. Foreign companies doing business in China wish to ensure that they fully comply with PRC laws in all their activities. In this respect, the 2014 version of the *Implementing Regulations to the PRC Law on the Protection of State Secrets* has been disconcerting to foreign investors. While the original and excessive scope of state secrets included in the 2012 draft for comments of this regulation (which included under the

<sup>10</sup> <<http://ec.europa.eu/yourvoice/>>

<sup>11</sup> <<http://www.chinalaw.gov.cn/>>





scope of state secrets such topics as “jeopardising social stability” and “undermining the economic and scientific and technological strength of the state”) has been abandoned, no clear scope has been determined in the final version, apparently owing to differences of opinions between institutions. Therefore foreign investors and their advisors still lack sufficient legal certainty to determine with confidence that they are not in breach of such regulations. For example, the recent stance taken by the Ministry of Environmental Protection (MEP) regarding the transfer of soil contamination information as state secrets has reinforced the view in the foreign business community that any information could constitute a state secret at the sole discretion of officials. The working group is also concerned that under the PRC Criminal Procedure Law, trials relating to state secrets are not conducted in open courts.

### Predictability

Predictability is one of the key requisites of the rule of law, as it increases trust in the legal system and allows companies and individuals to plan their activities. In China, predictability is negatively affected by the occurrence of retroactive application of laws and regulations.

### Retroactive application of laws and regulations

On occasion, regulations and circulars issued by PRC institutions have been applied retroactively, thereby creating uncertainties on the state of the law at any given time. By way of example, foreign investors have been particularly upset about the retroactive application of the social security regime (and on occasion, retroactive fines for non-compliance with a non-existent regime). In order to preserve legal certainty and the legitimate expectations of business operators, PRC institutions and regulators should apply the general principle of non-retroactivity of laws and regulations and refrain from issuing regulations with retroactive effect.

### Court judgements

European businesses welcome the increase in transparency and publicity of court judgements. They also appreciate the efforts that have been put into improving and extending the websites of the SPC<sup>12</sup> and local courts,<sup>13</sup> through which a growing selection of court judgements has now been made available.

<sup>12</sup> <<http://www.chinacourt.org/>>

<sup>13</sup> For example, <<http://bjgy.chinacourt.org/>>

However, the search capabilities and user-friendliness of these tools remains rudimentary. Improving and investing in these tools would be beneficial to the entire business and civil community.

The publication of *Guiding Cases* by the SPC is also a very welcome development towards a scientific approach to jurisprudence, and should contribute to a consistent implementation and interpretation of laws and regulations throughout the country's courts.

The amendment to Article 156 of the PRC Civil Procedure Law is a positive development to the extent that it expressly guarantees the public the right to check and review effective civil judgements and rulings, except for those involving state and commercial secrets and personal privacy. However, in addition to this, foreigners should have full public access to commercial and civil hearings in the People's Courts without the need to pre-register or be specially authorised. It is a basic requirement of a rule-of-law society that courts of law be freely accessible to all persons, regardless of their nationality.

The Legal and Competition Working Group commends the commitment of the Chinese leadership to advance the rule of law, as announced at the Fourth Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee (CPCCC). Most of the measures revealed in the Third Plenum's *Decision* go in the right direction, such as the fight against judicial corruption, reducing interference with the judiciary by public officials, the reduction of 'red tape', respect for the constitution, establishing a scientific legislation process and compiling a civil code. Although foreign investors understand that these reforms will take time and effort to be fully implemented, a partial or slow implementation of these measures would send a discouraging message to foreign investors. The working group encourages the Chinese Government to swiftly bring about substantial and visible results in the advancement of the rule of law.

### Recommendations

- Standardise the public consultation process, allow for at least eight weeks for comments on drafts of laws and regulations and publish stakeholders' comments and regulators' feedback.
- Publish all laws and regulations prior to implementation, improve the online publication of laws and regulations



and provide official English translations of important rules and regulations.

- Enforce only those laws and regulations that have been previously published in official journals or through other media.
- Ensure that the *Regulation Concerning the Publication of People's Courts Judgements and Rulings on the Internet 2013 Regulation* (SPC, 21<sup>st</sup> November, 2013) requiring the publication of court judgements on the SPC's designated official website will be implemented by individual people's courts, including cases involving local government interests.
- Ensure that all judgements issued by a court can be accessed and reviewed by any interested party, not only the litigants or their counsels.
- Permit foreigners to attend civil and commercial hearings in the People's Courts.
- Further define the scope of state secrets.
- Continue to focus on the advancement of the rule of law and quickly implement the blueprint set out in the *Decision*.

## Abbreviations

AMEA	Anti-Monopoly Enforcement Authority
AML	Anti-Monopoly Law
CAI	EU-China Comprehensive Agreement on Investment
CPCCC	Communist Party of China Central Committee
CEPA	Closer Economic Partnership Arrangement
CNY	Chinese Yuan
CRn	Concentration Ratio
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
DG	Directorate General
EC	European Commission
EU	European Union
FTZ	Free Trade Zone
HHI	Herfindahl–Hirschman Index
HKSARG	Hong Kong Special Administrative Region Government
ICL	International Competition Law
ICN	International Competition Network
IPR	Intellectual Property Rights
JLV	Joint Law Venture
JV	Joint Venture
MEP	Ministry of Environmental Protection
MOFCOM	Ministry of Commerce
MOJ	Ministry of Justice
NDRC	National Development and Reform Commission
PRC	People's Republic of China
SAIC	State Administration for Industry and Commerce
SCLAO	Legislative Affairs Office of the State Council
SHBOJ	Shanghai Municipal Bureau of Justice
SPC	Supreme People's Court
TRIPS	Trade-Related Aspects of Intellectual Property Rights
WTO	World Trade Organisation





## Public Procurement Working Group

### Key Recommendations

- ▶ **1. Improve Market Access for Foreign Enterprises Within the Framework of the Comprehensive Agreement on Investment (CAI)**
  - Ensure equal treatment of foreign-invested enterprises (FIEs) and Chinese-invested enterprises in China's public procurement market, in the same way that Chinese-invested enterprises enjoy equal treatment in Europe.
  - Decouple legitimate indigenous innovation policies from government procurement regulations.
  - Remove practices that unfairly bar FIEs from bidding on public projects.
  - Clearly define 'domestic' products and companies, as recognised per international practice, ensuring all entities legally established in China are considered 'domestic' regardless of the origin of their capital.
  
- ▶ **2. Define the Scope of Validity of the Government Procurement Law (GPL) and the Bidding Law (BL), and Ensure Compliance with the Implementation Rules of the GPL**
  - Provide a clear definition of the scope of application of the Government Procurement Law (GPL) and the Bidding Law (BL).
  - Ensure uniform, nationwide enforcement of the *Implementation Rules of the GPL (Implementation Rules)*.
  - Introduce implementation rules of the BL that are comparable with the provisions laid down in the *Implementation Rules*.
  - Include procurement covered by the BL in the framework of the Comprehensive Agreement on Investment (CAI) and the World Trade Organisation Government Procurement Agreement (WTO/GPA).
  
- 3. Improve Provisions of the Government Procurement Agreement (GPA) Offer and Accelerate Negotiations**
  - Provide a new and final Government Procurement Agreement (GPA) offer that is much more comprehensive than the fifth offer submitted in December 2014, and issue provisional temporary rules adopting all or parts of the fifth offer.
  - Address the inconsistencies found between domestic regulations and GPA regulations to pave the way for a smooth accession.
  
- 4. Strengthen Consideration of Environmental Impact and Life Cycle Costs in Public Procurement**
  - Increase the proportion of green public procurement within government procurement.
  - Apply more elaborate models to measure the environmental impact of public procurement.
  - Include life-cycle costs as an award criterion to identify the most economically advantageous tenders and favour high-quality solutions, lowering excessive dependency on price.

▶ Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.



## Introduction to the Working Group

The Public Procurement Working Group was established in March 2005, as a cross-sector platform to address issues related to public purchasing and contracting in China, covering public sourcing of products, projects and services. The working group consists of 57 member companies, representing all major industries.

The main objectives of the working group are to make constructive recommendations for improved public procurement processes, to advocate fair and open competition, to provide and share public procurement practices with key stakeholders and to support the development of the Chinese public procurement market to achieve the best use of public funds.

The field of public procurement is not just restricted to government procurement, the funds for which are managed by the Ministry of Finance (MOF). The Public Procurement Working Group defines public procurement as:

*Tendering by the central and sub-central government and other public entities and state-owned enterprises (SOEs) for projects, products and services that are of public interest and/or use public funds.*

This includes, among many others, procurement by the Ministry of Railways (MOR) as well as procurement by public institutions such as hospitals and universities.

## Recent Developments

In 2014, government procurement in China amounted to Chinese Yuan (CNY) 1,731 billion, an increase of 5.6 per cent, reaching a share of 2.7 per cent of China's GDP.<sup>1</sup>

In 2013, the total public procurement, including government procurement, military procurement, procurement by SOEs and public institutions such as universities, exceeded CNY 20 trillion,<sup>2</sup> equivalent to 35 per cent of GDP,<sup>3</sup> and far exceeding the 13 per cent average of Organisation for Economic Cooperation and Development (OECD)

member-countries.<sup>4</sup>

On 12<sup>th</sup> November, 2013, the Third Plenary Session of the 18<sup>th</sup> Communist Party of China Central Committee concluded with the promulgation of the *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform (Decision)*.<sup>5</sup>

Article 9 of the *Decision* states: "Enacting market rules that are fair, open and transparent. We will implement a unified market access system; and on the basis of making a negative list, all kinds of market players may enter areas not on the negative list on an equal basis and according to law."

The Public Procurement Working Group welcomes the *Decision*, and interprets this passage as a commitment that foreign-invested enterprises (FIEs) shall receive equal market access, including in the public procurement market, and expects that steps in this direction shall be implemented in the near future.

In late December 2014, China submitted its fifth offer for the entry to the Government Procurement Agreement (GPA)<sup>6</sup> under the World Trade Organisation (WTO). Compared with the fourth offer of late 2013, five more provinces have been included, bringing the total number of provinces to 19, covering almost all economically important provinces (except Sichuan and Jilin).

The revised offer also includes these notable aspects:

- The lower thresholds for which the GPA applies has been lowered by more than 50%, for example from euro (EUR) 600,000 to EUR 240,000 for central government purchases in the first and second year of the agreement.
- Four more service sectors have been added, including legal services.
- Procurement concerning the infrastructure of China (drinking water, electricity, energy, transportation, telecommunications or postal services) is now open to foreign bidders.

1 *A Brief Summary of National Public Procurement* (in Chinese), Ministry of Finance, 30<sup>th</sup> July, 2015, viewed 3<sup>rd</sup> August, 2015, <[http://gks.mof.gov.cn/redianzhuanti/zhengfucaigouguanli/201507/t20150730\\_1387257.html](http://gks.mof.gov.cn/redianzhuanti/zhengfucaigouguanli/201507/t20150730_1387257.html)>

2 Sun, Yang, *The Total Volume of China's Public Procurement Market exceeds CNY 20 Billion* (in Chinese), *Xinhua Net*, 26<sup>th</sup> March, 2014, viewed 22<sup>nd</sup> June, 2015, <[http://news.xinhuanet.com/fortune/2014-03/26/c\\_119959752.htm](http://news.xinhuanet.com/fortune/2014-03/26/c_119959752.htm)>


3 *Statistics of China's GDP in 2013* (in Chinese), *Baidu Knowledge*, 28<sup>th</sup> March, 2014, viewed 22<sup>nd</sup> June, 2015, <<http://tieba.baidu.com/p/2837868574>>

4 *Public Procurement*, OECD, viewed 22<sup>nd</sup> June, 2015, <<http://www.oecd.org/gov/ethics/public-procurement.htm>>

5 *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform* (in Chinese), approved 15<sup>th</sup> November, 2013, viewed 22<sup>nd</sup> June, 2015, <[http://news.xinhuanet.com/2013-11/15/c\\_118164235.htm](http://news.xinhuanet.com/2013-11/15/c_118164235.htm)>

6 *Accession of the People's Republic of China to the Agreement on Government, Communication from the People's Republic of China, Fifth Revised Offer*, World Trade Organisation, Committee on Government Procurement, December 2014.



Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
<p>9. "Enacting market rules that are fair, open and transparent. We will implement a unified market access system; and on the basis of making a negative list, all kinds of market players may enter areas not on the negative list on an equal basis and according to law."</p>	<p>Restrictions to foreign investment have been eased, but a nationwide negative list is not in place yet.</p> <p>There is a discrepancy between restrictions to foreign investment and actual market access. Because FIEs are not considered 'local Chinese' enterprises, FIEs may be founded but they still face market access restrictions.</p>	

However, as in previous offers, the fifth offer only covers procurement under the umbrella of the MOF. The large market of procurement by SOEs is still not mentioned in the new offer.

During its session on 31<sup>st</sup> December, 2014, the Chinese State Council adopted the *Implementation Rules of the Government Procurement Law (order no. 658) (Implementation Rules)*.<sup>7</sup> The *Implementation Rules* focus on curbing corruption, strengthening the rule of law, as emphasised in the Third Plenum's *Decision* and reiterated during the Fourth Plenum. The *Implementation Rules* don't distinguish between local and foreign suppliers, it explicitly states that all bidders should be treated equally, including having equal access to information and fair, non-biased tender criteria.

However, the overlying Government Procurement Law (GPL) still requires that government agencies prefer local Chinese products. Neither the Government Procurement Law nor the *Implementation Rules* provide a definition of 'Chinese products'.

▶ In 2015, China and the European Union (EU) have been negotiating a Comprehensive Agreement on Investment (CAI). Though this agreement shall not specifically cover public procurement, the Public Procurement Working Group expects that the CAI will include a clear definition of what constitutes 'made in China', giving FIEs in China equal market access, in the same way that Chinese-invested enterprises enjoy equal market access in the EU. The Public Procurement Working

Group encourages both parties to reach an agreement within 2015.

## Key Recommendations

### ▶ 1. Improve Market Access for Foreign Enterprises Within the Framework of the Comprehensive Agreement on Investment (CAI)

#### Concern

Public procurement under both China's Government Procurement Law (GPL) and the Bidding Law (BL) continues to discriminate against FIEs in China.

#### Assessment

Access to China's public procurement market remains a major concern for European-invested enterprises. Despite reassurances from the highest levels of China's government that FIEs should be treated equally to domestic companies, FIEs are still discriminated against in public procurement in a number of ways.

#### Definition of domestic goods and companies

A key factor contributing to difficulties of FIEs in engaging in government and public procurement in China is the lack of a definition of the term 'domestic goods'. The draft of the *Implementation Rules* released for public comment in 2010,<sup>8</sup> stated in article 10: "Chinese products are those manufactured in China, where the costs of manufacture within China exceed a certain percentage of the total cost of the final product." While this definition was in line with international

<sup>7</sup> *Implementation Rules of the Government Procurement Law of the Peoples Republic of China (Order no. 658)* (in Chinese), entered into force 1<sup>st</sup> March, 2015, viewed 22<sup>nd</sup> June, 2015, <[http://www.gov.cn/zhengce/2015-02/27/content\\_2822395.htm](http://www.gov.cn/zhengce/2015-02/27/content_2822395.htm)>

<sup>8</sup> *Notice: State Council of Legislative Affairs call for comments on the Draft Implementation Regulations on Government Procurement Law*, (in Chinese), State Council Legislative Affairs Office, 11<sup>th</sup> January, 2010, viewed 27<sup>th</sup> July, 2015, <[http://www.china.com.cn/policy/txt/2010-01/11/content\\_19215879.htm](http://www.china.com.cn/policy/txt/2010-01/11/content_19215879.htm)>





practice, it was deleted in the final version adopted on 31<sup>st</sup> December, 2014. The working group calls for a definition of 'domestic' companies and goods, ensuring that all companies legally registered in China are treated as domestic companies regardless of the origin of their capital.

### Restrictions on foreign-invested companies

In various cases, Chinese government agencies, SOEs or public institutions explicitly bar FIEs from bidding on public contracts.

For example, in the important railway market (mainlines and urban subway lines), no foreign entity is allowed to bid directly for a project in rolling stock or signalling segments in China.<sup>9</sup>

In the field of medical equipment, the National Health and Planning Commission launched an initiative, urging hospitals to favour local Chinese brands.<sup>10</sup>

Foreign-invested enterprises in China also report that they encounter discrimination in public procurement in a number of other ways. These stem from China's regulatory framework and bidding practices not being in line with the GPA principles of transparency, competition, integrity and sufficient remediation. This includes but is not limited to the following:

- Regulations automatically excluding FIEs, due to 'licensing requirements', for example in the construction, engineering, and architecture/design sectors where FIEs are at a disadvantage when it comes to obtaining the required licences.
- Bids not being published (against stated regulations), or published only few days ahead of the bid opening date, only domestic companies being informed of bids and only domestic companies being provided with additional information relating to the bids.
- FIEs being eliminated from bids on the grounds of not respecting the technical specifications, patent, trademark or brand-name requirements, which are not actually necessary for the bids.
- FIEs being eliminated from bids on the grounds of discriminatory requirements such as country of origin of supplier.
- FIEs being eliminated from bids due to biased

evaluation after bids are entered.

In contrast, Chinese-invested enterprises legally registered in any of the EU Member States are by definition regarded as European companies and enjoy the same equal treatment as a company with solely European shareholders.

The Public Procurement Working Group supports open markets and equal conditions for all actors, and encourages China to reciprocally open their public procurement markets to EU-invested enterprises, to the benefit of both EU and China business interests. Particularly so since China is showing increasing interest in entering public contracts abroad.

### Recommendations

- Ensure equal treatment of FIEs and Chinese-invested enterprises in China's public procurement market, in the same way that Chinese-invested enterprises enjoy equal treatment in Europe.
- Decouple legitimate indigenous innovation policies from government procurement regulations.
- Remove practices that unfairly bar FIEs from bidding on public projects.
- Clearly define 'domestic' products and companies, as recognised per international practice, ensuring all entities legally established in China are considered 'domestic' regardless of the origin of their capital.

## 2. Define the Scope of Validity of the Government Procurement Law (GPL) and the Bidding Law (BL)<sup>11</sup> and Ensure Compliance with the Implementation Rules of the Public Procurement Law

### Concern

Although the Government Procurement Law (GPL) and Bidding Law (BL) exist in parallel, the *Implementation Rules* only apply to the GPL, which may tempt local government agencies to favour application of the less stringent BL over the more strictly regulated GPL.

### Assessment

After five years of consultation, the Chinese State Council promulgated the *Implementation Rules* on 31<sup>st</sup>

<sup>9</sup> Please see page 254 of the *Rail Working Group Position Paper* for more information.

<sup>10</sup> Please see page 210 of the *Healthcare Equipment Working Group Position Paper* for more information.

<sup>11</sup> The official name of this law is 《中华人民共和国招标投标法》, which translates directly to the 'Law on inviting bids and submitting bids in the PR China'. On the English website of the National People's Congress, they use the 'Law of the People's Republic of China on Bid Invitation and Bidding', <[http://www.npc.gov.cn/englishnpc/Law/2007-12/11/content\\_1383557.htm](http://www.npc.gov.cn/englishnpc/Law/2007-12/11/content_1383557.htm)> For the purposes of this paper we will refer to it simply as the Bidding Law (BL).



December, 2014. It focusses on curbing corruption by stipulating detailed regulations for the tendering process. Significantly, the *Implementation Rules* don't distinguish between local and foreign suppliers, in fact it explicitly states that all bidders should be treated equally, including having equal access to information and fair, non-biased tender criteria.

The Public Procurement Working Group welcomes the *Implementation Rules*, and regards it as an important contribution to the stricter adherence to the rule of law as stipulated in the Third Plenum's *Decision* and reiterated in the Fourth Plenum. However ensuring compliance at the local level throughout China will be an arduous task.

The co-existence of GPL and BL creates ambiguity and uncertainty among FIEs. Although the *Implementation Rules* don't differentiate between Chinese-invested companies and FIEs, there are no equivalent implementation rules for the BL. This risks local government agencies circumventing the GPL—for example by establishing or entrusting an SOE or other public institution to assume responsibility for a given tender—and applying the criteria and requirements of the BL instead, thereby avoiding the need to apply equal treatment to FIEs and Chinese-invested enterprises in the tender process.

#### Recommendations

- Provide a clear definition of the scope of application of the GPL and the BL.
- Ensure uniform, nationwide enforcement of the *Implementation Rules*.
- Introduce implementation rules of the BL that are comparable with the provisions laid down in the *Implementation Rules*.
- Include procurement covered by the BL in the framework of the CAI and the WTO/GPA.

### 3. Improve Provisions of the Government Procurement Agreement (GPA) Offer, and Accelerate Negotiations

#### Concern

The working group is concerned that the China's accession to the WTO/GPA will continue to be delayed because China's offer is still not sufficiently comprehensive and does not fulfil the expectations of GPA signatories.

#### Assessment

Fourteen years since its WTO accession and eight years after negotiations first started, China presented its fifth offer to the WTO/GPA in December 2014. Compared with its previous offer, China's latest offer added five provinces and the threshold of projects to be covered by the GPA was lowered by about 50 per cent. While the Public Procurement Working Group welcomes the broader coverage of the fifth GPA offer, it is disappointed that the offer completely excludes the area of state-owned enterprises (SOEs). In addition, the working group sees no obvious reason why all of Western China, is excluded from the offer. The new offer also only covers a few selected hospitals, universities and libraries, constituting a very small fraction of state-operated non-commercial institutions in China.

The revised WTO/GPA came into force on 6<sup>th</sup> April, 2014, streamlining and modernising the agreement's text, for example, by taking proper account of the widespread use of electronic procurement tools. Since China had still not successfully joined the GPA prior to the revision, China needs to further revise its GPA offer for the accession negotiations and accelerate the process of fully opening up its procurement markets.

The working group would like to emphasise that accession to the GPA is not only an opportunity to offer the public procurement market access to other signatories but also a chance to establish a public procurement system in China on the basis of internationally-recognised best practices.

This would support China's overall interests and developmental goals of achieving better value for money, controlling government expenditure, encouraging competition in the market, curbing corruption and creating opportunities for small and medium-sized enterprises (SMEs).

#### Recommendations

- Provide a new and final GPA offer that is much more comprehensive than the fifth offer submitted in December 2014, and issue provisional temporary rules adopting all or parts of the fifth offer.
- Address the inconsistencies found between domestic



regulations and GPA regulations to pave the way for a smooth accession.

#### 4. Strengthen Consideration of Environmental Impact and Life Cycle Costs in Public Procurement

##### Concern

Environmental impact and life-cycle costs (LCCs) are not sufficiently nor efficiently taken into consideration in public procurement decision-making in China regulated by the GPL and BL.

##### Assessment

The European Commission defines green public procurement (GPP) as:

“A process whereby public authorities seek to procure goods, services and works with a reduced environmental impact throughout their life cycle when compared to goods, services and works with the same primary function that would otherwise be procured.”<sup>12</sup>

In China, environmental protection is a key goal under China’s 12<sup>th</sup> Five-Year Plan. In 2013, 29 per cent of all public procurement was theoretically under GPP regulation, of which 80 per cent was actually dedicated to energy efficiency and Environment Label Products (ELP).<sup>13</sup>

The Chinese Government has defined two product lists: the Energy Conservation Product (ECP) List and the ELP List. Procurement from the ECP List is mandatory, while procurement from the ELP List is voluntary. Both lists specify concrete manufacturers, to the exclusion of others.

Both ECP and ELP lists are based on certification and standards, i.e. it is a binary certified/non-certified decision. The working group recommends applying more elaborate models to measure the environmental impact of government procurement.

Almost all tenders are decided on purchase cost as opposed to life-cycle costs, e.g. energy and maintenance costs during operations are not a factor in the decision of a tender, resulting in an inefficient use of

public funds and natural resources.

##### Recommendations

- Increase the proportion of green public procurement within government procurement.
- Apply more elaborate models to measure the environmental impact of public procurement.
- Include life-cycle costs as an award criterion to identify the most economically advantageous tenders and favour high-quality solutions, lowering excessive dependency on price.

#### Abbreviations

BL	Bidding and Tendering Law
CAI	Comprehensive Agreement on Investment
CNY	Chinese Yuan
ECP	Energy Conservation Product
ELP	Environment Label Products
EU	European Union
EUR	Euro
FIE	Foreign-Invested Enterprises
GDP	Gross Domestic Product
GPA	Government Procurement Agreement
GPP	Green Public Procurement
GPL	Government Procurement Law
LCC	Life Cycle Cost
MOF	Ministry of Finance
MOR	Ministry of Railways
OECD	Organisation for Economic Cooperation and Development
SME	Small and Medium-sized Enterprises
SOE	State-Owned Enterprises
WTO	World Trade Organisation

<sup>12</sup> Denjean, Benjamin et. al., *Green Public Procurement in China, Quantifying the Benefits*, International Institute for Sustainable Development, Beijing, 2015, p.6

<sup>13</sup> Ibid p. 22



## Research and Development Working Group

### Key Recommendations

#### 1. Facilitate Scientist Exchanges at all Levels Including Experts and Young Talent in a Joint Effort with the European Union (EU)

- Grant an exemption in the visa policy that eases administrative requirements for young, foreign scientists and researchers.
- Provide more flexible conditions for visas allowing foreign scientists to work in China on short-term, joint research and development (R&D) projects.
- Allow talented, foreign, science students to do internships in China, in Chinese or foreign companies.
- Permit the hiring of talented, fresh science graduates in China, in Chinese or foreign companies.

#### 2. Encourage Foreign-Invested Companies to Contribute to Chinese Innovation Through R&D Operations by Clarifying the Financial Incentives Framework

- Lower the barrier for foreign companies doing upstream research in China through partnerships with Chinese academia or Chinese companies.
- Change the requirements that are typically limiting foreign-invested enterprises (FIEs) from applying for the High and New-Technology Enterprise (HNTE) status, in order to ensure that all the internationally qualified R&D institutions participating in the Chinese innovation system can benefit from this status.
- Allow FIEs to participate in national and regional key development projects by ensuring equal opportunities in the attribution of public subventions for R&D activities, e.g. early involvement in the development of innovation framework and inviting experts from FIEs to join technical committees.
- Set up a public, online platform publishing official information on all Chinese R&D public grants in a clear and transparent manner ahead of time, to ensure enough preparation time for the grant application process.

#### 3. Invest in China's Living Environment by Incentivising R&D for Sustainable Development Technologies

- Set up a consortium-type project like the Sustainable Technologies Initiative (SUSTECH) in Europe, where foreign companies with research operations in China can participate and bring their knowledge to boost progress with the same rights and duties as Chinese participants.
- Set up incentives in the form of subsidies or tax rebates and favourable policies for companies that run R&D operations focused on the development of new green technologies.
- Set up specific incentive programmes for companies who want to pilot new green technologies to help mitigate the upfront costs of developing these new technologies.
- Set up incentives for companies who are the first to implement new technology on an industrial level and who act as a pilot for authorities to see if these technologies should be extended.
- Consider partnering with Europe and setting up joint programmes in the spirit of the SUSTECH initiative in Europe.

#### 4. Harmonise China's Intellectual Property (IP) Laws with International IP laws and Improve and Facilitate Enforcement to Foster a Business Environment that Provides the Necessary Assurances to Enable World-class Innovation in China



- Improve the overall intellectual property rights (IPR) legal system and enforcement thereof.<sup>1</sup>

### 5. Promote Innovation in Growing Industry Sectors by Ending Forced Technology Transfers as Preconditions for Market Access

- Create a legal environment allowing FIEs to protect the confidentiality of their detailed engineering and design works.
- Adopt appropriate measures to end the mandatory approval of blueprints with authorised Chinese partners as a requirement to obtain construction permits, e.g. by also authorising foreign engineering bureaus to directly apply for such permits.

### 6. Ensure the Participation of FIEs in the Standards Definition Process in Order to Enhance the Competitiveness of China-developed Technologies in the International Market<sup>2</sup>

- Open the standards updating process to all stakeholders, including FIEs.
- Promote harmonisation of Chinese and international standards to incentivise FIEs to undertake more R&D activities in China.
- Create a mechanism providing flexibility to the standard context, in order to let practitioners carry out real-scale experiments and innovate.
- Accelerate the standards updating process by increasing the frequency of the editing of new versions.

## Introduction to the Working Group

The European Chamber's Research and Development Working Group was created in order to further develop the activities of the former Research and Development Forum of the European Chamber as members felt the need to engage directly with Chinese authorities at both the central and local levels. It is composed of professionals directly involved in R&D operations in China from more than forty European multinational corporations (MNCs) which all have R&D centres and large-scale R&D operations in China, mostly located in the Beijing and Shanghai areas. Various sectors of the industry are represented in the working group including companies that enjoy global leading positions in their sectors, such as automotive, chemicals and petrochemicals, aerospace, energy and pharmaceuticals.

The working group aims to provide a platform to exchange information, experiences and best practices among member companies and also aims to promote dialogue and transparency in the field of R&D policy.

It meets regularly with European and Chinese policy-makers, including the Ministry of Science and Technology (MOST) and the European Commission's Directorate-General for Research and Innovation.

## Recent Developments

China's ambition to transition to an innovation-driven society was one of the clear overarching themes of the Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee. The R&D Working Group understood this as a clear sign that the role of the European R&D industry as a contributor to China's advancement is now more significant than ever. Having gathered decades of localised experience and leadership in the field of science and technology across diverse regions, European technological enterprises are uniquely equipped to expedite innovative momentum beyond the perimeters of their own corporate walls.

With Chinese government spending on R&D increasing steadily each year (Chinese Yuan (CNY) 870 billion in 2011; CNY 1,000 billion in 2012; CNY 1,200 billion in 2013)<sup>3</sup> and numerous R&D-focused incentives rolled

<sup>1</sup> For related information and recommendations on these issues also see the *Intellectual Property Rights Position Paper*.

<sup>2</sup> For related information and recommendations on these issues also see the *Standards and Conformity Assessment Position Paper*.

<sup>3</sup> *China Statistical Year Book 2014*, National Bureau of Statistics of China, 2014, viewed on 9<sup>th</sup> July, 2015, <<http://www.stats.gov.cn/tjsj/ndsj/2014/zk/html/Z2001e.htm>>



out, it is clear that China's commitment to innovation is no less than it is for the European enterprises for which it constitutes their bread and butter. Nevertheless, the Research and Development Working Group still sees further opportunities in China for advancing this joint objective. Among others, there remains further progress to be made when it comes to transparency of incentives for top-level innovation, flexible access to global talent, solid legal assurances and stimulus of R&D for sustainable development.

Foreign-invested R&D centres have multiplied in China, growing from under 200 to over 1,500 over the past 15 years.<sup>4</sup> In 2013, China spent euro (EUR) 171.6 billion on R&D<sup>5</sup> (2.08 per cent of its gross domestic product (GDP)), compared to the EU's EUR 272 billion<sup>6</sup> (2.01 per cent of total EU GDP)<sup>7</sup> and, according to a United Nations (UN) report, China had already surpassed the United States (US) to become the world's 'most attractive' destination for R&D investment.<sup>8</sup> China is also the largest source of science graduates in the world, with approximately 900,000 engineering majors graduating every year, and already 2.8 million people working in China's R&D sector.

The Research and Development Working Group welcomes the ongoing updating process initiated by the State Council Legislative Affairs Office (SCLAO) and the MOST, of the *Law of the People's Republic of China on Promoting the Transformation of Scientific and Technological Achievements*. The current law was adopted back in 1996 by the Standing Committee of the National People's Congress and the update of this law should be a major step towards developing a new legal framework favouring R&D and innovation in China.

The Research and Development Working Group provided its comments on the draft law, and hopes that, in particular, the following priorities will be included in its

update:

- Acknowledge the importance of high-level research and education institutions, giving them more autonomy on the transfer and pricing of R&D projects.
- Develop a clear legal framework for industry-university-research cooperation under the leadership of the industry in order to ensure the market-driven aspect of the partnership.
- Strengthen the Science and Technology (S&T) Commissions resources and public services such as the public technological platforms and the overall administrative support of S&T local authorities.
- Develop new innovative ways of funding for R&D projects, such as state guarantees for loans to support patent applications, tax incentives, special innovation funds and risk compensation funds, and insurance.

Finally, the State Intellectual Property Office (SIPO) issued a new draft of the *Regulation on Service Inventions*<sup>9</sup> on 2<sup>nd</sup> April, 2015, calling for comments. Compared to the previous version of the draft, the Research and Development Working Group welcomes the changes, which reduce the burden of employers. However, the draft regulation still allows the possibility for the invalidation of reward policies and individual agreements if there is any non-compliance with the other articles regarding the rights of the service inventor in the draft regulation. This clause remains a big concern and constitutes risks and uncertainty for employers. In addition, it is still not clearly stated that only the employer of the inventor is liable to pay remuneration, and not the entity to whom the patent is granted.

## Key Recommendations

### 1. Facilitate Scientist Exchanges at all Levels Including Experts and Young Talent in a Joint Effort with the European Union (EU)

#### Concern

Tougher administrative visa requirements and inconsistent implementation of visa policies in different regions of China have become a major concern for foreign companies conducting R&D in China.

4 378 Foreign-owned R&D Centers located in Shanghai, Making up 25% of China Total, Ministry of Commerce, 13<sup>th</sup> November, 2014, viewed 8<sup>th</sup> June 2015, <<http://shfb.mofcom.gov.cn/article/ml/c/201411/20141100794777.shtml>>

5 National Science and Technology Fund Expenditures in 2013, National Bureau of Statistics of China, 2014, viewed 8<sup>th</sup> June 2015, <[http://www.stats.gov.cn/tjsj/tjgb/rdpcgb/qgkjfrtjgb/201410/t20141023\\_628330.html](http://www.stats.gov.cn/tjsj/tjgb/rdpcgb/qgkjfrtjgb/201410/t20141023_628330.html)>

6 Eurostat Statistics Explained, European Commission, 1<sup>st</sup> July, 2015, viewed 9<sup>th</sup> July, 2015, <[http://ec.europa.eu/eurostat/statistics-explained/index.php/R\\_%26\\_D\\_expenditure](http://ec.europa.eu/eurostat/statistics-explained/index.php/R_%26_D_expenditure)>

7 Eurostat Statistics Explained, European Commission, 1<sup>st</sup> July, 2015, viewed 9<sup>th</sup> July, 2015, <[http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Gross\\_domestic\\_expenditure\\_on\\_R%26D,\\_2003%E2%80%9313\\_\(%25\\_of\\_GDP\)\\_YB15.png](http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Gross_domestic_expenditure_on_R%26D,_2003%E2%80%9313_(%25_of_GDP)_YB15.png)>

8 Foreign investment shows more confidence in China's R&D, People's Daily, 29<sup>th</sup> January, 2014, viewed 9<sup>th</sup> July, 2015, <<http://en.people.cn/98649/8525483.html>>

9 Call for Comments on the *Regulation on Service Invention*, Legislative Affairs Office of the State Council, 2<sup>nd</sup> April, 2015, viewed 9<sup>th</sup> July, 2015, <<http://www.chinalaw.gov.cn/article/cazjgg/201504/20150400398828.shtml>>



Third Plenum Reality Check		
What the Third Plenum's <i>Decision</i> <sup>10</sup> say?	What is the reality?	Status
<p><b>13. Deepening reform of the management system for science and technology.</b></p> <p>“We will set up and improve mechanisms and institutions that encourage original innovation, integrated innovation, and re-innovation based on introduction and absorption, improve the mechanism that encourages market-based technological innovation, and give free rein to the market’s guiding role in technological research and development orientation, choice of paths, pricing of factors, and allocation of all innovation factors.”</p>	<p>The working group has not seen a great deal of progress from the perspective of FIEs. It remains difficult for us to participate in China’s key projects. See the working group’s recommendations for our thoughts on participation in major China projects and subsidies.</p> <p>Shanghai City’s announcement of new measures to develop Shanghai as a scientific and innovative city covers quite a few of these topics. The working group looks forward to seeing these announced measures take effect.</p>	
<p><b>13. Deepening reform of the management system for science and technology.</b></p> <p>“We will strengthen the application and protection of intellectual property rights (IPR), improve the technological innovation incentive mechanism, and explore ways to set up IPR courts.”</p>	<p>Three IP Courts were set up in 2014, as promised. In Beijing on 6<sup>th</sup> November, Guangzhou on 16<sup>th</sup> December and Shanghai on 28<sup>th</sup> December.</p>	
<p><b>13. Deepening reform of the management system for science and technology.</b></p> <p>“We will develop the technology market, improve the technology-transfer mechanism, improve the financing conditions for small and medium-sized enterprises of science and technology, improve the venture capital investment mechanism, innovate business models, and promote the capitalisation and industrialisation of scientific and technological achievements.”</p>	<p>The China National Technology Transfer Eastern Centre was opened on 24<sup>th</sup> April, in Shanghai, integrating roles of technology transfer, incubation, investment and connection to the global market.</p>	

### Assessment

China is now the “most attractive destination for research and development (R&D) investment”<sup>11</sup> and the biggest producer of science graduates in the world. Despite this, both local companies and MNCs in China are still looking for skilled scientists and researchers. As an example, a senior R&D manager costs 20-25 per cent higher in China compared to Europe. Multinational

corporations are not bringing foreign scientists to replace Chinese scientists even though it is established that a variety of profiles and a cosmopolitan work environment stimulates researchers and scientists in the R&D centres.

Without the presence of different profiles and cultures in the R&D centres in China, as is the case in other countries, and despite the quality of infrastructure and staff, China risks being perceived as a ‘second choice’ for foreign scientists and researchers, preventing the country from attracting great talent in the future and benefiting from their work.

<sup>10</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.

<sup>11</sup> *Foreign investment shows more confidence in China’s R&D*, *People’s Daily Online*, 29<sup>th</sup> January, 2014, viewed 9<sup>th</sup> July, 2015, <<http://en.people.cn/98649/8525483.html>>



The working group sees that the Chinese Government is at least partially aware of the importance of such personnel exchanges as can be understood from the joint statement issued at the conclusion of the 17<sup>th</sup> EU-China Summit: "The EU and China acknowledged that people-to-people exchanges, including cooperation in the areas of culture, higher education, youth, multilingualism and gender equality are vital to deepen mutual understanding, foster innovation and creativity, and enhance contacts between the peoples of both sides."<sup>12</sup>

Multinational corporations have all developed internal mobility programmes for their employees. International mobility, exchanges and experimentation with different environments are essential for scientists and researchers to foster new ideas, create and develop new products, processes and technologies. This is particularly established for R&D operations and even more important for junior R&D staff in order for them to be trained as early as possible with all the equipment and processes in labs all over the world according to their research area. Offering a favourable and stimulating environment to R&D staff is essential to promote the emergence of innovative and creative ideas. However, the recent visa requirements set up by the government are preventing young talent from working and contributing to the development of China's innovation ecosystem.

Multinational corporations' R&D centres are not competing on the market with domestic companies, but are developing products and technologies that would eventually benefit the entire Chinese society. International mobility for R&D staff and junior researchers and scientists is an essential part of the R&D strategy of MNCs. Therefore the Research and Development Working Group recommends that in order to foster innovation in China, young foreign scientists and researchers should have a specific status regarding visa requirements to work in China and for foreign scientists to work in China on short-term, joint R&D projects.

#### Recommendations

- Grant an exemption in the visa policy that eases

administrative requirements for young, foreign scientists and researchers.

- Provide more flexible conditions for visas allowing foreign scientists to work in China on short-term, joint R&D projects
- Allow talented, foreign science students to do internships in China, in Chinese or foreign companies.
- Permit the hiring of talented, fresh science graduates in China, in Chinese or foreign companies.

## 2. Support Foreign-Invested Companies Contributing to Chinese Innovation through R&D Operations by Clarifying the Financial Incentives Framework

### Concern

Despite being an essential part of the Chinese innovation system, compared with Chinese domestic companies foreign companies operating R&D in China face increased difficulties when they apply to obtain public funding and grants for R&D.

### Assessment

In order to maximise the potential of the Chinese innovation network as a contributing factor to the development of a prosperous and harmonious society, it is essential that all key stakeholders work together on an equal level. There should therefore be minimal difference in the way that foreign companies and Chinese companies are encouraged to engage in R&D work in China.

Foreign R&D is part of the Chinese National Innovation System: foreign companies' R&D centres employ Chinese nationals, generate Chinese patents and industrialise their innovations in China. They collaborate with Chinese universities and academic laboratories. All in all, they are, as much as Chinese companies, a living part of the Chinese innovation ecosystem.

China has a solid set of incentives in place to stimulate innovation including 'strategic support' (long-term structural incentives like the High and New-Technology Enterprise (HNTE) status<sup>13</sup> and the super-deduction scheme) and 'tactical support' (focused grants for projects with a definite scope and target). Unfortunately,

<sup>12</sup> *EU-China Summit joint statement: the way forward after forty years of EU-China cooperation*, Council of Europe, 29<sup>th</sup> June, 2015, viewed 9<sup>th</sup> July, 2015, <<http://www.consilium.europa.eu/en/meetings/international-summit/2015/06/150629-eu-china-joint-statement/>>

<sup>13</sup> *Regulation on the Determination and Administration of High and New-Technology Enterprise*, issued on 1<sup>st</sup> January, 2008 by the MOST, the Ministry of Finance (MOF) and the State Administrations of Taxation (SAT), <<http://www.innocom.gov.cn/gxjsyqrdw/ztwj/200808/4403b501b1164254b9da12e1a6e96839.shtml>>





up until now, foreign companies are not taking part in this incentive system as much as they should due to several reasons.

For example, the rules for obtaining the HNTE status should be harmonised China-wide – currently, obtaining this status depends on the local authorities' interpretation of the status as well as their political and industrial strategies. While the nationwide rules are quite clear, they are applied locally with some degree of flexibility, thereby enabling local authorities to deal with the complexity and fluidity of the innovation world. However, this flexibility creates uncertainty for companies and accession to HNTE status is now very much dependant on the location and the company that applies. The Research and Development Working Group believes that it would be more efficient to set lighter, less stringent regulations, but to apply them strictly and uniformly all over China.

In terms of grants, foreign companies are restricted to applying in certain strategic sectors, and, when they do, the lack of clarity and reliability of the selection process, as well as the discretionary decision by local authorities in favour of domestic 'champions', creates a common feeling among foreign companies that there is no level playing field. Chinese companies operating in Europe on the other hand are fully eligible to participate in local projects. The working group therefore welcomes China and the EU's joint commitment "to promote and monitor reciprocity of access to the EU and China's respective research and innovation funding programmes", as stated at the 17<sup>th</sup> China-EU Summit that took place on 29<sup>th</sup> June, 2015.<sup>14</sup>

European projects are advertised on a common, online platform that makes the submission process very clear, transparent and fair.<sup>15</sup> The main advantage of such a system is that every innovative company can bring its contribution to the European research world. The working group believes that China would benefit tremendously from such a system adapted to the Chinese innovation environment.

<sup>14</sup> EU-China Summit joint statement: the way forward after forty years of EU-China cooperation, Council of Europe, 29<sup>th</sup> June, 2015, viewed on 9<sup>th</sup> July, 2015, <<http://www.consilium.europa.eu/en/meetings/international-summit/2015/06/150629-eu-china-joint-statement/>>

<sup>15</sup> European Commission Research and Innovation Participant Portal, viewed on 9<sup>th</sup> July, 2015, <<https://ec.europa.eu/research/participants/portal/desktop/en/home.html>>

## Recommendations

- Lower the barrier for foreign companies doing upstream research in China through partnerships with Chinese academia or Chinese companies.
- Change the requirements that are typically limiting foreign-invested enterprises (FIEs) from applying for the High and New-Technology Enterprise (HNTE) status, in order to ensure that all the internationally qualified R&D institutions participating in the Chinese innovation system can benefit from this status.
- Allow FIEs to participate in national and regional key development projects by ensuring equal opportunities in the attribution of public subventions for R&D activities, e.g. early involvement in the development of innovation framework and inviting experts from FIEs to join technical committees.
- Set up a public, online platform publishing official information on all Chinese R&D public grants in a clear and transparent manner ahead of time, to ensure enough preparation time for the grant application process.

## 3. Invest in China's Living Environment by Incentivising R&D for Sustainable Development Technologies

### Concern

With foreign R&D companies based in China willing and well-equipped to contribute to a sustainable future and healthy living environment, the working group believes that more can be done to further incentivise efforts to this end and ensure their success.

### Assessment

When it comes to the future of innovation in China, the promotion of R&D aimed at curtailing China's pressing environmental issues by mobilising the best resources available should be a top priority. A major instrument used by the government to address environmental issues is the implementation and enforcement of new regulations that impose stricter environmental constraints. Additionally, China is modernising or closing down heavily polluting industry to reduce pollution and dramatically reduce environmental footprints. It is important to note that both national and local government authorities are also already promoting the development of new, sustainable technologies via the launching of various targeted projects. The working group believes that all these measures are good, but could be complemented by additional incentives



focusing on the long-term development of new breakthrough technologies. Such technologies would elevate China's position from merely making progress through the implementation of top technologies to becoming a *leader* in top technologies. Similar programmes, such as the Sustainable Technology Initiative (SUSTECH), have been successful in Europe. European companies with R&D operations in China can contribute significantly to this type of development by bringing together experience gathered through such projects in Europe and experience working in China with Chinese parties (authorities, academia, industry) to develop new technologies adapted to the Chinese environment.

The development of incentives for new clean technologies should also be further encouraged at the industrial level. Often these new, cleaner technologies can be expensive to develop and also more expensive to operate, which slows down or even halts the development of such technologies. Putting targeted incentives in place (and not only regulations) could drastically improve the speed of implementation for new clean technologies.

#### Recommendation

- Set up a consortium-type project like the SUSTECH in Europe, where foreign companies with research operations in China can participate and bring their knowledge to boost progress with the same rights and duties as Chinese participants.
- Set up incentives in the form of subsidies or tax rebates and favourable policies for companies that run R&D operations focused on the development of new green technologies.
- Set up specific incentive programmes for companies who want to pilot new green technologies to help mitigate the upfront costs of developing these new technologies.
- Set up incentives for companies who are the first to implement new technology on an industrial level and who act as a pilot for authorities to see if these technologies should be extended.
- Consider partnering with Europe and setting up joint programmes in the spirit of the SUSTECH initiative in Europe.

#### 4. Harmonise China's IP Laws with International IP laws and Improve and Facilitate Enforcement to Foster a Business Environment that Provides the Necessary Assurances to Enable World-class Innovation in China

##### Concern

Despite significant improvements to China's IP system of late, FIEs are still encountering procedural and enforcement difficulties when it comes to exercising their legal IPR. This goes directly against the level of assurances needed by companies to invest in top-level technological innovation in China.

##### Assessment

In China, FIEs developing new technologies and with Intellectual Property Rights (IPR) are making significant contributions to China's economic transformation – from 'made in China' to 'created in China'. China has risen to be one of the most attractive destinations for R&D investments resulting in spill over benefits for Chinese society as a whole. Advanced techniques and assembly lines are being sold or set up. Senior mechanics and skilled workers are being trained. Technological upgrading and innovation are being activated in domestic, technology-based companies. However, the confidence of FIEs is not rising with same vigour as they are being pressured to share essential technologies or to disclose trade secrets.

The State Council of the People's Republic of China published the *National Intellectual Property Strategy* on 5<sup>th</sup> June, 2008, which defines the establishment of a modern and efficient IP regulatory framework as a key priority for Chinese economic development. This was followed by the *12<sup>th</sup> Five-Year Plan on National Intellectual Property Development (2011-2015)* and the *12<sup>th</sup> Five-Year Plan for Patent Examination (2011-2015)*. Tremendous progress has been made over the past years to upgrade the laws and regulations related to IP, with the aim of encouraging innovation in China and offering better protection to innovative companies and individuals. Despite these efforts, the Research and Development Working Group sees room for improvement, both on the regulatory side and the enforcement side.

European Companies also face restrictions on ownership of IP produced from research and commercialisation



projects receiving Chinese government funding according to Article 21 of the Law on Progress of Science & Technology and industry-specific and local regulations. Indeed, new IP produced by projects that receive Chinese state funding require:

- approval from the relevant government authorities if the IP is to be transferred or exclusively licensed to non-Chinese entities (including to foreign project partners that contribute background IP); and
- that the new IP is 'used' first inside China (i.e. that first licensee for the newly-produced IP must be in China).

A contract solution may be sufficient in most cases (especially if the contract is seen and approved by the Chinese government funding agency from the outset). The situation may be complicated if other industry-specific regulations apply within technology areas receiving joint funding from China and another country – especially in areas designated as strategic emerging industries.

On the enforcement side, it is difficult for FIEs to spend the time and money necessary to enforce their rights when infringed, especially if it is infringed by a Chinese partner. Intellectual property disputes related to high-technology products or new materials are often very technical and complex. Besides Beijing, Shanghai and Guangzhou, there are few IP courts in China that have the resources, the expertise and the experience to properly handle these cases. This translates into the fact that, knowing any litigation process will be long and costly, FIEs will often adopt the most conservative position regarding their R&D strategy in China, or will choose not to enforce their rights and stop their activity.

#### Recommendation

- Improve the overall IPR legal system and enforcement thereof.

## 5. Promote Innovation in Growing Industry Sectors by Ending Forced Technology Transfers as Preconditions for Market Access

#### Concern

Foreign-invested enterprises are still subject to non-favourable practices, especially when it comes to technology transfer as preconditions to market access

(e.g. seed, construction or rail industries) or the confidentiality of trade secrets.

#### Assessment

After decades of development and reforms, a number of domestic Chinese technology companies have become strong enough to compete in both the Chinese and international markets. Perhaps one of the signs of China's innovation prowess is the drastic increase of applications for patents and inventions in China. However, European companies are confronted by *de facto* requirements to transfer technology in order to participate in government tenders in China. This rarely happens through formal regulations or tender documents, but through Chinese partners unofficially requiring transfer before agreeing to form joint ventures (JVs).

Foreign-invested enterprises spend great efforts and make huge investments in R&D in China, however, when they are willing to put a newly-developed technology on the Chinese market they face heavy and intrusive licensing approval processes. These processes often require companies to divulge detailed information related to the new technology, including proprietary information of the company and trade secrets.

Another aspect deterring FIEs from investing further in R&D in China is compulsory technology transfers as a precondition for market access. The working group has seen cases where Chinese local governments are using technology transfers to favour local companies when setting up JVs with FIEs. Domestic Chinese companies are also using compulsory technology transfers to put commercial pressure on FIEs when negotiating a partnership or a JV structure.

The Research and Development Working Group is convinced that these technology transfers as preconditions for market access, initially used to support local companies to build up innovation capabilities, are now achieving the opposite effect. Indeed, FIEs are incentivised not to partner up with local companies for R&D projects, therefore preventing the development of a sustainable innovation ecosystem in China. The working group believes that technology transfers should be negotiated between partners, and the government should not impose artificial requirements that are distorting competition and instead let the



market determine the technology transfer conditions for companies when partnering up.

#### Recommendations

- Create a legal environment allowing FIEs to protect the confidentiality of their detailed engineering and design works.
- Adopt appropriate measures to end the mandatory approval of blueprints with authorised Chinese partners as a requirement to obtain construction permits, e.g. by authorising foreign engineering bureaus to directly apply for such permits.

### 6. Ensure the Participation of FIEs in the Standards Definition Process in Order to Enhance the Competitiveness of China-developed Technologies in the International Market

#### Concern

Regarding the standards updating process in China, the Research and Development Working Group is concerned that the lack of FIEs' involvement in sector-specific standardisation organisations, and the lack of international harmonisation and flexibility in existing standards is preventing China from unleashing its full innovation potential.

#### Assessment

The standards definition and updating process is a cornerstone of innovation policy. It forms the bridge from where R&D is translated into innovative products that are on the market. In order to guarantee comprehensiveness of this mechanism, it is essential to have different points of view involved in the definition and updating processes of standards. It should comprise a multi-stakeholder engagement. The involvement of a wide variety of stakeholders ensures a higher level of security, transparency and compliance during the transition of products from R&D centres to the market. Today, most of the standards-setting bodies only allow very limited participation of FIEs, despite the fact that they are playing an essential part in R&D and innovation in China. This lack of visibility on standards evolution may deter FIEs from committing to R&D projects in China. Openness and transparency are fundamental to creating a standards dynamic that actively promotes innovation in China.

Underrepresentation of key stakeholders in standardisation

organisms results in lower compliance with standards from those that are excluded from the standards definition and updating process. Historically—and logically—innovation of products and systems is largely derived from industrial pioneers or professional associations, not academics more involved with fundamental research, or government authorities. All stakeholders have different agendas that all have valuable input into, and concerns for, the common good. Therefore a diverse group of stakeholders in the standardisation dynamic is key to progress, to the benefit of society, the environment and the economy. The addition of foreign experience brings greater diversity and makes for a more resilient process.

Standards are supposed to give similar products and systems a cohesive definition, to serve as simplified, universal reference that consumers can easily understand. An exaggerated nationalisation of standards in fields that were already harmonised internationally tends to create unnecessary complications, and confuses consumers. As a result, consumers become more conservative, avoiding bold choices and sticking to simple and well-known solutions. The harmonisation of China national standards with international standards will improve readability of common products and methods of quality in China. Moreover, it will increase focus and international visibility on China's truly innovative sectors, thus giving China global recognition for its R&D capacity.

By essence a standard can only follow the market, whereas innovation is supposed to precede the market. Innovation on products and methods which are already the object of a standard is bound to conflict with existing standards. Overly-detailed and rigid standards will inhibit further innovation of products that are largely standardised but still leave room for improvement (with integration of the latest research break-through). Given this, China's innovation will remain hindered if no mechanism is created to provide temporary flexibility to the standard environment of a particular product or method, which aims at improving itself. An experimentation mechanism would allow temporary and limited standard exemptions or modification for specified innovative technologies. After reviewing the safety and potential greater benefit to the product of the proposed method, an official temporary authorisation should be published as the first step towards a standards update. Finally, the low frequency of standards updating is



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keeping the Chinese market behind international markets, by preventing diffusion of the latest products and methods. The Research and Development Working Group believes that it is necessary to increase the frequency of updates to integrate the latest breakthroughs. To benefit from lessons learned from successful, reviewed and validated temporary authorisation as proposed above, they should be integrated into permanent standards. This requires standards to be updated frequently.

### Recommendations

- Open the standards updating process to all stakeholders, including FIEs.
- Promote harmonisation of Chinese and international standards to incentivise FIEs to undertake more R&D activities in China.
- Create a mechanism providing flexibility to the standard context, in order to let practitioners carry out real-scale experiments and innovate.
- Accelerate the standards updating process by increasing the frequency of the editing of new versions.

## Abbreviations

CNY	Chinese Yuan
EU	European Union
EUR	Euro
FIE	Foreign-Invested Enterprise
GDP	Gross Domestic Product
HNTE	High and New-Technology Enterprise
IP	Intellectual Property
IPR	Intellectual Property Rights
MNC	Multi National Corporation
MOF	Ministry of Finance
MOST	Ministry of Science and Technology of China
R&D	Research and Development
SAT	State Administration of Taxation
S&T	Science & Technology
SCLAO	State Council Legislative Affairs Office
SIPO	State Intellectual Property Office
SUSTECH	Sustainable Technology Initiative
US	United States





## Standards and Conformity Assessment Working Group

### Key Recommendations

- ▶ **1. Implement the Principles of the Agreement on Technical Barriers to Trade of the World Trade Organisation (WTO/TBT) Related to Standards, Technical Regulations and Conformity Assessment Procedures**
  - Ensure proper notification of all technical regulations, including mandatory standards, required for market access.
  - Limit the scope of technical regulations and standards according to the WTO/TBT agreement, to issues related to the protection of safety, health and environment.
  
- ▶ **2. Review Mandatory Market Access Requirements, Including the Simplification of Testing and Certification Procedures**
  - Optimise the synchronisation of mandatory standards, compulsory certification schemes and administrative licensing schemes.
  - Support the recognition of test reports at a national level.
  - Increase further the possibility for manufacturers to use their own testing laboratories.
  - Avoid the use of recommended standards in mandatory certification schemes or administrative licensing.
  
- ▶ **3. Continue the Current Reform of the Chinese Standardisation System with a Focus on These Key Issues**
  - Process and system related issues
    - Delegate the responsibility of all standardisation issues, especially issues related to mandatory standards management, to the Inter-ministerial Joint Meeting Mechanism for Standardisation Coordination and Promotion.
    - Optimise the standards development process, especially for mandatory standards and industry standards.
    - Grant fair access to all technical committees to all interested stakeholders.
    - Allow a reasonable period of time for commenting.
    - Introduce reasonable transition periods for mandatory standards.
    - Implement the European concept of transition periods to more industries.
    - Align Chinese standards more effectively with each other to avoid conflicting requirements.
    - Continue the efforts to reduce the number of Chinese standards.
  - International standards: optimise the alignment of Chinese standards with international standards
    - Encourage more Chinese experts to participate in international meetings.
    - Increase the number of identically-adopted international standards.
    - Reduce delays to the national adoption of international standards.
  - Social group standards
    - Give clear guidance on the standards development process, including consideration of intellectual property (IP) issues and the rules for participation, to ensure fair processes.
    - Clarify the role of standards developed by global organisations and consortia.
  - Enterprise standards

▶ Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.





- Define a clear and transparent process for the management of enterprise standards.
- Ensure that the disclosure of enterprise standards is voluntary and that trade secrets are protected during their disclosure.

#### 4. Ensure Fair and Transparent Market Surveillance

- Align market surveillance with market access requirements.
- Limit market surveillance to compliance with laws, regulations for quality assessment and mandatory standards.

## Introduction to the Working Group

The Standards and Conformity Assessment (SCA) Working Group was founded in 2008. Its members come from various sectors such as automotive, auto components, construction, cosmetics, healthcare equipment, electrical equipment, information and communication technology (ICT) equipment/services, and machinery.

The working group aims to support the development of China's SCA systems in order to facilitate China's integration into the world economy. In order to help achieve this and to better illustrate the points made by the working group, this paper draws on examples from the following working groups: Agriculture, Food and Beverage, Construction, Heating, Information and Communication Technology, Information Security, Petrochemicals, Chemicals and Refining, Rail, Research and Development, and Smart Grid.

## Recent Developments

### The Reform of the Standardisation System

On 26<sup>th</sup> March, 2015, the State Council released the *Notice on the Deepening Reform Plan for Standardisation Work* (Guofa [2015] No.13),<sup>1</sup> which includes reform objectives and a three-phase implementation timeline planned to be completed by 2020. The overall objectives of the reform are:

- to establish a new standards system: co-development and coordination of standards established by the government and the market;
- to establish a new standardisation management system: a coordinated, highly efficient management system under the governance of both government

and the market; and

- to make standards a safeguard for quality in order to move the Chinese economy up the value chain.

The reform will establish a new type of standards system consisting of government-driven and market-initiated standards. The government-driven standards will be streamlined from six previous categories to four categories, namely mandatory national standards, recommended national standards, recommended industry standards and recommended local standards. The market-initiated standards include social group standards and enterprise standards. Accordingly, the reform plan defines six measures:

- Build an effective and authoritative standardisation coordination mechanism.
- Consolidate and streamline mandatory standards.
- Optimise and improve recommended standards.
- Cultivate and develop social group standards.
- Ease restrictions to and allow more room for enterprise standards.
- Boost the level of internationalisation of Chinese standards.

The Standardisation Administration of the People's Republic of China (SAC) decided to further promote the reform by the publication of the *Opinions on Improving and Strengthening Local Standardisation Work*<sup>2</sup> on 8<sup>th</sup> April, 2015, and the *Main Points of the National Standardisation Work in 2015*<sup>3</sup> on 21<sup>st</sup> April, 2015. One purpose of the first document is to limit the scope of recommended local standards to technical requirements suiting local geographical conditions and customs. In the second document, the SAC intends to speed up

<sup>1</sup> *Notice on the Deepening Reform Plan for Standardisation Work* (Guofa [2015] No.13), State Council, 26<sup>th</sup> March, 2015, viewed on 15<sup>th</sup> April, 2015, <[http://www.gov.cn/zhengce/content/2015-03/26/content\\_9557.htm](http://www.gov.cn/zhengce/content/2015-03/26/content_9557.htm)>

<sup>2</sup> *Opinions on Improving and Strengthening Local Standardisation Work*, SAC, 8<sup>th</sup> April, 2015, viewed on 15<sup>th</sup> April, 2015, <<http://www.wxqts.gov.cn/zjyw/bzh/tzgg/52389.shtml>>

<sup>3</sup> *Main Points of the National Standardisation Work in 2015*, SAC, 21<sup>st</sup> April, 2015, viewed on 25<sup>th</sup> April, 2015, <[http://www.sac.gov.cn/bgs/zxtz/201504/20150424\\_187360.htm](http://www.sac.gov.cn/bgs/zxtz/201504/20150424_187360.htm)>





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the Reality?	Status
We will further streamline the administration and delegate more power to lower levels, deepen the reform of the system concerning matters subject to government examination and approval, and reduce the central government's administration in micro affairs to the greatest extent. We will cancel all administrative approval procedures for economic activities under the effective regulation of the market mechanism. We will manage matters that require administrative approval according to procedures and with high efficiency.	Several administrative licensing processes have been simplified, e.g. medical devices licensing and cosmetics licensing, but more efforts are needed.	
We will set up legal person governance structure for public institutions, transform qualified public institutions into enterprises or social organizations, and establish a unified registration system for the management of public institutions of all kinds.	Guiding opinions regarding the integration of testing, inspection and certification (TIC) bodies have been released, proposing a three-step reform timetable.	
The government will strengthen the formulation and implementation of development strategies, plans, policies and standards, enhance market activity monitoring and supply of public services.	The <i>Working Plan on Deepening the Standardisation Reform</i> shows a positive intention to optimise the current standards system. However, it takes time to see the results of cleaning-up of the existing outdated, overlapping and contradictory standards. In spite of positive changes, it is still difficult for foreign stakeholders to contribute to the standards formulation process. Besides, overly short and sharp transition periods as well as insufficient commenting periods are hindering the implementation of standards.	
Social organisations should be commissioned to provide public services that they are apt to supply and tackle matters that they are able to tackle.	The Chinese Government will introduce social group standards into the current standards system and encourage competent social groups and industrial alliances to develop such standards. In line with this market-driven approach, we suggest that alliance standards/consortia standards be included in social group standards.	

the revision of the Standardisation Law of China, the formulation of the *Administrative Measures for National Mandatory Standards*, and the guiding opinions and code of good practice for social group standards. In addition, the SAC will make a plan to clean-up and integrate mandatory standards.

### The Reform of the China Compulsory Certification (CCC) Scheme

The Certification and Accreditation Administration of

the People's Republic of China (CNCA) released the *Announcement on Updating List of Appointed CCC Certification Bodies and Testing Laboratories* (CNCA [2014] No.26)<sup>4</sup> in July 2014. Two independent foreign testing organisations were authorised as appointed testing laboratories for CCC of audio/video products and some house appliance products.

<sup>4</sup> *Announcement on Updating List of Appointed CCC Certification Bodies and Testing Laboratories* (CNCA [2014] No.26), CNCA, 30<sup>th</sup> July, 2014, viewed on 25<sup>th</sup> April, 2015, <[http://www.cnca.gov.cn/tzgg/ggxx/ggxx2014/201408/t20140828\\_21265.shtml](http://www.cnca.gov.cn/tzgg/ggxx/ggxx2014/201408/t20140828_21265.shtml)>





According to the previous CCC scheme, enterprises needed to obtain CCC certificates from certification bodies while applying for CCC marks with the Beijing Compulsory Certification Mark Centre. In March 2015, the China Quality Certification Centre (CQC), the China Certification Centre for Automotive Products (CCCAP), the China Quality Mark Certification Group (CQM) and the China Information Security Certification Centre (ISCCC) were approved as the first batch of certification bodies that can issue CCC certificates together with CCC marks.

### The Reform of China Testing and Inspection System

In March 2014, the State Commission Office of Public Sectors Reform (SCOPSR) and the General Administration of Quality Supervision, Inspection and Quarantine of the People's Republic of China (AQSIQ) jointly issued the *Opinions on the Implementation of the Integration of Testing, Inspection and Certification (TIC) Bodies* (Guobanfa [2014] No.8).<sup>5</sup> On 8<sup>th</sup> March, 2015, the AQSIQ issued the *Guiding Opinions on the Integration of Testing, Inspection and Certification Bodies Within the National Quality Inspection System* (Guozhijianke [2015] No.86)<sup>6</sup> (*Guiding Opinions*). The *Guiding Opinions* divided TIC bodies into two classes: public and commercial. More importantly, the *Guiding Opinions* proposed a three-step reform timetable:

- By 2015, basically complete the integration of TIC bodies directly under the AQSIQ and TIC bodies relevant to the entry-exit inspection and quarantine system, and make considerable achievements in pilots of vertical integration of TIC bodies relevant to special equipment.
- By 2017, basically complete the integration of TIC bodies within the national quality inspection system. The public class of TIC bodies will be in place with clear responsibilities while the transformation of commercial class of TIC bodies into enterprises will be basically completed.
- By 2020, basically complete the reform tasks of integration of TIC bodies within the quality inspection system with separation of government and enterprises, and form a batch of comprehensive testing, inspection and certification groups with global reach.

<sup>5</sup> *Opinions on the Implementation of the Integration of Testing, Inspection and Certification Bodies* (Guobanfa [2014] No.8), SCOPSR AQSIQ, 11<sup>th</sup> March, 2014, viewed on 26<sup>th</sup> April, 2015, <[http://www.aqsiq.gov.cn/zjxw/zjxw/zjftpxw/201403/t20140312\\_406000.htm](http://www.aqsiq.gov.cn/zjxw/zjxw/zjftpxw/201403/t20140312_406000.htm)>

<sup>6</sup> *Guiding Opinions on the Integration of Testing, Inspection and Certification (TIC) Bodies within National Quality Inspection System* (Guozhijianke [2015] No.86), AQSIQ, 8<sup>th</sup> March, 2015, viewed on 26<sup>th</sup> April, 2015, <[http://www.aqsiq.gov.cn/xxgk\\_13386/jgfl/tzbaqj/tzdt/201503/t20150316\\_434296.htm](http://www.aqsiq.gov.cn/xxgk_13386/jgfl/tzbaqj/tzdt/201503/t20150316_434296.htm)>

## Key Recommendations

- ▶ 1. **Implement the Principles of the Agreement on Technical Barriers to Trade of the World Trade Organisation (WTO/TBT) Related to Standards, Technical Regulations and Conformity Assessment Procedures**

### Concern

China's practices do not fully comply with the *Agreement on Technical Barriers to Trade of the World Trade Organisation (WTO/TBT)* principles, and hence create unnecessary obstacles for foreign enterprises trying to access the Chinese market.

### Assessment

- a) **Proper notification of technical regulations (including mandatory standards) and conformity assessment procedures required for market access**

According to the WTO/TBT, central government bodies in China are obliged to notify proposed technical regulations and conformity assessment procedures to members of the World Trade Organisation (WTO), together with a brief indication of their objectives and rationale, at an early stage, which enables amendments and comments to be taken into account.

In China, mandatory standards are deemed to be technical regulations. Other regulations contain compulsory certification schemes and administrative licensing schemes. The working group recognises that China has fulfilled its responsibilities to notify the WTO of new mandatory national standards, the CCC scheme and some regulations, for example, medical device regulations issued by the China Food and Drug Administration (CFDA), in a proper manner. However, non-compliance with the WTO/TBT notification rules has been observed in cases of mandatory industry standards, voluntary standards included in mandatory certification schemes as well as some regulations requiring conformity assessment procedures for market access, for example, China's energy labelling scheme, mining safety certification and wind power equipment certification. Specific examples of voluntary standards, which need to be applied for some reason, but which have not been notified to the WTO, are discussed in detail in Key Recommendation 1 of the *Information and Communication Technology Position Paper*.



**b) Limitation of the scope of technical regulations and standards according to the WTO/TBT agreement, to issues related to the protection of safety, health and the environment**

The WTO/TBT agreement allows countries to take necessary measures for fulfilling legitimate objectives: national security requirements, prevention of deceptive practices and protection of health, safety and the environment.

After the publication of the *Plan for Deepening the Reform of the Standardisation System* (Guofa [2015] No.13), the working group is pleased to note that China intends to limit the scope of mandatory standards to the above-mentioned objectives of the WTO/TBT agreement. This official document is a valuable step towards further carrying out WTO/TBT principles. The working group recommends that China continues its efforts and fulfils its commitments in this regard while implementing ongoing standardisation reforms. Additionally, similar efforts should be made to ensure that technical regulations can fulfil the legitimate objectives defined in the WTO/TBT agreement. Examples of non-compliance were observed in boiler safety technical supervision administration regulations (see Key Recommendation 3 of the *Heating Desk Position Paper*).

**Key Recommendations**

- Ensure proper notification of all technical regulations, including mandatory standards, required for market access.
- Limit the scope of technical regulations and standards according to the WTO/TBT agreement, to issues related to the protection of safety, health and the environment.

**2. Review Mandatory Market Access Requirements, Including the Simplification of Testing and Certification Procedures**

**Concern**

Some products are required to fulfil multiple market access requirements published by different ministries and authorities that are not well coordinated with each other, which creates market access barriers. In addition, some testing and certification procedures pose unnecessary burdens to manufacturers, generating unnecessary costs and hindering the import of technology and services, without increasing product safety.

**Assessment**

**a) Concurrent existence of mandatory standards, compulsory certification schemes and administrative licensing schemes**

According to the China Standardisation Law, many products have to comply with mandatory standards. In addition, other regulations require some products to comply with specific mandatory certification schemes (e.g. CCC, Mining Safety Certification) or individual administrative licensing schemes (e.g. Network Access Licence) (see Table 1).

Unfortunately, these regulations are usually not well coordinated with each other. As a consequence, manufacturers have to manage overlapping testing requirements: detailed examples can be found in Key Recommendation 1 of the *Automotive Position Paper*. This results in additional costs to manufacturers and even delays product launches.

Table 1: Market access requirements for selected products

Product Name	Market Access Regulations
Coal and mining industry products	- Industrial Production Licence for Explosion-proof Electrical Apparatus - Mining Safety Certification - Explosion-proof Electrical Product Certification
Mobile telecom devices	- China Compulsory Certification (CCC) - Network Access Licence (NAL) - Radio Type Approval (RTA)
Medical devices	- Product registration (CFDA) - China Metrology Approval (CMA)
IT equipment with encryption technology	- China Compulsory Certification (CCC) - Office of Security Commercial Code Administration (OSCCA) Licensing
ITE Equipment with Encryption Technology	- CCC - Office of Security Commercial Code Administration (OSCCA) Licensing

Part of the reason for this, is that these regulations have been formulated by different ministries and governmental authorities working independently in most cases. Here, the working group recommends better synchronisation to ensure that mandatory standards,



compulsory certification schemes and administrative licensing systems applicable to a specific product eliminate any existing overlaps and conflicts. Such a simplification of market access requirements would help Chinese customers to access the most up-to-date technologies developed in China and elsewhere alike, increase manufacturing efficiency and hence infuse new vitality into the Chinese economy.

#### **b) Recognition of test reports at a national level**

There are still examples of test reports issued by a CCC-designated testing laboratory not being accepted by other such laboratories for identical tests of the same product when manufacturers apply for CCC certificates. In such a situation, manufacturers have to re-test their products in the second testing laboratory as a pre-requisite for obtaining all necessary approvals, even though the identical test has already been performed by the first testing laboratory. Such practices affect not only foreign manufacturers active in China, but also Chinese companies willing to place their products onto the market in several or all Chinese provinces.

This duplicative testing is mere repetition, thus can neither increase product safety nor bring benefits to Chinese authorities or customers. Instead, it wastes company resources, ultimately results in delayed product launches, increased costs and reduced efficiency of the Chinese economy. The working group recommends ensuring nationwide recognition of test reports for the same technical qualification between all laboratories to avoid product test repetition. This requires the definition of certain requirements to ensure the equivalence of testing laboratories across China and hence the nationwide acceptance of their test reports. The working group recommends China uses the procedures already established for the certification bodies (CB) scheme as a model. Part of the efforts could be managed by the China National Accreditation Service for Conformity Assessment (CNAS).

#### **c) Tests in the manufacturers own testing laboratories**

Some years ago, tests for the CCC scheme and other licensing schemes had to be performed by domestic testing laboratories in their own testing facilities in China. While this was somehow acceptable to small products that could easily be transported, it was not the case for larger, cumbersome products. The Chinese Government has already recognised that some products are difficult and costly to be transported

from their manufacturing site to a Chinese testing laboratory and therefore granted exemptions to large and heavy medical devices. The CCC scheme followed this approach in September 2013, with the CNCA's publication of the new *General CCC Implementation Rules on Utilisation of Testing Resources of Enterprises and Other Certification Results* (CNCA-00C-004). Depending on the situation, the CNCA now allows either the procedure of Testing at Manufacturers' Premises (TMP) or the Witnessed Manufacturers Testing (WMP). The working group appreciates this development. The CNCA should develop a concrete implementation plan to ensure the new rules are being carried out without unnecessary requirements for manufacturers. In addition, tests in manufacturers' testing laboratories should be accepted if the test laboratory is accredited by the CNAS. Such an accreditation ensures a high quality level of both testing laboratories and their test reports.

#### **d) Recommended standards used as market access requirements**

Recommended standards need to remain voluntary in any case. Unfortunately, some became mandatory as they were chosen to be the basis of mandatory certification or administrative licensing schemes, particularly in the mobile phone business. Key Recommendation 4 of the *Petrochemicals, Chemicals and Refining Position Paper* discusses this issue. As a consequence, updates and modifications of these officially recommended standards are not always communicated to the WTO, despite being mandatory for market access under administrative licensing schemes. This lack of transparency causes difficulties to industries that need to comply with those mandatory market access schemes, including CCC and other industry-specific, mandatory certification schemes. The working group suggests that all mandatory-type approval schemes for market access be based only on national mandatory standards and be supervised by one standardisation committee in China. Recommended standards should not be used for this purpose unless they have passed the official procedure of mandatory standard drafting, and thus been converted to mandatory standards.

#### **Key Recommendations**

- Optimise the synchronisation of mandatory standards, compulsory certification schemes and administrative licensing schemes.
- Support the recognition of test reports at a national level.



- Increase further the possibility for manufacturers to use their own testing laboratories.
- Avoid the use of recommended standards in mandatory certification schemes or administrative licensing.

### 3. Continue the Current Reform of the Chinese Standardisation System with a Focus on the Key Issues Listed in the Assessment

#### Concern

A significant number of standards organisations in China currently publish both mandatory and voluntary standards, with parts of these standards being neither properly aligned with each other nor with international standards. Existing standards development processes often lack transparency and can even exclude important stakeholders, especially foreign-invested enterprises (FIEs).

#### Assessment

##### a) General remarks

As described in the section on recent developments, the *Deepening Reform Plan for Standardisation Work* (Guofa [2015] No.13) (*Reform Plan*) recognises the need for a comprehensive reform of the standardisation system. The working group is convinced that the implementation of the six reform measures according to the proposed milestones will not only significantly amend China's standardisation system, but also help all manufacturers based in China to find the most suitable standards for their products, ease certification procedures and boost the Chinese economy in general. However, the working group would like to make several suggestions to make the reform process an even greater success.

##### b) Process and system related issues

The Chinese standardisation system allows over 500 technical committees (TCs) to develop national standards, more than 60 organisations to develop industrial standards and many local bodies to be involved in developing local standards. This situation has led to a huge number of standards, and even many conflicting mandatory ones. This is unfavourable for the establishment of a unified market system. Instead, standards should be well aligned with each other and free of contradicting requirements. The total amount of standards should be reduced. The working group appreciates the State Council's establishment of a joint meeting mechanism addressing the above-mentioned

problems. This issue is further discussed in Key Recommendations 1 and 2 of the *Agriculture, Food and Beverage Position Paper*.

While it is commonly understood that all interested stakeholders should get fair access to a TC, this principle is not yet fully put into practice in China. Foreign-invested enterprises and their joint ventures (JVs) in particular are often completely excluded from membership or only granted observer status. The situation is even worse for industrial standards. For instance, some standardisation projects are managed by individual companies or organisations instead of formal TCs or working groups. Their opaque development processes result in many interested stakeholders being unable to contribute and submit comments. The management of public comments often lacks transparency as well: commenting periods are much too short, and even when stakeholders are able to submit comments via different channels, they cannot easily identify to what extent their comments have been considered. This concern is described by several other working groups (Key Recommendation 1 of the *Smart Grid Position Paper*; Key Recommendation 1 of the *Information and Communication Technology Position Paper*; Key Recommendation 2 of the *Information Security Position Paper*; Key Recommendation 2 of the *Rail Position Paper*; Key Recommendation 3 of the *Construction Position Paper*; and Key Recommendation 6 of the *Research and Development Position Paper*).

With respect to the publication of standards, the working group is aware of many cases where standards were formally published by the responsible organisations, but the contents were not publicly available even until after the date of implementation. In these situations manufacturers have no opportunity to integrate new requirements into their products in due time. This not only results in low quality of standards implementation, but also limits the number of products complying with the newly published standards, hence runs contrary to the original purpose of standardisation itself.

Moreover, the current transition-period system for standards needs to be improved in two aspects:

- Some standards are published with extremely short transition periods, particularly in the telecommunications industry. The working group recommends that transition periods be carefully defined and allow enough time for the integration of new standards into products.



- The Chinese understanding of transition periods doesn't take the reality of the situation into account: during the transition period, which is considered as the time between publication of the new edition of a standard and its implementation date, only the old edition is applicable. After the implementation date, only the new edition is applicable. Such a sharp transition makes product manufacturing more difficult. In this regard, the European concept of transition periods is much fairer and more realistic: during the transition period, EU law allows both editions of a standard to be used for regulatory purposes.

Finally, the working group has observed that many standards' online service platforms have already been or are pending setup, and hopes the scope of such a positive change will be expanded to cover all mandatory and voluntary standards / national, industrial and local standards.

The current standardisation reform plan is aligned with the *Standards and Conformity Assessment Position Paper* in many aspects. The working group welcomes this reform work plan and would welcome the opportunity to collaborate with Chinese authorities to achieve the reform objectives.

#### **c) International Standards: optimise the alignment of Chinese standards with international standards**

China is engaged in improving the level of internationalisation of its standards. Chinese experts are actively participating in international standardisation activities, holding an increasing number of seats in the three international standards developing organisations (SDOs): the International Electrotechnical Commission (IEC), the International Organisation for Standardisation (ISO), and the International Telecommunication Union (ITU), as well as in other globally-accepted standards organisations.

The working group appreciates this intense commitment to international standardisation, which gives China the opportunity to influence even strategic decisions at the management level of these organisations. On the operational level, China is now able to contribute to almost every future ISO and IEC standard. The working group recommends that China seizes this opportunity to increase the adoption rate of international standards as identical Chinese standards and to shorten the adoption

delay. China should support its technical experts to directly enter their position into international standards via the national mirror TCs of the respective ISO and IEC TCs, SCs and working groups. This would reduce the need to publish national deviations and would allow the introduction of innovative solutions developed by companies based in China into international standards and save the resources of valuable technical standardisation experts, as they would only have to contribute once to international standards. If national deviations seem to be unavoidable, China should preferably use the ISO and the IEC 'global relevance toolbox'.

Key Recommendation 1 from the position papers of the Smart Grid and Information and Communication Technology working groups, as well as Key Recommendation 2 from the *Information Security Position Paper* advocate for better alignment of Chinese standards with international ones. Key Recommendation 5 from the *Information Security Position Paper* focuses on the need to increase the participation of Chinese institutions in international dialogues on standards and standardisation.

#### **d) Social group standards**

China is about to introduce social group standards which is aimed at promoting innovation and enhancing market vitality. The Chinese Government will encourage competent social groups and industrial technology alliances, such as associations, chambers of commerce and federations, to formulate standards capable of meeting market demand and the need for innovation, in order to increase the effective supply of standards. Social groups and industrial technology alliances will be allowed to formulate and release standards without the need for administrative approval. The market shall select the superior and eliminate the inferior. It is also suggested to integrate patents into social group standards to promote technical innovation.

The working group welcomes in general these plans, but would like to propose several detailed recommendations. In line with its usual stance, the working group requests that the use of patent-related technical solutions under fair, reasonable and non-discriminatory (FRAND) conditions be allowed. In order to manage social group standards, the *Guideline and Code of Conduct for Social Group Standard Development* should be published. Such a code of conduct should especially respect the principles





of fair access, reasonable commenting periods and mutual coordination with other organisations and make clear that such standards cannot be used to restrict market access.

Additionally, the working group recommends that China accepts global alliances and consortia as Chinese social groups to avoid duplication of standards. Finally, necessary measures should be taken to ensure the market's decisive role and to avoid unnecessary government interference in any other forms.

#### e) Enterprise standards

The Chinese Government is going to ease the control of enterprise standards and commit to gradually cancelling their registration. Enterprises will be able to independently formulate and implement enterprise standards according to their own demands. An enterprise standards online service platform will be setup. Manufacturers are encouraged to disclose their enterprise standards online and sign the Self-Declaration of Conformity (SDoC). Correspondingly, a supervision system will be established as well. Pilot trials have been conducted in seven provinces since 2014.

The Chinese Government aims at fully implementing the enterprise standard SDoC and supervision system by 2017. The SAC is currently formulating a guideline on the management of enterprise standards. The working group is concerned about the possible need to disclose company internal intellectual property (IP) to the public. Such a requirement should be avoided by all means in order to boost the industry's acceptance of enterprise standards.

The working group would therefore recommend:

- that the disclosure of enterprise standards and the signing of the SDoC shall be voluntary, instead of being used as market access conditions;
- that trade secrets shall be protected during the disclosure of enterprise standards;
- that the scope of disclosed enterprise standards shall be limited; and
- that the supervision measures and process shall be transparent, practicable and reasonable.

**Case Study:** Enterprise standards formulated by enterprises with market dominant position, such as state-owned enterprises, become *de facto*

requirements for access to a huge portion of market when included in tenders, and hence must be made available to the public. National and international cooperation needs to be promoted to optimise the Chinese standardisation work on various levels (e.g. on management and operational level).

#### Key Recommendations

- Process and system related issues
  - Delegate the responsibility of all standardisation issues, especially issues related to mandatory standards management, to the Inter-ministerial Joint Meeting Mechanism for Standardisation Coordination and Promotion.
  - Optimise the standards development process, especially for mandatory standards and industry standards.
  - Grant fair access to all technical committees to all interested stakeholders.
  - Allow a reasonable period of time for commenting.
  - Introduce reasonable transition periods for mandatory standards.
  - Implement the European concept of transition periods to more industries.
  - Align Chinese standards more effectively with each other to avoid conflicting requirements.
  - Continue the efforts to reduce the number of Chinese standards.
- International standards: optimise the alignment of Chinese standards with international standards
  - Encourage more Chinese experts to participate in international meetings.
  - Increase the number of identically-adopted international standards.
  - Reduce the delay of national adoption of international standards.
- Social group standards
  - Give clear guidance on the standards development process, including consideration of IP issues and the rules for participation, to ensure fair processes.
  - Clarify the role of standards developed by global organisations and consortia.
- Enterprise standards
  - Define a clear and transparent process for the management of enterprise standards.
  - Ensure that the disclosure of enterprise standards is voluntary and that trade secrets are protected during their disclosure.



#### 4. Ensure Fair and Transparent Market Surveillance

##### Concern

The current market surveillance process for many products has been extended to voluntary requirements, which are not related to the mandatory market access requirements.

##### Assessment

The working group realises that product quality surveillance and inspection in China is becoming more standardised and systematic. However, the working group would like to highlight that some technical market surveillance requirements are not in line with mandatory market entry requirements.

Market surveillance has been extended to recommended and voluntary items. This has already resulted in the punishment of manufacturers whose products do not meet the requirements of voluntary standards (see Key Recommendation 2 of the *Agriculture, Food and Beverage Position Paper*). Such a situation leads to workload increase for both manufacturers and authorities, and prevents the latter from focusing on the original task of ensuring health, safety and environmental protection. Therefore, the working group recommends aligning market surveillance and market entry requirements and limiting market surveillance to compliance with national laws, regulations and mandatory standards, which aim to ensure that products do not affect health, safety or the environment.

##### Key Recommendation

- Align market surveillance and market access requirements.
- Limit market surveillance to compliance with laws, regulations for quality assessment and mandatory standards.

## Abbreviations

AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
CB	Certification bodies
CCC	China Compulsory Certification
CCCAP	China Certification Centre for Automotive Products
CFDA	China Food and Drug Administration

CMA	China Metrology Approval
CNAS	China National Accreditation Service for Conformity Assessment
CNCA	Certification and Accreditation Administration of the People's Republic of China
CQC	China Quality Certification Centre
CQM	China Quality Mark Certification Group
FIE	Foreign-Invested enterprise
FRAND	Fair, reasonable and non-discriminatory
ICT	Information and Communication Technology
IEC	International Electrotechnical Commission
IPR	Intellectual property rights
ISCCC	China Information Security Certification Centre
ISO	International Organisation for Standardisation
ITU	International Telecommunication Union
NAL	Network Access Licence
OSCCA	Office of Security Commercial Code Administration
RTA	Radio Type Approval
SAC	Standardisation Administration of People's Republic of China
SCA	Standards and Conformity Assessment
SCOPSR	State Commission Office of Public Sectors Reform
SDoC	Self-Declaration of Conformity
SDOs	Standards developing organisations
TC	Technical Committee
TIC	Testing, Inspection and Certification
TMP	Testing at Manufacturers Premises
WMP	Witnessed Manufacturers Testing
WTO	World Trade Organisation
WTO/TBT	Agreement on Technical Barriers to Trade of the World Trade Organisation





**European Chamber**  
中国欧盟商会

## **Section Three:** **Trade in Goods**

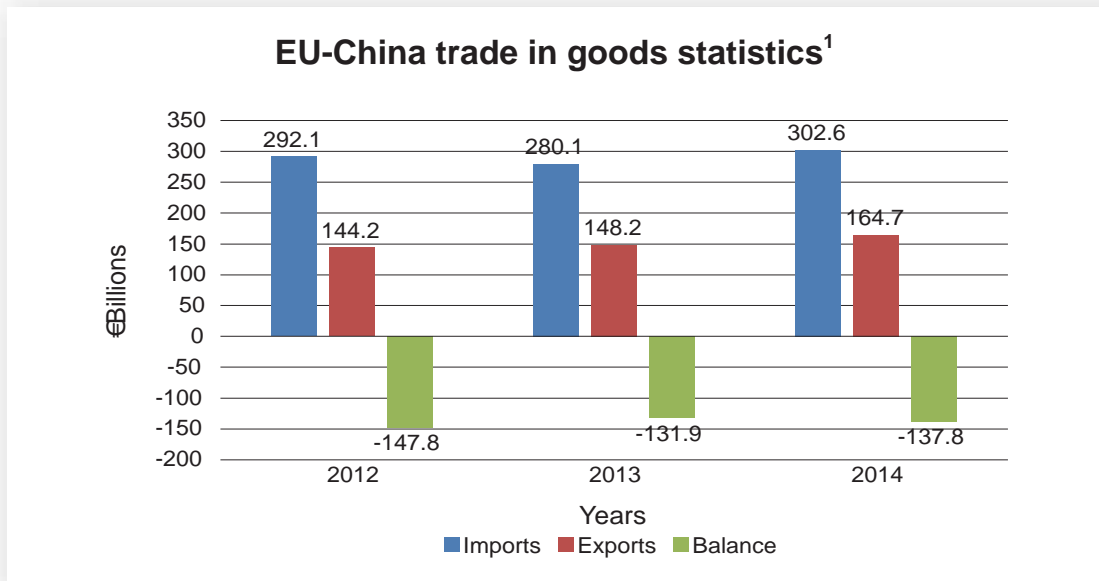




## Trade in Goods

The Trade in Goods section of the *European Business in China Position Paper 2015/2016* includes position papers from 16 European Chamber working groups:

- Agriculture, Food and Beverage
- Automotive
- Auto Components
- Carbon Market
- Cosmetics
- Energy
- Healthcare Equipment
- Heating
- Metals and Mining
- Paediatric Nutrition
- Petrochemicals, Chemicals and Refining
- Pharmaceutical
- Rail
- Renewable Energy
- Smart Grid
- Wood



The European Union (EU) is China's largest trading partner by value, and China is the EU's second largest trading partner behind the United States. In 2014, China exported euro (EUR) 302.6 billion in goods to Europe, compared with Europe's exports to China which totalled EUR 164.7 billion. Yet at the same time, the EU's trade deficit with China grew to EUR 137.8 billion in 2014.<sup>2</sup> Key reasons behind this trade imbalance are market access barriers and investment restrictions in China, and consequently investment flows are relatively low compared to the size of the overall trade relationship.

<sup>1</sup> EU-China Trade Statistics, European Commission, 2014, viewed 1<sup>st</sup> July, 2015, <[http://trade.ec.europa.eu/doclib/docs/2012/march/tradoc\\_149251.pdf](http://trade.ec.europa.eu/doclib/docs/2012/march/tradoc_149251.pdf)>

<sup>2</sup> Eurostat News Release, Eurostat Press Office, 2014, viewed 1<sup>st</sup> July, 2015, <<http://ec.europa.eu/eurostat/documents/2995521/6893875/6-26062015-AP-EN.pdf/44d4c87c-98dd-4061-bdf6-b292884a5073>>

Some of the many barriers to foreign direct investment include: the *Foreign Investment Industry Guidance Catalogue*, which outright prohibits or restricts foreign investments in a number of sectors; a lack of transparency and legal certainty; burdensome pre-approval processes for investment; technology transfer, local content and joint-venture (JV) requirements; favourable treatment granted to Chinese state-owned enterprises (SOEs); post-establishment restrictions and national treatment not being extended to foreign-invested enterprises.

According to the European Chamber's *Business Confidence Survey 2015*, the five most significant regulatory challenges in 2014 remained the same as those in 2013 – an unpredictable legislative environment, administrative issues, discretionary enforcement of regulations, licensing requirements and corruption.<sup>3</sup>

European pharmaceutical companies have reported that measures by the government to allow drug prices to be formed fairly in the open market have resulted in post-bidding price manipulation by local hospitals. This has put European manufacturers at a distinct disadvantage compared with local manufacturers of lower quality drugs, and is delaying Chinese patients' access to innovative drugs.

Pre-market approval processes for goods, which entail registering products before they can be imported, is extremely burdensome. Not only does this process add no additional safety benefits, it delays entry to the market for new products by creating internal delays and backlogs. The disadvantages of this process are particularly evident in the healthcare equipment, cosmetics, pharmaceuticals, and agriculture, food and beverage industries.

China continues to impose severe restrictions on ownership in several industries by only permitting foreign investment in the form of JVs and placing limits on the maximum equity allowed to be held by the foreign JV partner. For example, in the automotive industry, a foreign JV partner's equity share cannot exceed 50 per cent. Additionally, a foreign investor is limited to establishing no more than two such Sino-foreign JVs for the production of passenger cars, and two for commercial vehicles ('2+2'). Another example can be seen in China's railway manufacturing sector, where foreign players can only access markets under conditions of technology transfer to local partners. Foreign mining and energy companies are also subject to strong investment barriers. For example, since 2005, there has been a ban in place that prohibits foreign investors from controlling Chinese steel companies.

As of June 2015, the EU and China have completed six rounds of negotiations focused on the establishment of a Comprehensive Agreement on Investment (CAI). Such an agreement will benefit both sides by ensuring that markets are open to investment in both directions, while also providing a more transparent and predictable legal framework for investors in the long term.

As China and Europe continue negotiations over the details of the CAI, the European Chamber's *European Business in China Position Paper 2015/2016* has highlighted a number of key areas for reform in the individual working group papers that we hope will contribute to forming the basis of the agreement's framework.

<sup>3</sup> *European Business in China Business Confidence Survey 2015*, European Chamber of Commerce in China, 2015, viewed 17<sup>th</sup> July, 2015, p.6, <[http://www.eurochamber.com.cn/en/publications-archive/334/Business\\_Confidence\\_Survey\\_2015](http://www.eurochamber.com.cn/en/publications-archive/334/Business_Confidence_Survey_2015)>

# Agriculture, Food and Beverage Working Group

## Key Recommendations

### 1. Optimise Food-related Standards Systems

#### 1.1 Harmonise Different Types of Standards

- Assess the necessity of revising existing, or establishing new, voluntary national or industrial standards by fully assessing existing national food safety standards.

#### 1.2 Allow Voluntary Standards to be Voluntary as Stipulated in the Standardisation Law

- Clarify the status of food standards in law enforcement by supervision and administration authorities, ensuring that only situations related to mandatory standards should form the basis for law enforcement actions.

#### 1.3 Allow Companies to File Standards through the Actual Process of Filing Rather Than Having Their Standards Subjected to Examination

- Revert to the practice of filing company standards, and do not subject them to examination before approval is given, and grant food manufacturers the sole responsibility for establishing their own company standards.

### 2. Promote Good Governance in Food Regulation

#### 2.1 Expand Channels of Communication and Dialogues Between Policy-makers, Law Enforcement Officials and Industry to Improve the Consistency of Law Enforcement

- Encourage the China Food and Drug Administration (CFDA) to take a leading role in issuing and providing explanations for all non-hygiene-related food standards and policies, and provide technical training to local authorities to improve their capacity.

#### 2.2 Accelerate Structural Reforms of Food Supervision Authorities at Different Levels of Government and Publish a Clear Timeline and Plan for Institutional Reform

- Publish a clear timeline and systematic plan for the current round of institutional reforms, and set up a clear supervision channel from the central to the local level.

### 3. Offer Capacity Building to Daily Testing and Inspection Procedures

#### 3.1 Optimise Testing Procedures and Expedite the Response Process

- Allow other government laboratories and private, third-party laboratories to carry out testing in order to reduce the workload and expedite the response process.
- Allow companies to take alternative measures of remediation prior to customs clearance, such as returning or transferring to other regions if they are accepted there.

#### 3.2 Coordinate Cross-organisation Testing Procedures, Methods and Standards

- Provide, for each product, a testing matrix and field of application, cross-recognition and equivalence between local testing methods and international methods.
- Coordinate cross-organisation testing procedures, methods and standards to avoid contradictory requirements between different government bodies.
- Revise testing methods more than five years old according to international standards for global harmonisation.
- Improve the national food safety standard of technical guidance on food re-testing.

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.



#### 4. Distribute Responsibilities Proportionately Across the Supply Chain and Strengthen Communication of Food Safety Risks

- Introduce comprehensive, reasonable and fair rules to clarify corresponding responsibilities of all suppliers and participants in the food supply chain.
- Establish a coordination mechanism to evaluate and report the risk across the entire food supply chain, namely a rapid-alert system for food and feed (the Mechanism).
- Require state and local government departments to be involved in the process of establishing the Mechanism so that the measures can be practical and reasonable.
- Maintain the integrated management of the Mechanism by national government departments such as the CFDA and the Ministry of Agriculture.
- Allow all stakeholders in the food supply chain, from primary agricultural products to processed foods, to participate in the implementation of the Mechanism.

### Introduction to the Working Group

The Agriculture, Food and Beverage (AFB) Working Group is a communication platform between European companies and Chinese regulators and authorities. The working group aims to foster better understanding and implementation of policies and regulations, and to promote food safety in China. The working group includes a wide range of companies including importers and exporters, manufacturers, distributors, retailers, catering service providers, specialised testing laboratories and consultancies. Currently over 160 member companies are in the group.

### Recent Developments

China has made great progress in improving safety and quality controls across the food supply chain by making food safety a national priority. In support of these efforts, industry experts are promoting a risk-analysis approach (risk assessment, risk communication and risk management), in legislation and enforcement. The working group has actively participated in providing comments on various laws and regulations. By sending industrial comments and holding follow-up meetings with Chinese authorities, the working group is hoping the voice of European industry is heard.

In the Third Plenum's *Decision on Some Major Issues Concerning Comprehensively Deepening the Reform (the Decision)*,<sup>1</sup> Chinese authorities pointed out specifically that grass-roots-level law enforcement

<sup>1</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*. The *Decision*, a 60-point reform blueprint, detailed the Party's reform plan for the next six years.

for food, drug and production safety should be strengthened. During the Two Sessions (*Lianghui*)<sup>2</sup> in March 2015, Premier Li Keqiang reiterated that the government will take stronger measures to ensure food and drug safety throughout the production process. Food safety is considered as the number one priority of the government as it affects people's livelihood and social stability.

#### Food Safety Law Amendment in 2015

On 25<sup>th</sup> April, 2015, after two rounds of soliciting comments and revisions in 2013 and 2014, the Standing Committee of National People's Congress (NPC) passed the amended Food Safety Law. The new law will take effect on 1<sup>st</sup> October, 2015.

The law, among others, regulates labelling, introduces punishment measures for offenders, bans the production of infant and kids formula by subcontracting or sub-packaging, regulates the management of food production licences and the current standards system. These are the issues that the Agriculture, Food and Beverage Working Group has discussed with regulators and legislative institutions on various occasions.

In addition, the new law regulates label defects, which can help address the problem of professional buyers.<sup>3</sup>

<sup>2</sup> The Two Sessions refer to Chinese People's Political Consultative Conference (CPPCC) and National People's Congress (NPC), which are held during the first quarter of the year. The Two Sessions, attended by thousands of officials and business leaders, discusses various issues, including economic reform processes and targets for the upcoming year.

<sup>3</sup> Professional buyers are a group of people whose main job is to look for counterfeit products or products that do not comply with laws and regulations in the market. They will then send complaints to relevant government departments or file a lawsuit with the court in order to obtain compensation as their major source of income.



Third Plenum Reality Check		
What did the Third Plenum's Decision Say?	What is the Reality?	Status
Improve and unify an authoritative food and drug safety supervision organisation.	At the central level, the framework is already set up – the China Food and Drug Administration (CFDA) leads in food safety supervision in coordination with food safety units within the State Administration of Industry and Commerce (SAIC) and the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ). At the local level, however, implementation does not strictly follow the central framework. In some areas, there is no coordination among local FDA, SAIC and AQSIQ authorities.	
Establish the most stringent regulatory system covering the whole process.	The new Food Safety Law, which was passed on 25 <sup>th</sup> April, 2015, is more stringent than previous laws and regulations in terms of introducing dissuasive civil, administrative and criminal penalties for offenders. As the details of its implementation regulations have not yet been released, companies do not know clearly how to comply with the new law. In terms of a regulatory system that covers the whole process, China is far behind this target. This has been reflected particularly in agricultural product safety – from farm to processing to the table.	
Establish a food tracing system and quality labelling system.	Current problems of the tracing system include unclear requirements of food origin traceability, a lack of clear leading and responsible government departments, and government departments at all levels having their own interests in building separate tracing systems. This may add extra costs to companies in order for them to adapt their business to different tracing systems. There is also a lack of recognition and harmonisation of existing tracing systems already established by businesses.	

Moreover, it also stipulates punishments for, and can restrain, non-compliant behaviour of the media, such as fabricating or disseminating false information. The new law also takes into account new consumer habits, such as online shopping, and sets new requirements on online shopping with a clarification of liabilities of shopping platforms.

The working group believes China is going in the right direction to tackle food safety challenges. If properly implemented, the new Food Safety Law will have the power to restore consumers' confidence in the Chinese food and agriculture industries. However, the working group regrets that the opportunity to also cover e-commerce in the application of the Food Safety Law has been missed, which leaves out a large part of the

food trade. This serves as a hidden subsidy for the e-commerce sector and poses uncontrollable risks to the consumer.

### Standards

In the 12<sup>th</sup> Five-Year Plan for National Food Safety Standard (Plan),<sup>4</sup> one of the key missions in food supervision is to rationalise and consolidate the food standards system by applying food safety and mandatory quality indicators to enforce a comparative analysis on the principles and methods used to develop standards. The review of more than 2,000 existing national standards and more than 2,900 food industry

<sup>4</sup> Notice on Issuing the 12<sup>th</sup> Five-Year Plan for National Food Safety Standard, China Food and Drug Administration, 11<sup>th</sup> June, 2012, viewed 2<sup>nd</sup> July, 2015, <<http://www.sda.gov.cn/WS01/CL0056/73134.html>>



standards was completed at the end of 2013. According to the *Plan*, basic completion of the integration and abolishment of inappropriate standards will be finished by 2015. Having been published at the central level, the deployment of new standards and regulations in China will be managed locally with some discretion given to local authorities. Improved accuracy and transparency of deployment of standards will allow for better enforcement of standards and regulations in China.

### Agriculture

On 1<sup>st</sup> February, 2015, the Communist Party of China Central Committee (CPCCC) and the State Council released the *No. 1 Central Document*<sup>5</sup> – *Suggestions on Reinforcing Reform and Innovation to Accelerate Agricultural Modernisation (Suggestions)* to the public. The *Suggestions* emphasise the need to enhance the quality and safety levels of agricultural products. In it, the central authorities pledge to enhance capacity building for the supervision of the quality and food safety of agricultural products at county or township level, improve the comprehensive coordination system for the supervision of food safety, and reinforce the responsibility of local governments.

### Traceability

Traceability has become a key factor in ensuring food safety. It is necessary to have an efficient way of ensuring food safety which doesn't bring extra costs to food producers and distributors. The Third Plenum's *Decision* committed to establish a food production origin tracing system and quality labelling system to guarantee food and drug safety. Premier Li Keqiang's government report to the NPC also highlighted the importance of food safety. However, unclear requirements may have a negative impact on the industry.

The working group fully supports the government's efforts in promoting food traceability and believes that the related government agencies, including the CFDA, the AQISQ and the Ministry of Commerce (MOFCOM), should have better coordination on this issue. However, it is unclear how the tracing system for food products will be implemented due to a lack of a clear division of responsibilities among the different government departments and the possible systemic reform direction or roadmap. Moreover, a large number of government

departments, including ministries, bureaus and even local governments, have expressed the intention and willingness to build their own tracing systems. To some extent, the lack of clear responsibilities among government departments and different interpretation and enforcement of the tracing system has caused great confusion in the business community. It is also costly for companies to fit into different tracing systems. It is hoped that traceability could be built to reflect the common practices of the industry, for example the lot code for imported food. In practice, codes for tracing purposes marked on imported products are intentionally damaged or erased in the shipment. Such codes/marks are indispensable for operators to trace the production origin in case of food safety risks, and thus should be recognised and protected. Damage to/erasure of such codes should be punished according to the law.

### Imported Food

According to a survey by international research company IPSOS,<sup>6</sup> an increasing number of Chinese consumers have turned to imported consumer brands due to rising concerns over food safety in recent years. For example, dairy products, grains, oil and children's food were some of the most popular imported products purchased by Chinese consumers in 2012. According to US-based Association of Food Industries, China will become the biggest importer of food products in the world by 2018.<sup>7</sup> The central government launched several decrees on strengthening supervision and administration of food importation, and will continue to step up their efforts in product inspections and regulation of pharmaceutical ingredients and also strengthen the enforcement of the Consumer Rights Protection Law.

## Key Recommendations

### 1. Optimise Food-related Standards Systems

#### 1.1 Harmonise Different Types of Standards

##### Concern

The campaign aimed at cleaning-up national food safety standards led by the National Health and Family Planning Commission (NHFP), has helped to optimise the national food safety standards system. But

5 The *No. 1 Central Document* refers to the first major policy document of each year released by the CPCCC and the State Council. This is the 12<sup>th</sup> consecutive year in which the document has focused on agriculture and rural issues.

6 *Consumers turn toward imported food*, *China Daily*, 22<sup>nd</sup> August, 2012, viewed 3<sup>rd</sup> July, 2015, <[http://usa.chinadaily.com.cn/business/2012-08/22/content\\_15694709.htm](http://usa.chinadaily.com.cn/business/2012-08/22/content_15694709.htm)>

7 *China Imported Food Product Market*, *Marketing China*, 11<sup>th</sup> September, 2012, viewed 3<sup>rd</sup> July, 2015, <<http://marketingtochina.com/china-imported-food-product-market/>>



National food safety standards are not the only type of standards for food products, so instead of becoming more streamlined, the overall system for food safety standards is becoming more complicated.

### Assessment

National food safety standards cover food safety requirements and quality requirements related to food safety. These requirements should be regulated by the government based on a food safety risk assessment. The safety-related requirements are normally common for a group of food products, hence a national food safety standard usually covers a group of food products. Other requirements like common quality indicators, which may vary upon properties of food products, marketing demands and so on, are less relevant to national food safety standards.

Based on the principles above, among the standards reviewed during the clean-up campaign, some are brought into the national food safety standards system, while some are not. All the standards which are not brought into national food safety standards system are voluntary standards mainly regulating quality indicators of specific food products. Revision of these standards has been started by the government agencies who initiated them. In addition, drafting of some new voluntary standards for specific food products has also been started. In this case, for a specific food product, there are both the national food safety standards of the food group in which the product is included, and also the voluntary standard for the specific food product. As a result, there will be more and more standards made by different government authorities for food manufacturers to follow.

### Recommendation

- Assess the necessity of revising existing, or establishing new, voluntary national or industrial standards by fully assessing existing national food safety standards.

### Case study (cheese)

#### Concern

The GB5420-2010 National Food Safety Standard Cheese (GB5420-2010) and the GB25192-2010 National Food Safety Standard Processed Cheese (GB25192-2010) are partly not rational, which has hindered the importation of cheese products and

the development of domestic cheese industry.

### Assessment

Europe has a great experience and a long and rich history of cheese manufacturing. There are hundreds of varieties of cheeses in Europe. Flavours, textures, colours and shapes of cheeses are influenced by many factors: the type of animal that produced the milk and the kind of feed that animal ate; the way the milk was treated; and the unique processes of the cheese maker. There are also many different types of bacteria, yeast and mould and different methods of preparing, maturing and ageing cheese.

European manufacturers want to pass on to Chinese consumers this diversity of taste, providing them with high quality products. But Chinese regulations hamper the marketing of many cheeses imported from Europe. Nor can Chinese domestic manufacturers produce some kinds of cheeses because of the existing standards. Among other points:

- The GB5420-2010 sets thresholds on yeast and mould at a very low level. Yeast and mould are normal microbes found in cheese. They are used as culture adjuncts in many cheeses and are totally safe. This cheese microbiota has long been known to be the major contributor to cheese flavour, aroma, texture, and appearance. The amounts of yeast and mould vary substantially depending on the types of cheeses and technologies used. The threshold laid down by Chinese regulations is not compatible with all kind of cheeses and technologies.

- Chinese regulations recognise very few microorganisms for food fermentation. The only microorganisms recognised are essentially those used in yoghurt and fermented milk. No microorganism traditionally used in cheese making is recognised in China. Cheese is a fermented food, alive with bacteria, yeasts and mould whose metabolic activity generates the aromas, flavours and textures that account for an enormous diversity of cheeses. These bacteria and fungus have a very long history of safe use.

Besides, Chinese regulations raise other





issues. For instance, analytical methods to test phosphates in GB25192-2010 does not distinguish between added phosphates as additives and natural phosphates present in processed cheeses. As a result, the thresholds required for the use of polyphosphates in processed cheese laid down by GB25192-2010 are sometimes too low. Similarly, the thresholds in total plate count are inappropriate and not adapted to process cheese making.

Lastly, GB5420-2010 is not totally in line with international standards, specifically with the Codex General Standard for cheese (CODEX STAN 283-1978).

To improve the development of cheese industry, the European cheese industry recommends:

- Revising GB5420-2010 and GB25192-2010 to better take into account the differences between cheese making and the varieties of cheeses. For instance, there is a need to delete or increase the thresholds in yeast and mould laid down by the GB5420-2010 and the threshold in total plate count laid down by the GB25192-2010, as these threshold are inappropriate for a lot of cheeses;
- Expanding the list of microorganisms authorised in China in cheese making; and
- Aligning GB5420-2010 with the Codex Stan 283-1378.

## 1.2 Allow Voluntary Standards to Be Voluntary As Stipulated in the Standardisation Law

### Concern

Voluntary standards for food manufacturers are increasingly enforced as if they are compulsory.

### Assessment

According to Article 14 of the Standardisation Law,<sup>8</sup> only mandatory standards should be enforced. Production, sale and importation are forbidden for products which do not meet mandatory standards. In addition, the government encourages enterprises to employ voluntary standards.

However, in many cases authorities enforce voluntary

<sup>8</sup> The Standardisation Law was passed at the fifth meeting of the 7<sup>th</sup> National People's Congress on 29<sup>th</sup> December, 1988, and took effect on 1<sup>st</sup> April, 1989.

standards as if they were compulsory. For example, when a manufacturer applies for a food production licence for a specific food product, if there is a voluntary national standard for this food product that is more specific than the relevant national food safety standard, the food product is required to meet all the requirements set out in the voluntary national standard. In fact, there are national food safety standards for groups of food products rather than specific food products; there are national food safety standards for contaminants, pathogens, pesticides, etc., and there are national food safety standards related to good hygiene practices of food manufacturers. This means that the national food safety system already covers all the aspects of food safety in food manufacturing. Therefore if food manufacturers respect the national food safety standards, their food products are safe for consumption. Food manufacturers may follow voluntary standards according to market demands, however, it should not be necessary for the government to force food manufacturers to meet them.

### Recommendation

- Clarify the status of food standards in law enforcement by supervision and administration authorities, ensuring that only situations related to mandatory standards should form the basis for law enforcement actions.

## 1.3 Allow Companies to File Standards Through the Actual Process of Filing Rather Than Having Their Standards Subjected to Examination

### Concern

The standards filing process for food companies has become an actual examination in practice at the local level.

### Assessment

According to Article 30 of the new Food Safety Law: "the State encourages food manufacturers to develop company standards more stringent than the national or local food safety standards. The company standards are applicable to the company. The company standards shall be reported to the provincial, autonomous regional and municipal health administrative department for record."<sup>9</sup>

Filing a record means the manufacturer shall submit the required documents to the relevant authority. It is

<sup>9</sup> Food Safety Law of People's Republic of China, reviewed and passed by the 14<sup>th</sup> meeting of Chinese National People's Congress on 24<sup>th</sup> April, 2015, viewed 3<sup>rd</sup> July, 2015, <[http://www.npc.gov.cn/npc/cwhhy/12jchw/2015-04/25/content\\_1934591.htm](http://www.npc.gov.cn/npc/cwhhy/12jchw/2015-04/25/content_1934591.htm)>







food manufacturers' responsibility to make sure that the company standards are well developed and food products meet these requirements. However, the current practice is that provincial health administrative departments engage experts to examine the company standards submitted by food manufacturers. If the company standards cannot pass the examination, they will be revised according to the experts' suggestions. In addition, there is always a cost for the experts' examinations, which are paid by food manufacturers. Based on current practice, it usually takes six months or more for a food company standard to 'pass' the so called 'record filing'.

#### Recommendation

- Revert to the practice of filing company standards, and do not subject them to examination before approval is given, and grant food manufacturers the sole responsibility for establishing their own company standards.

## 2. Promote Good Governance in Food Regulation

### 2.1 Expand Channels of Communication and Dialogues Between Policy-makers, Law Enforcement Officials and Industry to Improve the Consistency of Law Enforcement

#### Concern

Unclear laws and regulations and inconsistent interpretation still remain key challenges to business operators, and there is insufficient communication between industry and the relevant policy-makers.

#### Assessment

There remains a large number of national food industry standards and local food standards that are updated by industry associations or the local Food and Drug Administration (FDA), without centralised supervision or guidelines, or even communication. In addition, State Council decrees issued at different stages and local administrative regulations that were developed for the safety supervision of food production and sales leads to local government authorities' own interpretation and enforcement in the absence of an official explanation for these standards or regulations. The unclear laws and regulations and inconsistent interpretation and enforcement of the laws have opened up food regulation to further potential risks.

The industry standard—set by the MOFCOM and

commonly known as *Shangbiao/Tuijian* (SB/T)—and the renewal of the names of food raw materials was formulated by business associations without an official explanation of the standard or implementation guidelines, which has led to enforcement discretion in different areas. In some cities, the local authorities consider recommended industry standards as compulsory and issue penalties based on the Food Safety Law for non-compliance. The working group would like to support the CFDA by providing resources to train local enforcement agencies. The working group believes that improved enforcement of the regulations would create a more favourable business environment.

#### Recommendation

- Encourage the CFDA to take a leading role in issuing and providing explanations for all non-hygiene-related food standards and policies, and provide technical training to local authorities to improve their capacity.

### 2.2 Accelerate Structural Reforms of Food Supervision Authorities at Different Levels of Government and Publish A Clear Timeline and Plan for Institutional Reform

#### Concern

Due to unclear information at the central level regarding the government supervision administrative structure, the industry finds it very challenging to foresee which authorised party is appropriate to approach for approvals during the transition period.

#### Assessment

Since 2013, the Chinese Government has actively promoted institutional reform regarding food supervision in order to improve law enforcement and safeguard food safety. Despite the formation of the CFDA and its local branches, improving cohesion between government supervisory agencies is highly anticipated and much needed for the current round of institutional reforms. Further to instructions from the new leadership, the local municipal government is free to make decisions on the restructuring, such as the establishment of the Market Supervision Bureau, which merged the local FDA, Bureau of Quality and Technology Supervision (BQT) and the Administration of Industry and Commerce (AIC) into one agency. Due to different situations at the local level, no timeline or clear plan for this round of reforms has been announced. The industry finds it very challenging to foresee which authorised



party is appropriate to approach for approvals during the transition period, for example, most of cities have set up a Market Supervision Bureau but there is not an equivalent at the provincial level (in most provinces). The working group hopes that the Chinese Government could issue a clear timeline and a systematic plan for this round of institutional reforms. This would help to improve business efficiency and maintain a good level of government supervision of food safety.

 **Recommendation**

- Publish a clear timeline and systematic plan for the current round of institutional reforms, and set up a clear supervision channel from the central to the local level.

**3. Offer Capacity Building to Daily Testing and Inspection Procedures**

**3.1 Optimise Testing Procedures and Expedite the Response Process**

**Concern**

The lack of laboratory capacity and/or expertise is dramatically slowing down product releases and is affecting product traceability and the required transparency.

**Assessment**

Several trade-related tests, such as nutrition-labelling-related tests, food contact material-related tests, crisis or emergency-related tests (e.g. melamine and phthalates) must be conducted through government laboratories or government authorised laboratories, such as the local port of China Entry-Exit Inspection and Quarantine (CIQ) laboratories. Third-party bodies must be locally accredited and certified by government-affiliated bodies to conduct accredited and certified tests, audits and certification in China.

Even if internationally approved and accredited, a third-party organisation operating in China must go through a local process of accreditation and certification regardless of its global recognition, experience in the field and network.

According to the Food Safety Law, imported foods, food additives and food-related products should be compliant with related Chinese national food-safety-related standards. The CIQ should sample and test the products to confirm the compliance and then issue the sanitary certification, which will be the proof for China

Customs to release the products.

Before customs clearance, if some tests fail according to Chinese national food-safety-related standards but can still be accepted in other regions, companies could take alternative measures of remediation, such as returning the cargo or transferring it to other regions rather than destroy to reduce the loss.

 **Recommendations**

- Allow other government laboratories and private, third-party laboratories to carry out testing in order to reduce the workload and expedite the response process.
- Allow companies to take alternative measures of remediation prior to customs clearance, such as returning or transferring to other regions if they are accepted there.

**3.2 Coordinate Cross-organisation Testing Procedures, Methods and Standards**

**Concern**

Different requirements of testing procedures, methods and standards bring contradictory results and slow trade and the exchange of products in China, often resulting in companies having to re-engineer their internal control plan to comply with local regulations.

**Assessment**

Several standards used and promoted in China refer to local methods, such as the *Guobiao* (GB), standards and local accreditation. Locally-accredited results lead to different results or interpretation by international methods, such as the International Organisation for Standardisation (ISO), the US Food and Drug Administration (USFDA) and the Association of Analytical Communities (AOAC).

 **Recommendations**

- Provide, for each product, a testing matrix and field of application, cross-recognition and equivalence between local testing methods and international methods.
- Coordinate cross-organisation testing procedures, methods and standards to avoid contradictory requirements between different government bodies.
- Revise testing methods more than five years old according to international standards for global harmonisation.
- Improve the national food safety standard of technical guidance on food re-testing.



#### 4. Distribute Responsibilities Proportionately Across Supply Chain and Strengthen Communication of Food Safety Risks

##### Concern

There is an overall lack of awareness of the responsibilities of relevant stakeholders across the supply chain, which to some extent increases safety risks across the entire supply chain, and the absence of a rapid response system and information exchange channels has resulted in great loss and damage.

##### Assessment

These concerns not only impair consumers' confidence, they also have a negative impact on industrial development. It is critical that all operators across the supply chain, including raw material providers and logistics companies, share their corresponding responsibilities. Sometimes, even though a producer makes every effort to prevent food safety risks, negligence still occurs across other parts of the supply chain. This can eventually lead to the outbreak of food safety incidents, triggering public health concerns. For example, in 1996, mad cow disease originating in Britain endangered the whole of Europe. Incidents like this diminish consumers' trust in individual state's governments.

To strengthen security management measures in the supply chain, the European Commission (EC) increased punishments by defining the responsibilities of each participant, in the *White Paper on Food Safety*.<sup>10</sup> From the perspective of food safety, it effectively transforms the supply chain into a chain of responsibility.

After establishing a responsibility mechanism, a management concept for the supply chain can only be implemented with effective information sharing. For this reason, all participants in the supply chain should ensure that they share all relevant information and communicate clearly with all other parties. Timely communication of potential risks can help operators and regulators react rapidly to prevent potentially hazardous products from entering the market. Led by

the EC, the Rapid Alert System for Feed and Food (RASFF) is a communication and assessment system for responding to food and feed issues. In response to a health threat caused by food or feed, the whole system is run in a coordinated manner. Through the exchange of information, great transparency has been achieved to act more expediently, thereby offering better protection to other participants and consumers. When one participant involved in the supplier chain becomes aware of a potential risk product, or takes the decision to recall a product, that participant has the obligation to proactively notify the EC via the RASFF. The same action is applied when the product in question is placed in circulation.

##### Recommendations

- Introduce comprehensive, reasonable and fair rules to clarify corresponding responsibilities of all suppliers and participants in the food supply chain.
- Establish a coordination mechanism to evaluate and report the risk across the entire food supply chain, namely a rapid alert mechanism for food and feed (the Mechanism).
- Require state and local government departments to be involved in the process of establishing the Mechanism so that the measures can be practical and reasonable.
- Maintain the integrated management of the Mechanism by national government departments such as the CFDA and Ministry of Agriculture.
- Allow all stakeholders in the food supply chain, from primary agricultural products to processed foods, to participate in the implementation of the Mechanism.

#### Abbreviations

AIC	Administration of Industry and Commerce
AOAC	Association of Analytical Communities
AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
BQT	Bureau of Quality and Technology Supervision

<sup>10</sup> The *White Paper on Food Safety* was released to the public by the European Commission on 12<sup>th</sup> January, 2000. It set out the plans for a proactive new food policy: modernising legislation into a coherent and transparent set of rules, reinforcing controls from the farm to the table and increasing the capability of the scientific advice system, so as to guarantee a high level of human health and consumer protection, *White Paper on Food Safety – Introduction*, viewed 3<sup>rd</sup> July, 2015, <[http://ec.europa.eu/food/food/intro/white\\_paper\\_en.htm](http://ec.europa.eu/food/food/intro/white_paper_en.htm)>





CIQ	China Entry-Exit Inspection and Quarantine
CFDA	China Food and Drug Administration
CPCCC	Communist Party of China Central Committee
GB	<i>Guobiao</i> or Chinese national standard
ISO	International Organisation for Standardisation
MOFCOM	Ministry of Commerce
NHFPC	National Health and Family Planning Commission
NPC	National People's Congress
RASFF	Rapid Alert System for Feed and Food
SB/T	<i>Shangbiao/Tujijian</i> (Industry standards set and recommended by the MOFCOM)
USFDA	US Food and Drug Administration



# Automotive Working Group

## Key Recommendations

### 1. Create a Central Government Agency Under the State Council Legislative Affairs Office (SCLAO) to Coordinate Relevant Policies and Regulations for the Automotive Industry

- Improve coordination among relevant government agencies and streamline administrative red tape, especially repetitive tests and approvals.
- Centralise the authority within one governmental agency for homologation/type approval.
- Clarify the administrative responsibilities of the various ministries regulating the automotive industry.
- Consult with industry stakeholders for comments when introducing new rules and regulations and allow industry ample time to adjust to new rules

### 2. Lift Limitations on Foreign Investment

- Allow free foreign investment in the automotive industry without limitations.

### 3. Establish Technology-neutral Targets for Fuel Efficiency and Environmental Performance

- Set fuel-efficiency and environmental performance targets for the automotive industry, and do not prescribe technological pathways.

### 4. Allow Imports of Auto Components, Used Vehicles and Used Auto Components for the Purpose of Remanufacturing Development, and Research and Development (R&D)

#### 4.1 Allow Imports of Auto Components and Improve the Relevant Regulations to Promote the Development of Remanufacturing Industry.

- Revise the *Category of Old Parts Prohibited for Importation* to enable cores importation for remanufacturing.
- Promulgate competent regulations and policies to facilitate market circulation of remanufactured products.
- Roll out more incentives to encourage consumption of remanufactured products and lift consumer cognition towards remanufactured products.

#### 4.2 Allow Imports of Used Vehicles and Used Auto Parts for R&D Purposes

- Amend the *Forbidden Import Catalogue of Used Machinery and Electronic Products* and the *Administration Rules of Machinery and Electronic Products Import* or issue supplementary rules to allow imports of used vehicles and used parts for R&D purposes.

### 5. Link Vehicle Tax to Fuel Consumption and Carbon Dioxide (CO<sub>2</sub>) Emissions

- Replace the current consumption tax and vehicle purchase tax based on engine displacement with a tax scheme based on carbon dioxide (CO<sub>2</sub>) emissions or fuel consumption per kilometre.

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.





## 6. Simplify the Procedure for Applying for Temporary Testing Licences and Extend their Time Validity

- Simplify the procedure for applying for temporary testing licences.
- Extend the time validity and loosen vehicle number restrictions of temporary testing licences.

## 7. Implement Strict Enforcement of Safety Rules

- Enforce strict annual vehicles safety inspections and random road-side safety inspections.

## 8. Align Repair and Maintenance Information (RMI) Disclosure Requirements with Other Legislation

- Formulate RMI disclosure requirements to align with other existing legislation.
- Put necessary safeguards in place when opening up the aftermarket for spare parts.

## Introduction to the Working Group

The Automotive Working Group is composed of European manufacturers and importers of passenger vehicles, commercial vehicles, automotive components (including tyres) special vehicles and automated systems. The Automotive Working Group currently has 43 member companies and works closely with the Auto Components Working Group. The core members of the Automotive Working Group are also member companies of the European Automobile Manufacturers' Association (Association des Constructeurs Européens d'Automobiles, ACEA).

## Recent Developments

### Market Growth

In 2014, a total of 23.49 million automotive units were sold in China – a 6.86 per cent increase over 2013, a slowed growth rate that is partly due to the reasons explained below; 19.70 million were passenger cars (a 9.89 per cent increase); and heavy truck sales shrunk by 14 per cent compared with 2013, reaching 566,000 units.<sup>1</sup>

### The Regulatory Environment of Automotive Industry

China is already the world's largest automotive market and it is poised to grow for decades to come. With China's rapid urbanisation, the transport and mobility-

based market will continue to expand. Thanks to the advancement of technology, automotive industry development is shifting towards a sustainable model which integrates all modes of transport into a system with improved connectivity and efficiency.

In such an integrated system, cars, buses and trucks will no longer be isolated. Instead they will be constantly interacting with other system components such as road infrastructure design, information technology services and traffic management. The government, redefined as a 'rule maker' during the Third Plenum 2013,<sup>2</sup> should promote an efficient transport and mobility system through setting clear rules. The rule making has to be built on a few key pillars: promoting technology neutrality, enforcing strict regulations, adopting a systematic approach, prioritising cost-effective solutions and recognising equal market access.

Currently, the automotive industry in China is still confronted by a number of regulatory challenges, such as inconsistent regulations among different governmental authorities, obvious deviation between local and national standards, time-consuming and uncoordinated certification procedures and inadequate enforcement of rules and regulations. Combined, these issues have been constantly interfering with the normal functions of the market and have invited rule-bending behaviours

1 *The Accumulative Output and Sales of Automotive in December has exceeded 23 million*, China Association of Automotive Manufacturers, 6<sup>th</sup> February, 2015, viewed 3<sup>rd</sup> July, 2015, <<http://www.caam.org.cn/hangye/20150206/1105147290.html>>

2 *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform*, *Xinhua*, 15<sup>th</sup> November, 2013, viewed 3<sup>rd</sup> July, 2015, <[http://news.xinhuanet.com/2013-11/15/c\\_118164235.htm](http://news.xinhuanet.com/2013-11/15/c_118164235.htm)>





Third Plenum Reality Check		
What did the 3 <sup>rd</sup> Plenum's <i>Decision</i> <sup>3</sup> say?	What is the reality?	Status
Let the market play a decisive role in allocating resources.	A foreign investor's maximum share in the automotive industry is limited to 50 per cent and each foreign car maker is limited to establish no more than two such Sino-foreign joint ventures (JVs) for the production of passenger cars, and two for commercial vehicles ('2+2'). In addition there are requirements to invest at the minimum level and to set up component manufacturing and R&D centres.	
Improve the transparency and efficiency of the government.	Multiple government agencies regulate the automotive industry in an uncoordinated manner, resulting in different understanding, inefficient work and unnecessary costs.	
Let the market come up with innovation.	The government keeps recommending technical road maps.	
Market supervision is a key and basic prerequisite for the creation of a unified and open, competitive and orderly market system.	Today's system is still not efficient mainly because of weak enforcement on vehicles and road side safety.	

from market players.

The Automotive Working Group believes that the government's lack of a coordinated and holistic approach is hampering the growth of the whole automotive industry. In Beijing for example, car ownership in the centre of the city is 2.5 times higher than in other international cities and car travel in China is 25 per cent higher than that of the world average.<sup>4</sup> In conjunction with poor road infrastructure design that restricts the smooth flow of vehicles, the explosion of private car use has led to severe traffic congestion problems in Beijing and numerous other cities in China.

### The Automotive Industry and China's Public Transportation System

In recent years, a number of Chinese cities have undergone ambitious expansion of their public transportation systems, such as subway extensions, which in theory have been undertaken to alleviate road traffic pressure. However, local governments'

purchasing decisions are made mainly on the basis of price, leading to city buses often being manufactured to a lower quality level compared with metro train carriages. As a result, many people view city buses as a cheap mode of transport for the poor—despite the fact that passenger flows are fairly evenly-distributed between the metro system and the public bus system—leading more and more people to choose not to make full use of the public transportation system. From the perspective of the working group, the government should upgrade the public bus system to make the whole public transportation system attractive enough to attenuate the traffic pressure caused by private car use.

In other countries where the popularity of private cars has a longer history, cars are often used for long distance travels between cities. However, in China the use of cars for long distance travel is rather limited. This is partly because highways have not been fully taken advantage of. In China, the highways are mostly occupied by heavy commercial vehicles, which often are wrongly-specified, overloaded and driven by over-fatigued drivers. The combination of these factors often results in dangerous traffic conditions on China's highways, and this is deterring more and more private car owners from driving between cities.

<sup>3</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the Decision. The *Decision*, a 60-point reform blueprint, detailed the Party's reform plan for the next six years.

<sup>4</sup> *Beijing Transportation Development Annual Report 2013*, Beijing Transportation Research Centre, 10<sup>th</sup> September, 2013, viewed 3<sup>rd</sup> July, 2015, <<http://www.bjtrc.org.cn/InfoCenter/NewsAttach/2013年北京交通发展年报.pdf>>



The Automotive Working Group believes that the demand for new cars is choked by China's unique dilemma. On the one hand, cities are congested and are constantly introducing car restrictions; on the other hand, the highways are perceived as too unsafe for driving.

### **The Automotive Industry, Environment and Technology**

Vehicle discharge is a major source of air pollution in China which has pushed the Chinese Government to adopt a number of measures to curb the pollution caused by road transportation. From the Automotive Working Group's point of view, the most efficient measure is to encourage abandonment of old cars (especially energy-intensive trucks) and strengthen the enforcement of emissions limits.

Promoting the use of electric vehicles is also a possible way to reduce urban emissions over time. However, this approach fails to systematically address the whole issue. European companies hope to be able to work with the Chinese authorities to design truly sustainable transportation and mobility solutions for China.

Connected vehicles have received considerable media attention since 2014. It has been a common understanding that connected vehicles can contribute to enhancing road safety, alleviating traffic congestion and promoting fuel efficiency. Despite high expectations, there are still significant policy challenges in terms of incentivising technology development in this area, and the involvement of governments in supporting technology advancement is relatively limited. Besides the technical challenges, there are other important issues that need governments' attention, such as connected vehicle-related infrastructure development, high resolution maps, insurance, traffic codes, cyber security and privacy protection. All these issues cannot be resolved without government support.

## **Key Recommendations**

### **1. Create a Central Government Agency Under the State Council Legislative Affairs Office (SCLAO) to Coordinate Relevant Policies and Regulations for the Automotive Industry**

#### **Concern**

Multiple government agencies regulate the automotive industry in an uncoordinated manner, resulting in inconsistent policy interpretation and inefficient work for the government, and unnecessary costs and barriers against technical innovation for enterprises.

#### **Assessment**

Automotive products in China are subject to more than one type approval/homologation system. Taking the example of heavy-duty trucks, a new heavy-duty truck model is firstly required to be type-approved by the Ministry of Industry and Information Technology (MIIT), which ensures the model's conformity to a set of technical standards including fuel consumption standards. Meanwhile, the model also needs to be approved for entering the market by the China Compulsory Certification (CCC) system, which is run by the Certification and Accreditation Administration (CNCA) under the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ).

In fact, most of the technical requirements for these two approvals are almost the same. However, automotive companies will have to submit two sets of test reports and technical data for approval, only in different format, to the MIIT and the CNCA respectively.

What's worse, besides those two repetitive approvals, which both include requirements on fuel emission standards, automotive manufacturers will still have to prove compliance with current national emissions standards to the Ministry for Environmental Protection (MEP) before they can put the vehicle into use. And if the model is to be sold in Beijing, approval by the Beijing Environmental Protection Bureau is also unavoidable.

And this is still not enough – a further approval by the Ministry of Transport (MOT) will have to be received before the truck manufacturer can obtain a Commercial Transportation Permit for the truck model.

Finally, the truck model will need to be checked again by the Ministry of Public Security (MPS) in accordance with its own standard for vehicle safety, GB 7258, in order to receive a licence plate.

This uncoordinated function among different agencies not only doubles their own administrative burden





but also incurs unnecessary costs for automotive manufacturers. Sometimes, those agencies have a different understanding of the same test results, which can result in a further burden to auto manufacturers. It is of little benefit to society as it interrupts product development and affects customer satisfaction.

#### Recommendations

- Improve coordination among relevant government agencies and streamline administrative red tape, especially repetitive tests and approvals.
- Centralise the authority within one governmental agency for homologation/type approval.
- Clarify the administrative responsibilities of the various ministries regulating the automotive industry.
- Consult with industry stakeholders for comments when introducing new rules and regulations and allow industry ample time to adjust to new rules

## 2. Lift Limitations on Foreign Investment

#### Concern

A foreign investor's maximum share in an automotive enterprise is limited to 50 per cent and a foreign investor is only allowed to establish no more than two such Sino-foreign joint ventures (JVs) for passenger vehicles production, and two for commercial vehicles ('2+2') production. In addition to the '2+2' regulation, there are strict requirements for the minimum investment amount from foreign investors, and foreign investors are also required to invest in auto component manufacturing as well as research and development (R&D) centres.

#### Assessment

Such limitations run contrary to the main tenets of China's present reform agenda, which promises to "substantially reduce direct government allocation of resources, promote that resource allocation is based on market principles, market prices and market competition, to realise productivity maximisation and efficiency optimisation."<sup>5</sup> In accordance with these principles, investors should be allowed to hold a share percentage which is proportional to the risk they are ready to take in an automobile company. That is how the European economy works and a number of Chinese investors in Europe benefit from this restriction-free investing environment, so this same market access

<sup>5</sup> Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform, *Xinhua*, 15<sup>th</sup> November, 2013, viewed 3<sup>rd</sup> July, 2015, <[http://news.xinhuanet.com/2013-11/15/c\\_118164235.htm](http://news.xinhuanet.com/2013-11/15/c_118164235.htm)>

should be allowed to European investors in China.

The principle to let the "market play a decisive role in allocating resources"<sup>6</sup> means that the government should set the rules for the industry and ensure strict enforcement of the same. Market forces will force industry restructuring and consolidation. With free ownership investors can decide when, where, how and how much to invest in order to meet market needs. The European automotive industry is hoping to see ambitious market access openings in the Chinese automotive industry.

#### Recommendation

- Allow free foreign investment in the automotive industry without limitations.

## 3. Establish Technology-neutral Targets for Fuel Efficiency and Environmental Performance

#### Concern

Chinese authorities' current focus on new-energy vehicles (NEVs) is narrowly defined and governments have prescribed the technological pathways for companies, thus significantly hindering technological innovation.

#### Assessment

The future of mobility is, and increasingly will be, a jigsaw puzzle composed of a variety of competing and mutually-complementary solutions. E-mobility is on the course to become part of the mix of solutions to the challenges of carbon fuel dependency and other negative, environmental side-effects of transportation. Meanwhile, continuous technological development of energy sources, ranging from fuel cells to diesel, also contributes to addressing some of the environmental challenges that the auto industry faces.

When the Energy Saving and New *Energy Vehicles Industry Development Programme (2012-2020)*<sup>7</sup> was published in 2012, the government set out production and sales targets for electric vehicle industry: in 2015, a cumulative total of 500,000 battery electric vehicles (BEVs) and plug-in hybrid electric vehicles (PHEVs) were supposed to be in use. While the sales of NEVs in

<sup>6</sup> Ibid

<sup>7</sup> *Energy Saving and New Energy Vehicles Industry Development Programme (2012-2020)*, State Council, 10<sup>th</sup> July, 2015, viewed 14<sup>th</sup> July, 2015, <[http://www.nea.gov.cn/2012-07/10/c\\_131705726.htm](http://www.nea.gov.cn/2012-07/10/c_131705726.htm)>



2014 have significantly increased, this ambitious goal is unlikely to be met. Based on the statistics released from the MIIT, the sales plan for NEVs from 2013 to 2015 is 336,000, but only a total of 92,900 were put into use by 2014, which means that about 250,000 NEVs have to be manufactured and sold in 2015 alone.<sup>8</sup>

The automotive industry has consistently called upon regulators to adopt a technology-neutral approach, which is to let market forces play the decisive role in producing the desired outcome. The Chinese authorities should loosen its focus on NEVs as they are currently narrowly defined, and concentrate instead on setting fuel-efficiency and environmental performance targets and allow industry come up with the technological solutions enabling their products to meet these targets.

#### Recommendation

- Set fuel-efficiency and environmental performance targets for the automotive industry, and do not prescribe technological pathways.

### 4. Allow Imports of Auto Components, Used Vehicles and Used Auto Components for the Purpose of Remanufacturing Development, and R&D

#### 4.1 Allow Imports of Auto Components and Improve the Relevant Regulations to Promote the Development of the Remanufacturing Industry.

##### Concern

Although the remanufacturing industry has been identified as an eco- and environmentally-friendly industry and is encouraged by China's central government on paper, auto parts remanufacturing companies are still facing challenging regulatory bottlenecks to start a business in China, especially in terms of the sourcing of core parts for remanufacturing.

##### Assessment

It is encouraging that the Chinese central government released a number of policies and planning documents since 2005, recognising the remanufacturing industry as an eco- and environmentally-friendly industry that should be supported. In addition, the *2015 Circular Economy Promotion Plan*, recently released by National

Development and Reform Commission (NDRC), and the State Council's *Made in China 2025* endorsed the importance of the remanufacturing industry. Furthermore, four ministries released an incentive programme in 2013 to subsidise customers trading in old parts for remanufactured parts.

Despite efforts made by the Chinese Government, remanufacturers are still facing severe regulatory bottlenecks to ramp up production in scale. Current regulations restrict them from obtaining core parts for remanufacturing, both from overseas and domestic markets. Various obstacles, such as value-added tax (VAT) deductions, are challenging the market circulation of remanufactured products due to the lack of competent regulations and policies supporting reverse logistics systems, which is separating this unique category of products from new parts distribution. There is a strong business case for permitting remanufactured products, though. Since remanufactured products are guaranteed for equal quality standards, and even the same warranty terms as new parts, the Chinese authorities do not need to be concerned whether customers' interests are damaged as long as remanufactured products are used within the warranty period.

##### Recommendations

- Revise the *Category of Old Parts Prohibited for Importation* to enable cores importation for remanufacturing.
- Promulgate competent regulations and policies to facilitate market circulation of remanufactured products.
- Roll out more incentives to encourage consumption of remanufactured products and lift consumer recognition towards remanufactured products.

#### 4.2 Allow Imports of Used Vehicles and Used Auto Parts for R&D Purposes

##### Concern

Vehicle engines, complete vehicles and most automotive components are listed in the *Forbidden Import Catalogue of Used Machinery Products*. This restriction harms innovative, domestic companies by increasing their R&D costs and severely limiting their opportunities to take overseas R&D orders and to learn international technologies.

<sup>8</sup> The sales goal of new energy vehicles in 2015 is hard to fulfill, but Premier Li Keqiang hopes to give it strong promotion, sohu, 6<sup>th</sup> March, 2015, viewed 14<sup>th</sup> July, 2015, <<http://auto.sohu.com/20150306/n409421351.shtml>>



### Assessment

The regulations on restrictions of importation of used vehicles and auto parts were put in place over 10 years ago. They are outdated and have created an obstacle to domestic R&D centres of auto makers and parts suppliers.

In addition, the Chinese Government has been encouraging scientific outsourcing services for many years. If a R&D centre cannot import used vehicles and parts, it would not be able to take overseas orders, such as co-design work with international partners.

Furthermore, when Chinese auto makers and parts suppliers want to export their products to other markets, they need to perform tests in the designated country. In case of test failure, the failed products need to be imported to China for analysis or further improvement. According to the current regulation, these products cannot be imported back to China again for further tests due to importation rules. It increases the development cost and creates barriers for some companies, especially small and medium-sized enterprises (SMEs), to export to the global market.

### Recommendation

- Amend the *Forbidden Import Catalogue of Used Machinery and Electronic Products*<sup>9</sup> and the *Administration Rules of Machinery and Electronic Products Import*,<sup>10</sup> or issue supplementary rules to allow imports of used vehicles and used parts for R&D purposes.

## 5. Link Vehicle Tax to Fuel Consumption and CO<sub>2</sub> Emissions

### Concern

Both the current consumption tax and purchase tax for vehicles are based on engine displacement rather than fuel efficiency, and do not sufficiently encourage fuel efficiency or the development of low-emitting vehicles.

### Assessment

Offering fiscal incentives for consumers to choose fuel-efficient vehicles is an effective mechanism to provide

<sup>9</sup> *Forbidden Import Catalogue of Used Machinery Products*, Ministry of Commerce (MOFCOM), General administration of Customs (GAC) and the AQSIQ, 1<sup>st</sup> January, 2001, viewed 3<sup>rd</sup> July, 2015, <<http://www.mofcom.gov.cn/aarticle/b/e/200207/20020700031667.html>>

<sup>10</sup> *The Administration Rules of Machinery and Electronic Products Import*, MOFCOM, GAC & AQSIQ, 1<sup>st</sup> May, 2008, viewed on 3<sup>rd</sup> July, 2015, <[http://www.gov.cn/jffg/2008-05/04/content\\_960775.htm](http://www.gov.cn/jffg/2008-05/04/content_960775.htm)>

a market 'pull' that supports the 'push' created by the fuel economy regulations aimed at manufacturers. Therefore, the industry supports the use of these instruments in China as it does in the European Union (EU), where the majority of Member States have already implemented CO<sub>2</sub>-based vehicle taxes. By putting a price tag on each gram of CO<sub>2</sub> emitted per kilometre, the consumer receives a clear signal to compare the efficiency of competing products. Furthermore, it supports a sound investment in innovative technologies and cars with a higher residual value.

In this context, China should reconsider its current engine displacement taxation. The taxation should instead encourage manufacturers and customers to introduce or to buy fuel-efficient vehicles, regardless of the technologies used, to achieve the consumption targets. Protecting the environment by reducing the total amount of CO<sub>2</sub> emissions per car has become a major policy target. However, evidence shows that some bigger engines have less CO<sub>2</sub> emissions than smaller ones. The working group is willing to help develop rules that are more effective in helping to protect the environment.

### Recommendation

- Replace the current consumption tax and vehicle-purchase tax based on engine displacement with a tax scheme based on CO<sub>2</sub> emissions or fuel consumption per kilometre.

## 6. Simplify the Procedure for Applying for Temporary Testing Licences and Extend their Time Validity

### Concern

Based on the current regulation on car testing, car makers need to buy compulsive insurance for the to-be-tested car and drive it to the inspection station to have it examined first before they can apply for its temporary testing licence. The temporary testing licence is only valid for three months, which does not meet the need for the common one-year testing period.

### Assessment

Before a temporary testing licence expires, car makers have to run through licence application procedures again. To follow this regulation, car makers usually have to stop testing every two and half months, no matter



where the test is conducted, and ship the car back to have it inspected in order to renew its temporary testing licence. This regulation has negative impact on car product development since it increases the testing time and results in an increased cost burden for car manufacturers.

Because vehicles are very complex products, verification and validation tests take quite a long time. It normally takes one year or longer to run compulsory tests, and it usually also involves multiple vehicles to test various functions on the same model.

#### Recommendations

- Simplify the procedure for applying for temporary testing licences.
- Extend the time validity and loosen vehicle number restrictions of temporary testing licences.

### 7. Implement Strict Enforcement of Safety Rules

#### Concern

Currently the law enforcement in China is not sufficient to ensure vehicle and road safety.

#### Assessment

According to the *Decision*, China will “Reform market supervision and management systems, implement uniform market supervision and management”.<sup>11</sup> The intention is to create a level playing field with fair competition. For the commercial vehicles industry, such principles take on an even deeper significance, as the design and usage of commercial vehicles has a direct influence on the efficiency of the transport and logistics industry as well as on road safety in general. Ensuring that all vehicles conform to the law can be done through a system of strict annual vehicle safety inspection and random road side safety inspections. When all commercial vehicles live up to the same basic standards, transport companies will have to compete through good management, excellent services and innovative business models, thus avoiding traffic accidents caused by overloading and the use of sub-standard unsafe vehicles.

An additional benefit would be safer roads and

<sup>11</sup> *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform*, Xinhua, 15<sup>th</sup> November, 2013, viewed on 3<sup>rd</sup> July, 2015, <[http://news.xinhuanet.com/2013-11/15/c\\_118164235.htm](http://news.xinhuanet.com/2013-11/15/c_118164235.htm)>

highways which would attract more people to use their private cars for long distance driving, which in turn will give a new push to the sales of passenger cars and long distance coaches.

#### Recommendation

- Enforce strict annual vehicles safety inspections and random road-side safety inspections.

### 8. Align Repair and Maintenance Information (RMI) Disclosure Requirements with Other Legislation

#### Concern

While the draft *Implementation Administration Measures on the Disclosure of Automotive Repair and Maintenance Technical Information* was welcomed by European original equipment manufacturers (OEMs), the framework lacks specificities unique to the Chinese context. Without due caution, the opening up of the aftermarket for spare parts may not fully reflect the interests of vehicle safety and ultimately affect all road-users.

#### Assessment

Ten governmental agencies, under the leadership of the Ministry of Transport (MOT), published the *Guiding Opinions on the Transformation and Upgrading of the Automotive Repair and Maintenance Industry* in September 2014, and issued the draft *Implementation Administration Measures on the Disclosure of Automotive Repair and Maintenance Technical Information* in February 2015. The European Automotive Manufacturers' Association (ACEA), representing the European automotive industry, submitted written comments on these draft measures in March. Currently the publication of a final text is being awaited.

The Automotive Working Group is well aware that the average age of China's vehicle fleet increases over time (it stands currently at 4.7 years); with more vehicles entering their post-warranty phase, the proportion of repair and maintenance activities within the entire range of auto-related economic activities increases correspondingly. Coupled with the slowdown of new vehicle sales, correlating with China entering the 'new normal', the case for liberalising the aftermarket becomes compelling.

It is encouraging to see that the Ministry of Transport



(MOT) anticipated this trend through their legislative initiatives. However, the working group would urge the MOT to further deliberate on specificities unique to the Chinese context during its legislative process. The working group's member companies have collectively submitted a range of comments on the draft measures, making the following key points:

- Given that the *Auto Brand Sale Management Measures of 2005*<sup>12</sup> is still in effect today, the new rules affecting sales and after-sales services ought to be consistent with existing ones, or existing ones ought to be amended to align with the new ones so as to avoid confusion.
- The persisting problem of widespread counterfeit spare parts in the Chinese market indicates weak enforcement of intellectual property rights (IPR) protection. Therefore strengthening IPR enforcement should be a precondition before further liberalising the repair and maintenance aftermarket.
- The scope of RMI to which the repair and maintenance industry is to be given access, needs to be carefully defined.
- There should be sufficient lead-time between the publication date of the finalised measures, and their effective date.

The opening up of the aftermarket for spare parts should also be carried out with due caution, because independent repair workshops in China often have insufficient knowledge and technology to deal with modern automobiles that are aptly described as 'computers on wheels'. Thus the access to repair and maintenance information is of little practical use if independent repairers do not also invest in appropriate equipment and tools, and in building up the technical know-how of the repair operators. That is why OEMs advise caution when opening up the spare parts market. In particular, auto parts related to core safety (e.g. encoding and decoding software), reprogramming and anti-theft systems should not be freely resold by independent workshops in order to mitigate safety risks and reduce misuse.

Neither the manufacturer nor the authorised dealers should be held responsible for any defect or damage caused by improper handling of original parts by independent workshops. In the current situation, to

<sup>12</sup> *Auto Brand Sale Management Measures of 2005*, MOFCOM, NDRC and the State Administration for Industry and Commerce (SAIC), 1<sup>st</sup> April, 2005, viewed 14<sup>th</sup> July, < [http://www.gov.cn/gongbao/content/2005/content\\_108159.htm](http://www.gov.cn/gongbao/content/2005/content_108159.htm) >

introduce and promote the use of so-called 'equal quality parts' comprises a risk to consumers' safety because 'equal quality parts' are hard to define and may in practice overlap with what are just fake spare parts. The Automotive Working Group believes that safeguards should be put into place to shield both consumers and manufacturers from blurring boundaries between counterfeit and 'equal quality parts'.

When repairing automobiles with non-original spare parts, service providers should expressly inform consumers of the nature of such parts and should highlight the non-original spare parts in invoices and the job orders so that consumers are clearly aware of what choice they making. Given that the warranty for equal quality parts shall be provided by the selling supplier, manufacturers will naturally not be held responsible for any defects of non-original parts or any damage caused thereby to vehicles, passengers or pedestrians.

#### Recommendations

- Formulate RMI disclosure requirements to align with other existing legislation.
- Put necessary safeguards in place when opening up the aftermarket for spare parts.





## Abbreviations

ACEA	European Automobile Manufacturers' Association
AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
BEV	Battery Electric Vehicle
CO <sub>2</sub>	Carbon Dioxide
CCC	China Compulsory Certification
CNCA	Certification and Accreditation Administration
EU	European Union
GDP	Gross Domestic Product
IPR	Intellectual Property Rights
JV	Joint Venture
MIIT	Ministry of Industry and Information Technology
MEP	Ministry of Environmental Protection
MOT	Ministry of Transport
MOFCOM	Ministry of Commerce
MPS	Ministry of Public Security
NEV	New-Energy Vehicle
NDRC	National Development and Reform Commission
OEM	Original Equipment Manufacturer
PHEV	Plug-in Hybrid Electric Vehicle
R&D	Research and Development
RMI	Repair and Maintenance Information
SCLAO	State Council Legislative Affairs Office
SME	Small and Medium-sized Enterprises
VAT	Value-added tax

# Auto Components Working Group

## Key Recommendations

### 1. Regulate the Automotive Independent Aftermarket and Vehicle Technical Information and Data More Effectively

#### 1.1 Allow Access to the Automotive Independent Aftermarket Business

- Revise the current *Auto Industry Development Policy* and promulgate the *Automotive Sales Administrative Measures* to ensure free and balanced market competition in vehicle aftermarket service.
- Stipulate regulations to enforce the *Guidance of Promoting Transformation and Upgrade and Improving Service Quality of Automotive Repairing Industry* jointly issued by 10 Chinese ministries in September 2014, in Beijing.
- Adopt and enforce the regulations as stated in the *Provisions on the Prohibition of the Abuse of Intellectual Property Rights to Eliminate or Restrict Competition*, which was issued by the State Administration for Industry and Commerce (SAIC), whereby a vehicle manufacturer could not use its intellectual property rights (IPR), especially its design rights on visible parts, to restrict the original parts supplier's (OPS's) ability to sell spare parts for vehicle repair which will eliminate and/or restrict free competition.
- Adopt regulations whereby a vehicle manufacturer cannot use tooling agreements/arrangements to restrict the OPS from using original equipment manufacturer-(OEM)-owned tooling exclusively for the OEM.
- Adopt regulations whereby a vehicle manufacturer cannot forbid the OPS from using the OEM-owned commercial names, trademarks and other proprietary names for the sole purpose of identifying the application of the products.
- Continue the efforts to enforce relevant Chinese Anti-Monopoly Law provisions which guarantee general accessibility of the automotive aftermarket business to all vehicle components suppliers.
- Allow OPSs to access the auto aftermarket by allowing them to sell spare parts of matching quality to independent repair shops.
- Promulgate a regulation according to which only certified parts are authorised to be sold to the aftermarket.

#### 1.2 Improve Access to Technical Information

- Enforce the regulations that permit independent operators to access technical information from vehicle manufacturers.

#### 1.3 Enlarge End Consumer Choices During Both the Statutory Warranty Period and Any Extended Warranty Period

- Strengthen enforcement of regulations that permit independent operators' access to the end consumer for non-warranty work during both the statutory warranty period and any extended warranty period.

### 2. Strengthen Law Enforcement and Enhance Protection of IPR

- Define the manufacturing, distribution and sales of counterfeit products—and in general the



- infringement of any intellectual property (IP) held by the genuine IPR owner—as a penal crime.
- Pursue with determination and administer severe punishments for such crimes.

### 3. Remove Obstacles to Research and Development (R&D)

- Ease the restrictions on importing used prototypes and test samples for R&D applications and used R&D equipment.

### 4. Improve Efficiency in the Supply Chain

- Phase out the joint venture (JV) rule for carmakers and reduce the role of Chinese shareholders.

## Introduction to the Working Group

The Auto Components Working Group was created in 2000. It consists of over 100 European and foreign companies involved in the manufacture of auto components, machine tools for production of auto components and automotive assembly lines. They also import and distribute auto components and provide after-sales services. An Independent Automotive Aftermarket (IAM) Desk was established in October 2014, by Auto Components Working Group members, which pledges to explore the possibilities of applying a European Union (EU) *Motor Vehicle Block Exemption Regulation* (MVBBER) to improve the accessibility of the IAM business to suppliers through advocating the improvement of existing laws and regulations,<sup>1</sup> which includes the draft of the *Disclosure of Vehicle Repair and Maintenance Information Administrative Methods* and the revision of the *Automotive Sales Administrative Measures*.

The working group has fostered ties with various organisations and government bodies in the Europe and China.

## Recent Developments

After a period of rapid growth over the last five years until 2014, during which sales of passenger cars and heavy duty vehicles averaged growth at 26 per cent and 11 per cent per annum, respectively, a slowdown

is expected in the automotive industry, corresponding with China's overall economic slowdown as it transitions towards the 'new normal'. Growth of sales of passenger cars and heavy duty vehicles is expected to decelerate to 12 per cent and six per cent per annum until 2020, as a result of lower market demand.

By December 2014, the average age of the total PARC in China was 4.7 years.<sup>2</sup> The progressive ageing of the vehicle PARC is an important indicator for the growth of the aftermarket business in China.

In this context, the automotive maintenance, repair and service industry has the ability to absorb a significant proportion of new jobs, which is essential to counter the economic slowdown, provided that market forces are allowed to operate in a competitive environment. Important steps in this direction have been taken to allow the independent aftermarket to be an attractive option to the authorised networks for vehicle owners.

### Loosen the Control of Vehicle Manufacturers over 4S<sup>3</sup> Shops Regarding Parts Distribution

According to the *Auto Brand Sale Management Measures*, released by the Ministry of Commerce (MOFCOM) and revised on 5<sup>th</sup> August, 2009, vehicle manufacturers were granted the sole discretion to issue permission and authorisation for 4S shops' business. This encouraged vehicle manufacturers to take advantage of this market position and leverage it to create monopoly power.

1 Commission Regulation (EU) No 461/2010 of 27 May 2010 on the Application of Article 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices in the Motor Vehicle Sector., European Parliament, 1<sup>st</sup> June, 2010, viewed on 7<sup>th</sup> May 2015, <<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010R0461&from=EN>>

2 The vehicle PARC is the number of vehicles available in certain area, or the number of vehicles in comparison to the population, geographical spread, make, model and body style, age breakdown (up to 15 years – we assume that vehicles over 15 years are considered to be at the end of their life), fuel type, transmission, engine type and capacity and emission norms of a vehicle.

3 4S stands for sales, spare parts, service and survey (feedback).





However, on 31<sup>st</sup> July, 2014, the *Notice on Suspension of Filing for Vehicle General Dealers and Brand Authorised Dealers* was issued by the State Administration of Industry and Commerce (SAIC), which cancelled the authorisation registration regime in practice, preventing vehicle manufacturers from controlling parts distribution and thereby liberalising the IAM market.

### Promotion of the Service of the Auto Repair Industry in the IAM

The authorised network (4S shops) still commands a much larger market share compared to the IAM. The reasons include: 1) the inclusion of restrictions in the supply agreements that prohibit the OPS from selling to the IAM the same authorised parts used for the first installation on the vehicle; 2) the inclusion of restrictions that prevent the use of trademarks and proprietary names owned by the OEMs; 3) the use of warranty clauses to avoid use of the IAM; 4) the low quality and poor service of some IAM workshops; and 5) the lack of control of counterfeit products of workshops.

In order to promote the services of IAM workshops, the Ministry of Transport (MOT), together with 10 other ministries, issued the *Guideline On Promoting the Transformation and Upgrading of the Automobile Repairing Industry* on 18<sup>th</sup> September, 2014.

On 1<sup>st</sup> January, 2015, the national *standard Conditions of Commencing Business in Vehicle Maintenance Industry* (GB/T 16739) (*Conditions*) was formally implemented under the guidelines of the MOT. All operators that intend to apply for a vehicle maintenance business licence and road transport permit should prepare an application in accordance with the newly-issued *Conditions*.

### Measures to Combat Pollution

Environmental pollution is one of the most pressing issues the government has to tackle to ensure that China's economic development is sustainable. Premier Li Keqiang made a firm declaration in his Government Working Report during the National People's Congress (NPC) in March 2014, stating the government's strong determination to "declare war against pollution and fight against it with the same determination we battled poverty", with further improvements expected in the near future.<sup>4</sup> Although restricting the use of vehicles helps

to improve air quality, a more sustainable way is to use green technologies and continuously implement stricter standards on emissions and fuel consumption and quality. The recently announced *New Energy Vehicle Subsidy Measures* (published on 17<sup>th</sup> September, 2013) and the *Fuel Consumption Evaluation Methods and Targets for Passenger Cars* (public opinion collected on 17<sup>th</sup> January, 2014), as well as the announcement by Premier Li that all diesel vehicles supplied in China must meet the Guo 4 Standard (5<sup>th</sup> March, 2014), are leading the Chinese auto industry to a greener future. Furthermore, China's State Council has listed the energy-saving and new-energy vehicle (NEV) sector as one of the 10 key sectors to promote under its 10-year plan *Made in China 2025* introduced in May 2015.<sup>5</sup> The Auto Components Working Group hopes that the Chinese Government will adopt more concrete actions to promote the use of green technologies (for example, tyre pressure monitoring systems) in the automotive and fuel supply industry, and strictly enforce relevant regulations and standards.

## Key Recommendations

### 1. Regulate the Automotive Independent Aftermarket and Vehicle Technical Information and Data More Effectively

#### 1.1 Allow Access to the Automotive Independent Aftermarket Business

#### Concern

Original part suppliers are often blocked by OEMs from selling in the independent aftermarket the same authorised auto components supplied by OPSs to OEMs for the first installation on the vehicles.

#### Assessment

Frequent restrictions imposed on OPSs selling to the independent aftermarket clearly limit the choice for consumers in the automotive aftermarket, and forces them to choose only between either 4S stores, which are controlled by vehicle manufacturers selling authorised parts at a significant premium price, or *Qi Pei Cheng* where inferior quality products or counterfeit products are sold.<sup>6</sup>



Technically, such direct or indirect restrictions, often

<sup>4</sup> Premier Li's 2014 Government Working Report, China.com.cn, 5<sup>th</sup> March, 2014, viewed 31<sup>st</sup> May 2015, <[http://www.china.com.cn/news/2014lianghui/2014-03/05/content\\_31678795.htm](http://www.china.com.cn/news/2014lianghui/2014-03/05/content_31678795.htm)>

<sup>5</sup> 'Made in China 2025' plan unveiled, *China Daily*, 19<sup>th</sup> May, 2015, viewed 21<sup>st</sup> May, 2015, <[http://www.chinadaily.com.cn/business/2015-05/19/content\\_20760528.htm](http://www.chinadaily.com.cn/business/2015-05/19/content_20760528.htm)>

<sup>6</sup> A *Qi Pei Cheng* ('auto parts town') is a comprehensive, multifunctional market that hosts the wholesale, shipment and retail of auto components on a nationwide scale.



Third Plenum Reality Check		
What did by the Third Plenum's <i>Decision</i> <sup>7</sup> say?	What is the reality?	Status
Enacting market rules that are fair, open and transparent.	European automotive suppliers in China are often forced to establish JVs with Chinese OEMs in order to get business. (KR4)	
Deepening reform of the administrative law-enforcement system.	The presence of counterfeit products is the strongest impediment to the development of a healthy independent aftermarket. This inhibits growth for real competition in the service and repair of vehicles. (KR1 and KR2)	

imposed by certain vehicle manufacturers on an OPS, constitute a 'monopoly agreement/arrangement', which restricts free competition, and therefore, to the working group's understanding, should be prohibited under the current Anti-monopoly Law (AML). On the question of exclusivity, as regulated by the AML:

- Article 17 of the AML, states: "A business operator with a dominant market position shall not abuse its dominant market position to conduct following acts:"
  - Article 17(4): "requiring a trading party to trade exclusively with itself or trade exclusively with a designated business operator(s) without any justifiable cause;"

Based on the *Notice on Suspension of Filing for Vehicle General Dealers and Brand Authorised Dealers*, released on 31<sup>st</sup> July, 2014, and the *Guideline On Promoting the Transformation and Upgrading of The Automobile Repairing Industry*, released on 18<sup>th</sup> September, 2014, it is becoming increasingly apparent that the Chinese authorities are aware of this contradictory situation and are trying to correct it.

The key driver of some monopoly situations in the Chinese vehicle aftermarket is the current *Auto Industrial Development Policy* and the corresponding implementing measures entitled *Administrative Measures for Branded Vehicle Sales*. In the *Auto Industrial Development Policy*, effective 21<sup>st</sup> May, 2004, (revised on 5<sup>th</sup> August, 2009), Article 34 and 35 create a new vehicle sales and service method by obliging each auto maker to

establish their branded distribution and aftermarket service system. On 1<sup>st</sup> April, 2005, the *Implementing Measures for Branded Sales* were officially published and came into effect, which further specified how each auto maker shall distribute their vehicles through one general distributor in China who has the exclusive power to nominate/choose their delegated dealers to carry out sales and aftermarket service business in China.

In September 2014, 10 PRC ministries, including the MOT and the National Development and Reform Commission (NDRC), jointly issued the *Guidance of Promoting Transformation and Upgrade and Improving Service Quality of Automotive Repairing Industry*, which addressed concerns about improving the accessibility of the IAM market.<sup>8</sup> Also, since November 2014, Chinese legislators have been drafting the *Automotive Sales Administrative Measures* in this regard. The Auto Components Working Group hopes that this draft regulation can be promulgated and enforced at an early stage.

While the original and early policies did play a positive role in regulating the Chinese automotive distribution order, the market has matured since then and is ready for greater liberalisation. With the 'obligations' set forth for vehicle manufacturers in these policies, the auto parts supply to 4S shops is controlled by the vehicle

<sup>7</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.

<sup>8</sup> *Guidance of Promoting Transformation and Upgrade and Improving Service Quality of Automotive Repairing Industry*, MOT, NDRC, Ministry of Education (MOE), Ministry of Public Security (MPS), Ministry of Environmental Protection (MEP), Ministry of Housing and Urban-Rural Development (MOHURD), MOFCOM, SAIC, Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), China Insurance Regulatory Commission (CIRC), 18<sup>th</sup> September, 2014, viewed 7<sup>th</sup> May, 2015, <[http://www.moc.gov.cn/zfxgk/bnssj/dlyss/201409/t20140918\\_1693089.html](http://www.moc.gov.cn/zfxgk/bnssj/dlyss/201409/t20140918_1693089.html)>



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manufacturers and sold to consumers at high prices.

Research by the China Automotive Maintenance Association<sup>9</sup> showed that if the vehicles were to be assembled by putting together the separate parts purchased in the authorised network, the total cost could be up to 600 per cent, 700 per cent or even 1,200 per cent of the vehicles' retail price. In mature markets a reasonable ratio is considered to be around 300 per cent.

The proliferation of counterfeit parts is an additional negative side effect of this high price gap. Due to the high prices of authorised components, many unauthorised and fake products are widely available in small repair stores and markets. A survey released on 17<sup>th</sup> March, 2015, conducted by the *China Auto Newspaper* shows that among 40 consumers, 50 per cent were cheated with counterfeit parts and 60 per cent of them, with little knowledge of how to protect their consumer rights, chose to take no actions.<sup>10</sup>

To ensure fair competition in the automotive aftermarket between vehicle manufacturers and vehicle components suppliers, the latter should have general access to the automotive aftermarket, so that Chinese consumers can have the opportunity to purchase high-quality spare parts of matching quality at a competitive price. Chinese market regulators should clearly prohibit restrictions preventing or limiting vehicle components suppliers' access to this market. Again, the Auto Component Working Group hopes that the promulgation of the *Automotive Sales Administrative Measures* can address this issue with a legislative approach.

The issue discussed above is not unique to China. In fact, it has been handled in various ways in other markets.

As a general concern, under the current European Union (EU) rules (Commission Regulation (EU) No 461/2010 of 27<sup>th</sup> May 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices in the Motor Vehicle Sector), the

following restrictions imposed on an OPS regarding access to the automotive aftermarket are prohibited and automatically void, as they violate EU competition law:

- Article 5(b): "The restriction, agreed between a supplier of spare parts, repair tools or diagnostic or other equipment and a manufacturer of motor vehicles, of the supplier's ability to sell those goods to authorised or independent distributors or to authorised or independent repairers or end users."

Regarding tooling, the Commission Notice, *Supplementary Guidelines on Vertical Restraints in Agreements for the Sale and Repair of Motor Vehicles and for the Distribution of Spare Parts for Motor Vehicles* (Text with EEA relevance) (2010/C 138/05), explains the EU Commission's perception of the EU rules, especially with respect to the above Commission Regulation:

- Paragraph 23: "Article 5(b) of the Motor Vehicle Block Exemption Regulation concerns any direct or indirect restriction agreed between a supplier of spare parts, repair tools or diagnostic or other equipment and a manufacturer of motor vehicles, which limits the supplier's ability to sell these goods to authorised and/or independent distributors and repairers. So-called 'tooling arrangements' between component suppliers and motor vehicle manufacturers are one example of possible indirect restrictions of this type."

Regarding intellectual property rights (IPR), the use by car manufacturers of alleged design rights to restrict original OPSs sales to the IAM appears to be all the more groundless in light of OPSs' significant contribution to the design, development and innovation of such products. Numerous countries, mainly in the EU but outside the EU as well, have thus adopted regulations whereby a vehicle manufacturer cannot use its patent design rights on visible parts to restrict the spare parts used to repair or restore the initial appearance of a complex product (the so-called 'repair clause'). These provisions are respected by European vehicle manufacturers; as a matter of fact, with the cooperation of European vehicle manufacturers, the EU enjoys the presence of the IAM as a reliable source for repair and maintenance. As a result, there are several important benefits, such as the creation of qualified jobs in the IAM, the promotion of healthy competition between the authorised networks and the IAM, a wider range of choices for consumers for service and repair

<sup>9</sup> *Behind the High Maintenance and Repair Fees*, *China Daily*, 10<sup>th</sup> April, 2014, viewed 1<sup>st</sup> June, 2015, <[http://www.chinadaily.com.cn/hqgj/jryw/2014-04-11/content\\_11578167.html](http://www.chinadaily.com.cn/hqgj/jryw/2014-04-11/content_11578167.html)>

<sup>10</sup> *50% have been cheated by fake parts, but 60% chose not to protect their legal interests*, Gasgoo Information Centre, 17<sup>th</sup> March, 2015, viewed 28<sup>th</sup> May, 2015, <<http://auto.gasgoo.com/News/2015/03/160619271927391.shtml>>



and a market-driven price for such services.

In China, the SAIC issued the *Provisions on Prohibition of the Abuse of Intellectual Property Rights to Eliminate or Restrict Competition* on 7<sup>th</sup> April 2015,<sup>11</sup> and the Chinese regulators should enforce such rules in the automotive industry.

Based on the above, stricter enforcement of existing AML rules, together with prohibition of restrictive practices, are necessary to guarantee healthy competition between OPSs and vehicle manufacturers in the automotive aftermarket.

However, considering that OPSs depend heavily on projects granted by vehicle manufacturers, they may fear retaliatory commercial measures and thus be reluctant to raise non-confidential claims or complaints when facing restrictive practices. Regulation can correct this situation through an enlarged list of restricted practices and reinforced rights for relevant authorities to initiate investigations based on practices observed on the market or verbal information received on a confidential basis. A full comprehensive text with appropriate recitals will facilitate sometimes difficult interpretation.

Various governmental bodies have issued guidelines and suggestions to prevent vehicle manufacturers from applying restrictions to OPSs in manufacturing and distributing equivalent authorised parts in the independent aftermarket.

Such restrictions by vehicle manufacturers may not only apply to the sales of original parts but also to the use of trademarks and proprietary names on the parts. This may create a differentiation between parts sold by the 4S showing original equipment (OE) trademarks or proprietary names, and those sold in the independent aftermarket without these OE trademarks or proprietary names. Not only would this differentiation make it difficult for end users to confirm that the parts can be fitted on their vehicles but it would also make it difficult to justify that they are authorised parts rather than fake products.

Even if the original parts sold in the aftermarket do not violate any restriction, without mentioning the name of

the vehicle manufacturer, the vehicle or engine model or type, it will be impossible for customers and consumers to associate the part to the brand, type of vehicle or engine, which as a matter of fact obliges them to use the parts sold by the vehicle manufacturer through their authorised network, or to use products of inferior quality not authorised by the vehicle manufacturer or facilitate the choice of counterfeit parts.

Such prohibitions can be included in legally-binding contracts regulated by compulsory Chinese laws. The guidelines and suggestions issued so far do not have any equivalent legal power.

In fact, restrictions are still in place and OPSs must comply with the provisions included in binding agreements.

### Case Study

The following case refers to an actual occurrence of an OEM (Company A) using its dominant position towards a subsidiary of an auto supplier (Company B).

Company B is an authorised supplier of original parts to Company A.

Company A has requested Company B to sign a supply contract whereby any use of Company B's trademarks, logos and proprietary names is prohibited.

In addition, Company B has the obligation of assuring that no other subsidiary of Company B uses those trademarks, logos and proprietary names.

Another subsidiary of Company B has replicated products based on reverse engineering of the original product and manufactured these products in a different factory with a different set of tooling.

Company A has found such products sold in the independent aftermarket and has threatened Company B with breach of contract and cancellation of the status of 'preferred supplier', together with a claim for damages.

The clauses included in the contract by Company A prohibiting Company B and all the subsidiaries

<sup>11</sup> *Provisions on Prohibition of the Abuse of Intellectual Property Rights to Eliminate or Restrict Competition*, SAIC, 7<sup>th</sup> May, 2015, viewed 6<sup>th</sup> June, 2015, <[http://gkml.saic.gov.cn/auto3743/auto3746/201504/20150413\\_155105.htm](http://gkml.saic.gov.cn/auto3743/auto3746/201504/20150413_155105.htm)>



of Company's B group from using in any way trademarks, logos and proprietary names as a matter of fact exclude any possibility for Company B to participate with its product in the IAM.

All the above violate the *Provisions on Prohibition of the Abuse of Intellectual Property Rights to Eliminate or Restrict Competition*, which was issued by the SAIC, whereby a vehicle manufacturer could not use its IPR, especially its design rights on visible parts, to restrict the OCS's ability to sell spare parts for vehicle repair which will eliminate and/or restrict free competition.

### Recommendations

- Revise the current *Auto Industry Development Policy* and promulgate the *Automotive Sales Administrative Measures* to ensure free and balanced market competition in vehicle aftermarket service.
- Stipulate regulations to enforce the *Guidance of Promoting Transformation and Upgrade and Improving Service Quality of Automotive Repairing Industry* jointly issued by 10 Chinese ministries in September 2014, in Beijing.
- Adopt and enforce the regulations as stated in the *Provisions on the Prohibition of the Abuse of Intellectual Property Rights to Eliminate or Restrict Competition*, which was issued by the SAIC, whereby a vehicle manufacturer could not use its IPR, especially its design rights on visible parts, to restrict the OPS's ability to sell spare parts for vehicle repair which will eliminate and/or restrict free competition.
- Adopt regulations whereby a vehicle manufacturer cannot use tooling agreements/arrangements to restrict the OPS from using OEM-owned tooling exclusively for the OEM.
- Adopt regulations whereby a vehicle manufacturer cannot forbid the OPS from using the OEM-owned commercial names, trademarks and other proprietary names for the sole purpose of identifying the application of the products.
- Continue the efforts to enforce relevant Chinese Anti-Monopoly Law provisions which guarantee general accessibility of the automotive aftermarket business to all vehicle components suppliers.
- Allow OPSs to access the auto aftermarket by allowing them to sell spare parts of matching quality to independent repair shops.
- Promulgate a regulation according to which only

certified parts are authorised to be sold to the aftermarket.

## 1.2 Improve Access to Technical Information

### Concern

Independent aftermarket operators currently do not have access to the technical information necessary to carry out diagnosis and the subsequent repairs and maintenance on increasingly sophisticated vehicles, which limits the choice for consumers in the automotive aftermarket.

### Assessment

According to Chinese regulations, vehicle manufacturers do not have any legal obligation to give independent operators access to technical information.

With the adoption of sector-specific guidelines, the EU has emphasised the importance of independent operators – distributors and garages. It has recognised that the independent aftermarket increases choice for consumers and keeps the price of repairs competitive by putting pressure on car manufacturers' authorised repair networks.

In order to truly achieve effective competition in the aftermarket services market, it is essential that independent operators can get the technical information necessary to carry out repairs and maintenance on increasingly sophisticated vehicles. Several technical European-type approval regulations in the EU already contain key provisions on the access to vehicle repair and maintenance information for independent operators.

The regulations contain a generic definition of technical information, which provides a good summary of what technical information is required for the repair and maintenance of vehicles<sup>12</sup> – vehicle repair and maintenance information required for diagnosis, servicing, inspection, periodic monitoring, repair, reprogramming or re-initialising of the vehicle, which the manufacturers provide for their authorised dealers and repairers, including all subsequent amendments and supplements to such information.

<sup>12</sup> Commission Regulation (EU) No 461/2010 of 27<sup>th</sup> May, 2010, on the Application of Article 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices in the Motor Vehicle Sector, European Parliament, 1<sup>st</sup> June, 2010, viewed 7<sup>th</sup> May 2015, <<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010R0461&from=EN>>



The way in which technical information is supplied is also important. Access should be given upon request and without undue delay, in a useable form, and the price charged should not discourage access to it by failing to take into account the extent to which the independent operator uses the information.

Taking EUR 5/6 emissions regulation 715/2007 Article 6 and its amendments 892/2008 and 566/2011 as a reference:

“Manufacturers shall provide unrestricted and standardised access to vehicle repair and maintenance information to independent operators through websites using a standardised format in a readily accessible and prompt manner, and in a manner which is non-discriminatory compared to the provision given or access granted to authorised dealers and repairers. With a view to facilitating the achievement of this objective, the information shall be submitted in a consistent manner (initially in accordance with the technical requirements of the Open Artwork System Interchange Standard (OASIS) format).

The information shall include:

- an unequivocal vehicle identification;
- service handbooks, including repair and maintenance records;
- technical manuals;
- component and diagnosis information (such as minimum and maximum theoretical values for measurements);
- wiring diagrams;
- diagnostic trouble codes (including manufacturer specific codes);
- the software calibration identification number applicable to a vehicle type;
- information provided concerning, and delivered by means of, proprietary tools and equipment;
- data record information and two-directional monitoring and test data; and
- standard work units or time periods for repair and maintenance tasks if made available, either directly or through a third party, to manufacturers' authorised dealers and repairers.

Where vehicle repair and maintenance records are kept in a central data base of the vehicle manufacturer or on its behalf, independent repairers, approved and authorised as required in point 2.2 of Annex XIV

to Commission Regulation (EC) No 692/2008 (5), shall have access to such records free of charge and under the same conditions as authorised dealers or repairers in order to record information on repair and maintenance performed.

Manufacturers shall also make training material available to independent operators and authorised dealers and repairers.”

The Auto Components Working Group, and especially the IAM Desk, have been closely involved with the call for comments action related to improved access to technical information launched by the MOT in January 2015, and would welcome trial methods being introduced within the year.

#### Recommendation

- Enforce the regulations that permit independent operators to access technical information from vehicle manufacturers.

### 1.3 Enlarge End Consumer Choices During Both the Statutory Warranty Period and Any Extended Warranty Period

#### Concern

During the Auto Warranty Period (repair, replacement and refund), all services and repairs must be carried out by the vehicle manufacturers' network, otherwise it will not conform to the *Three Guarantees* regulations (*3R Regulations*), thereby limiting consumers' choice in servicing and repairing of non-statutory auto components and parts in the automotive aftermarket.

#### Assessment

It is currently required by the *3R Regulations*, with respect to stipulated responsibilities on the part of sellers for the repair, replacement and refund of private cars manufactured and sold in China during the auto warranty period, that all services and repairs must be carried out by the vehicle manufacturers' network, otherwise it will be considered as not conforming.

The new regulation protects the rights of customers to a great extent, but damages the right of choice for customers and the development of repair shops beside the vehicle manufacturers' network, which limits the choice for consumers in the servicing and repairing of



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non-statutory, auto warranty-period components and parts in the automotive aftermarket. Referencing the experience from the EU, one of the major improvements in the new European Competition Law framework is that vehicle manufacturers may not make the warranties conditional on the repair and servicing of a vehicle within their network, or on the use of their own branded spare parts. According to the new set of rules, consumers have the right to use any repair shop for non-warranty work, during both the statutory warranty period and any extended warranty period. Of course, every operator is subject to statutory product and service liability. Thus, anyone who damages a vehicle as a result of negligent work or use of defective parts is responsible for it.

This improvement could be considered and adopted in China.

#### Recommendation

- Strengthen enforcement of regulations that permit independent operators' access to the end consumer for non-warranty work during both the statutory warranty period and any extended warranty period.

## 2. Strengthen Law Enforcement and Enhance Protection of Intellectual Property Rights (IPR)

#### Concern

The widespread presence of counterfeit parts in the IAM causes mistrust among vehicle owners and users. Confronted with the uncertainties involved in parts purchased through IAM, an authorised network is always preferred for the repair, service and maintenance of automobiles, meaning that the IAM cannot play its competitive role in the market as a balancing force to the authorised network.

#### Assessment

The current law differentiates between the manufacturing, distribution and sales of small and large quantities of counterfeit products.

If those engaged in the above activities are found in possession or trading of small quantities, the law treats such an offence as a civil case with extremely mild punishments for the culprits. Only when the quantities are considered to be large and substantial in value can the case be treated as a penal one with tougher

punishment, including imprisonment.

As a consequence of this legal differentiation, counterfeiters are not deterred from manufacturing, distributing, or selling counterfeit parts, albeit in smaller quantities. In fact, the number of counterfeiters has multiplied while the overall presence of counterfeit products maintained its status quo. With the pervasive existence of counterfeiters, investigation and prosecution of perpetrators has become extremely costly for the lawful brand and trademark owners, as in most cases only very small quantities are seized but the fees incurred to the OPS are often large, fixed sums. Even when cases are brought to justice, the burden for the plaintiff includes the cost of transportation of the seized goods to the warehouses designated by the authorities, the cost of storage and the cost of destruction.

Additionally, repetitive investigations initiated by the OPS are not at all sustainable in the long run, for counterfeiters face extremely lenient punishments that do not necessarily deter them from engaging again in the same illegal activities.

Aside from the economic costs incurred in the investigation and prosecution of counterfeit part manufacturers, other social costs imposed by the manufacturing of counterfeit parts also exist.

In terms of passenger car safety, counterfeit auto parts often raise concerns regarding their ability to meet safety requirements imposed by the authorities. With its potential to cause serious consequences to users, fatal risks involved in the use of counterfeit part should be taken into consideration in regulating counterfeit auto components.

From a profit perspective, the high profit embedded in the production and sale of counterfeit parts often provides the wrong incentive for both manufacturers of automotive components and authorised networks. Faced with the potential profit that could be generated through the production of counterfeit products, domestic manufacturers of automotive components are more encouraged to counterfeit instead of innovating or improving existing products. With the amount of trust endowed by customers and the profitability involved, authorised networks also find it tempting to sell counterfeit parts alongside those of vehicle



manufacturer brands, which in turn infringes consumer rights and undermines fair competition in the market.

For the manufacturing industry, the damage done can be long-term. Inability to innovate and develop industrial know-how will inevitably leave Chinese manufacturers stranded and dependent on foreign technologies in the long run. From a global trade perspective, exportation of counterfeit products worldwide can also pose threats internationally to consumers' perceptions of Chinese products.

#### Recommendations

- Define the manufacturing, distribution and sales of counterfeit products—and in general the infringement of any IP held by the genuine IPR owner—as a penal crime.
- Pursue with determination and administer severe punishments for such crimes.

### 3. Remove Obstacles to Research and Development (R&D)

#### Concern

In an international Research and Development (R&D) environment, even though it is necessary to bring used test equipment, test samples and prototypes in and out of China, such importation of certain used products is prohibited or restricted by Chinese customs.

#### Assessment

Chinese regulations have created a favourable environment for foreign companies to carry out R&D in China. More and more foreign companies are setting up R&D centres in China and transferring expertise and technology to enable those centres to develop products for China, in China. These R&D centres become a part of the global engineering network of a company.

The process of developing products includes the testing of prototypes to make sure products meet specified requirements. To make optimal use of its global engineering resources, an international company might conduct these tests in different locations, both in and outside of China. Therefore, it is necessary to transfer prototypes from China to other locations and from overseas to China. As the prototypes are used in tests, they cannot be declared as new anymore. Yet for different products, such as engines, it is not permitted to import or re-import them into China unless they are

new.

A similar problem occurs when bringing new test equipment to China. Some test rigs are manufactured, assembled and tested abroad. These tests are carried out using prototypes or other samples. After successful acceptance, the test rig is disassembled and shipped to China, where it is re-assembled. Usually, an acceptance run is carried out after the machine is re-assembled, using the same prototypes or samples that were used for the initial test abroad. As these prototypes or samples are then 'used', they might be banned from being imported into China.

When R&D centres abroad install new state-of-the-art equipment, most of the time the replaced equipment is still very useful. It is a great benefit to install them for example in R&D locations in China. Nevertheless, Chinese regulations are very strict when it comes to importing used equipment into China, making it very difficult, or sometimes almost impossible, to bring this equipment to China.

#### Recommendation

- Ease the restrictions on importing used prototypes and test samples for R&D applications and used R&D equipment.

### 4. Improve Efficiency in the Supply Chain

#### Concern

European automotive suppliers in China are often forced to establish JVs with Chinese OEMs in order to get business.

#### Assessment

Global carmakers can only produce cars in China through JVs with Chinese carmakers. While this is mandatory for carmakers, suppliers often see themselves compelled to establish JVs with the same Chinese carmakers as well. In many cases, suppliers that do not have JVs with carmakers will not get contracts, because JV partners are preferred. In some specific cases, sourcing decisions are not only made regarding the vehicles of the Chinese carmaker, but also, and more importantly, regarding the parts for the cars of the JVs.

Typically a JV supplier has the Chinese OEM and its JVs as main clients and is not able to get contracts with





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other significant Chinese OEMs and their JVs. For this reason, many large global suppliers have set up several JVs with many different partners.

These JVs are quite independent from the headquarters of the suppliers. This makes it very difficult for the suppliers to coordinate all activities in China. In some cases suppliers are able to carry over the part from the region of origin. In other cases, suppliers have not been able to set up a JV with the Chinese carmaker, because the Chinese carmaker may prefer single sourcing and does not want to establish a second JV for the same type of part. In this case, a JV supplier is often nominated, although the global carmaker does not source the part from that supplier in the region of origin.

This presents a loss in terms of economies of scale for the original supplier and also for the JV supplier.

Furthermore global carmakers are compelled to transfer know-how from one global supplier to another.

The parts produced in this fashion tend to be more expensive than they should be and the quality often does not match the quality of the original part, because in some cases the nominated suppliers do not master all processes of the original supplier.

Global suppliers treat these JVs correctly as entities outside of the normal business activities and see them only as units that make or assemble parts, not as units that would perform any significant R&D other than adaptations of the parts carried over. This also means that the Chinese carmaker which is the partner in this JV will also not gain any real know-how, but will just learn how to produce or assemble a certain part. Typically most of the value added is not in the manufacturing or assembly of a part, but in the R&D of the part.

In any case, a supplier JV means additional administrative functions that are duplicating the efforts of the headquarters and that would be unnecessary if the supplier could operate as a wholly foreign-owned enterprise (WFOE), again adding more cost into the system without any additional benefit.

### Recommendation

- Phase out the JV rule for carmakers and reduce the

role of Chinese shareholders.

## Abbreviations

3R Regulations	Three Guarantees Regulations
4S	Sales, Service, Spare parts and Survey
AML	Anti-Monopoly Law
AQSIQ	Administration of Quality Supervision, Inspection and Quarantine
CIRC	China Insurance Regulatory Commission
EU	European Union
IAM	Independent Aftermarket
IP	Intellectual Property
IPR	Intellectual Property Rights
JV	Joint Venture
MEP	Ministry of Environmental Protection
MOE	Ministry of Education
MOFCOM	Ministry of Commerce
MOHURD	Ministry of Housing and Urban-Rural Development
MOT	Ministry of Transportation
MPS	Ministry of Public Security
MVBER	Motor Vehicle Block Exemption Regulation
NDRC	National Development and Reform Commission
NEV	New-Energy Vehicle
NPC	National People's Congress
OPS	Original Part Supplier
OE	Original Equipment
OEM	Original Equipment Manufacturer
PARC	number of vehicles available in a certain area
R&D	Research and Development
SAIC	State Administration for Industry and Commerce
WFOE	Wholly Foreign-Owned Enterprise





## Carbon Market Working Group

### Key Recommendations

- 1. Promote Fairness, Openness and Transparency in China's Pilot Emissions Trading Schemes (ETSs)**
  - Provide access to complete, unrestricted data on trading, emissions and compliance.
  - Improve the policy-making process by involving appropriate stakeholders.
  - Increase competition and improve data quality in the validation and verification services market by accrediting designated operational entities (DOEs) based on merit and experience for participation in the pilot ETS and Chinese Certified Emission Reduction (CCER) schemes.
  - Promote fair treatment of all ETS participants by adopting allocation methodologies that recognise and reward energy efficiency and adoption of advanced technologies.
  - Permit trading of forward and futures products.
  - Allow foreign entities to be members and active traders in the platforms of the various pilot ETSs and future national ETS.
  
- 2. Develop the National ETS so that it Contributes to Cost-Effective Emission Reductions En Route to a Low-Carbon China**
  - Acknowledge and stress the fundamental goal of emissions trading, which is to mitigate emissions at the lowest possible cost.
  - Determine the cap for the national ETS based on sound and transparent data.
  - Explicitly couple the ETS design in terms of cap-setting with China's pledge to peak emissions as soon as possible.
  - Link the design, in terms of cap-setting and offset use, to mitigate costs in the ETS and—via the offset mechanisms—to the non-ETS sectors.
  - Give ample consideration to other key fundamental issues surrounding the national ETS design, such as the link to other existing policies, the existence of a regulated power market in China and the significant differences within China in terms of economic development, structure and institutional capacity.
  
- 3. Urge Governments along with Civil Society and the Private Sector to Work Together to Reach a New International Climate Change Agreement by 2015**
  - Encourage the European Union (EU) to stick to its binding emissions target of at least 40 per cent domestic reduction of greenhouse gas (GHG) emissions by 2030, compared to 1990 levels in order to continue its leadership in tackling climate change while boosting innovation and economic growth.
  - Incentivise China to reduce its emissions per unit of gross domestic product (GDP) by 60 to 65 per cent from 2005 levels, and increase the share of non-fossil fuels as part of its primary energy consumption to about 20 per cent by 2030, in line with submitted Intended Nationally Determined Contributions (INDCs), while putting China on a low carbon pathway.
  - Recognise the need for a proactive role of non-state actors, including local governments, civil society and the private sector, to work together towards transformative and ambitious actions that provide practical solutions commensurate with the challenge of climate change.

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.





## Introduction to the Carbon Market Working Group

The Carbon Market Working Group is comprised of 60 member companies representing all aspects of the carbon market sector, including project developers, carbon funds, investors, lawyers, auditors, consultants as well as financial institutions and companies under compliance obligations.

The working group is interested in working with Chinese and other stakeholders to ensure the sustainable development of the carbon market in order to upgrade China's industries and resolve its environmental problems. With the pilot Emissions Trading Scheme (ETS) presently in operation across China, the working group is keen to understand and feed into the process from a European-business-in-China perspective.

## Recent Developments

On 11<sup>th</sup> November, 2014, the United States (US) and China issued the *US-China Joint Announcement on Climate Change and Clean Energy Cooperation*.<sup>1</sup> For the first time, China announced to peak its carbon dioxide (CO<sub>2</sub>) emissions around 2030, with the intention to try to peak early, and to increase the non-fossil fuel share of all energy to around 20 per cent by 2030.

On 19<sup>th</sup> May, 2015, the State Council issued the plan *Made in China 2025*.<sup>2</sup> It is a ten-year action plan stating that the Chinese manufacturing industry must cut its carbon intensity by 40 per cent by 2025 compared to 2015 levels. The plan also targets the reduction of energy intensity in manufacturing to 34 per cent by 2025. *Made in China 2025* accelerates China's decarbonisation process and puts itself on track to peak its greenhouse gas (GHG) emissions by 2025.<sup>3</sup>

On 29<sup>th</sup> June, 2015, the European Union (EU) and China issued the *EU-China Joint Statement on Climate Change* during the 17<sup>th</sup> bilateral summit in

Brussels.<sup>4</sup> Both sides have committed to stepping up their cooperation to fight the global threat of climate change. The statement also includes that the ongoing cooperation on emissions trading will be expanded, in view of China's plans to establish a nationwide ETS by 2020.

### From ETS Pilots Towards National ETS

China's 12<sup>th</sup> Five-Year Plan (FYP) lays out plans to gradually set up a carbon trading market. In November 2011, the National Development and Reform Commission (NDRC) approved seven ETS pilots. Since mid-June, 2014, all seven pilots have been operational. So far, very few carbon traders and investors from Europe, North America and Australia have started trading in China's pilot markets due to poor liquidity and a lack of transparency.<sup>5</sup>

In 2014, the NDRC announced that its national carbon trading scheme would begin in the second half of 2016. But according to an NDRC climate official, China might postpone the start of its national carbon market until early 2017 to make sure that all the rules and regulations are finalised.<sup>6</sup>

China's national ETS is expected to transform into a mature market by 2020, and would then be the world's biggest carbon market. At this stage it is still very unclear how the national ETS will work.

### Chinese Certified Emission Reduction (CCER)<sup>7</sup>

During a meeting in February 2015, 22 projects were approved to receive the offsets they applied for while four projects were denied. So far, around 17 million CCERs have been issued, with the seven pilot markets allowing up to 110 million CCERs to be used in total. The seven pilots are expected to complete their annual compliance cycle by the end of June 2015.

On 18<sup>th</sup> May, 2015, the NDRC announced that China issued three million CCERs eligible for compliance use in its pilot ETSS, but the majority of the projects

1 FACT SHEET: *US-China Joint Announcement on Climate Change and Clean Energy Cooperation*, The White House, 11<sup>th</sup> November, 2014, viewed 28<sup>th</sup> May, 2015, <<https://www.whitehouse.gov/the-press-office/2014/11/11/fact-sheet-us-china-joint-announcement-climate-change-and-clean-energy-c>>

2 *China sets 40% carbon intensity reduction target for industry*, Carbon Pulse, 20<sup>th</sup> May, 2015, viewed 28<sup>th</sup> May, 2015, <<http://carbon-pulse.com/china-sets-40-carbon-intensity-reduction-target-for-industry/>>

3 *China's new carbon target for industry paves way for earlier GHG peak – analysts*, Carbon Pulse, 21<sup>st</sup> May, 2015, viewed 28<sup>th</sup> May, 2015, <<http://carbon-pulse.com/chinas-new-carbon-target-for-industry-paves-way-for-earlier-ghg-peak-analysts/>>


4 *EU-China summit*, European Commission, 29<sup>th</sup> June, 2015, viewed on 6<sup>th</sup> July, 2015, <[http://europa.eu/rapid/press-release\\_IP-15-5279\\_en.htm](http://europa.eu/rapid/press-release_IP-15-5279_en.htm)>

5 *China takes step to set up carbon futures exchange*, Carbon Pulse, 21<sup>st</sup> April, 2015, viewed on 19<sup>th</sup> May, 2015, <<http://carbon-pulse.com/china-takes-step-to-set-up-carbon-futures-exchange/>>

6 *China climate official flags potential later start for national ETS*, Carbon Pulse, 28<sup>th</sup> May, 2015, viewed 3<sup>rd</sup> June, 2015, <<http://carbon-pulse.com/china-climate-official-flags-potential-later-start-for-national-ets/>>

7 CCERs are used in the Chinese domestic offset trading scheme. One CCER is equal to one tonne of CO<sub>2</sub> equivalent reduced from the atmosphere.



Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
We will ... implement a trading system for ... carbon emission ... establish a market-oriented mechanism to attract private capital to ecological and environmental protection.	<p>The launch of the ETS pilots in 2013 represents one of the first attempts in the use of the market as a tool to allocate resources and determine the price of a commodity. But it is now time to act on this principle and develop the market in a fair, open and transparent way.</p> <p>The market mechanism should also be improved so that the emissions price is determined by the market resulting in lowest cost reductions.</p>	

receiving offsets are ruled out in most markets.<sup>8</sup>

billion cubic metres, compared to 2005 levels.<sup>11</sup>

### Carbon Futures Trading

On 20<sup>th</sup> April, 2015, the State Council approved the creation of a free trade zone (FTZ) in Guangdong Province including the introduction of a new futures exchange for carbon permits. This is said to make China's planned national ETS more attractive for international traders. The NDRC is strongly in favour of carbon futures trading because it can boost liquidity and provide a price signal to help emitters make investment decisions.<sup>9</sup>

### United Nations Framework Convention on Climate Change (UNFCCC) Negotiations

In the framework of the UNFCCC negotiations, it was agreed that all "parties ready to do so"<sup>10</sup> communicate to the UNFCCC secretariat their Intended Nationally Determined Contributions (INDCs) by 31<sup>st</sup> March, 2015.

On 30<sup>th</sup> June, 2015, China submitted its INDCs in which it promised the following by 2030:

- To achieve the peaking of CO<sub>2</sub> emissions around 2030, and making best efforts to peak early.
- To lower CO<sub>2</sub> emissions per unit of gross domestic product (GDP) by 60 per cent to 65 per cent from 2005 levels.
- To increase the share of non-fossil fuels in primary energy consumption to around 20 per cent.
- To increase the forest stock volume by around 4.5

Each INDC is considered as a building block towards a global climate deal to be sealed in Paris in December 2015, and to enter into force in 2020. By 1<sup>st</sup> November, 2015, the UNFCCC secretariat will prepare a synthesis report to assess whether the submitted INDCs put us on track to keep global warming below the ceiling of 2°C above pre-industrial levels.<sup>12</sup>

On 29<sup>th</sup> May, 2015, the EU called on the Paris global climate deal to include clear provisions on how countries can count the use of international markets towards their climate commitments. The EU believes that a lack of clear provisions would not only undermine the ambition and environmental integrity of the global agreement but also "the transparency of contributions and the accountability of parties".<sup>13</sup>

### ► Negotiations on the EU-China Comprehensive Agreement on Investment (CAI)

The Carbon Market Working Group would like to emphasise the need to promote fairness, openness and transparency in China's Pilot ETSs by allowing the market to play a greater role. Moreover, in order for the future CAI to be truly comprehensive, it should include certain provisions that address low-carbon and low-emissions products and services, thereby enhancing technology transfer around the globe.

8 *China issues 3 million CCERs*, Carbon Pulse, 18<sup>th</sup> May, 2015, viewed 19<sup>th</sup> May, 2015, <<http://carbon-pulse.com/china-issues-3-million-ccers/>>

9 *China takes step to set up carbon futures exchange*, Carbon Pulse, 21<sup>st</sup> April, 2015, viewed 19<sup>th</sup> May, 2015, <<http://carbon-pulse.com/china-takes-step-to-set-up-carbon-futures-exchange/>>

10 *Report of the Conference of the Parties on its nineteenth session, held in Warsaw from 11 to 23 November 2013*, UNFCCC, 31 January, 2014, viewed on 24 June, 2015, <<http://unfccc.int/resource/docs/2013/cop19/eng/10a01.pdf#page=3>>

11 *Enhanced Actions on Climate Change: China's Intended Nationally Determined Contributions*, 30<sup>th</sup> June, 2015, viewed on 6<sup>th</sup> July, 2015, <<http://www4.unfccc.int/submissions/INDC/Published%20Documents/China/1/China%27s%20INDC%20-%20on%2030%20June%202015.pdf>>

12 European Commission Directorate-General for Climate Action, European Commission, 29<sup>th</sup> May, 2015, viewed 3<sup>rd</sup> June, 2015, <[http://ec.europa.eu/clima/policies/international/negotiations/future/index\\_en.htm](http://ec.europa.eu/clima/policies/international/negotiations/future/index_en.htm)>

13 *EU finds voice on use of carbon markets in UN climate deal*, Carbon Pulse, 2<sup>nd</sup> June, 2015, viewed 3<sup>rd</sup> June, 2015, <<http://carbon-pulse.com/eu-finds-voice-on-use-of-carbon-markets-in-un-climate-deal/>>

## Key Recommendations

### 1. Promote Fairness, Openness and Transparency in China's Pilot Emissions Trading Schemes (ETSs)

#### Concern

Although the launch of the pilot ETS represents a milestone in the Chinese environmental regulatory framework, the lack of fairness, openness and transparency in the system creates an environment in which fair competition is not guaranteed to all participants.

#### Assessment

##### Publication of ETS data

Well-designed measurement, reporting and verification (MRV) guidelines, although necessary, are not sufficient to establish the credibility of an ETS. Given the importance and sensitivity of MRV data, market participants and the public in general are more likely to trust its accuracy if the process by which it is collected and verified is perceived as open and accountable, and follows international standards.

Emissions Trading Schemes regulators should provide access to complete, unrestricted data on trading, emissions and compliance, which promotes public confidence in the environmental integrity of the scheme and financial integrity of the allowance and CCER market. This will provide an additional level of scrutiny, allowing third parties and competitors to assist in checking for irregularities and detecting fraud.

Regulated firms require market information regarding supply and demand imbalances, and allowance usage in order to design and implement a sound compliance strategy. The lack of data not only harms the regulated community, but also makes markets more volatile and open to manipulation.

##### Stakeholder involvement

In a market aiming to be open, fair and transparent rule making and communication between regulators and stakeholders plays a very important role. Transparency of information and appropriate and continuous involvement of stakeholders are key to ensuring that the regulations are well-targeted, coherent with the experience and the views of market participants, and evidence-based. Unfortunately, the level of openness

and the frequency of involvement still fails to meet the stakeholders' expectations.

##### Proposed allocation mechanism for new entrants in the petrochemical and chemical industry

Relevant policies and rules are being formulated via a top-down process on the basis of research by local universities and consulting firms without significant stakeholder involvement. As a result, a benchmark based on tonnes of CO<sub>2</sub> per Chinese Yuan (CNY) output has been proposed.<sup>14</sup>

But such a proposed benchmark is disconnected from industry performance in terms of energy efficiency, and neglects the heterogeneity within the industry sectors. The lack of industry stakeholders' involvement has resulted in a regulation being produced which is not coherent with the reality of a complex industry sector and ultimately not effective in reaching its targets.

##### Accreditation of Foreign Designated Operational Entities (DOEs)

In order to improve the credibility of pilot ETSs, China needs to develop an effective, accountable regulatory framework to measure, report and verify carbon emissions.

An essential role in providing reliable data is played by DOEs, whose competence and quality of their processes are paramount to ensure the ETS's credibility and integrity. Therefore, the implementation of an effective accreditation process is key to ensuring that DOEs operating in the scheme are reliable and qualified to give an expert opinion on emission reports and to establish and issue verification reports and statements.

The fact that it is taken for granted that an accreditation process should rely on technical elements and aim at the selection of the most qualified entities leads to doubts over the effectiveness of China's current framework. The implemented accreditation rules, both in the CCER scheme and pilot ETS, has resulted in the exclusion of foreign DOEs and, in some cases, the accreditation of entities previously not involved in any emissions market.

No foreign DOE has received accreditation in any of the

<sup>14</sup> Notice on Carbon Emissions Intensity, Beijing Development and Reform Commission, 8<sup>th</sup> May, 2014, viewed 5<sup>th</sup> June, 2014, < <http://www.bjpc.gov.cn/tzq/201405/t7684245.htm> >



Chinese pilot ETSs so far, despite their accreditation in more established emissions markets and experience in validation and verification of emissions reduction projects in China. This demonstrates that the accreditation rules, or the way in which they are being applied, create unfair market entry barriers for foreign entities and favour local DOEs. This approach weakens the schemes by:

- denying access to much needed knowledge and international market experience;
- not enabling Chinese DOEs to improve their processes and qualifications by operating in the same market with more experienced competitors;
- leaving the MRV market—which lacks a sufficient number of qualified operators—vulnerable to distortions, causing harm to the regulated community; and
- rendering Chinese DOEs more vulnerable to Chinese corporate influence, thereby making them less accountable, especially in a market unchecked by competition.

#### Grandfathering versus benchmarking

The allocation method has to ensure that emissions producers have a strong incentive to reduce emissions and produce as efficiently as possible. In this regard, free allocation on the basis of historical emissions is problematic. With grandfathering, the plants that emitted most received most allowances, meaning that the biggest polluters benefitted the most. The expectation of receiving further free allowances can also impact investment decisions towards a more emissions-intensive choice.

On the other hand, industry-specific benchmarking based on tonnes of CO<sub>2</sub> per unit of product has the potential for creating a fairer system, as it is more aligned with future growth, provides greater incentives for adopting emissions reduction technologies and applying a consistent allocation methodology for both new entrants and existing installations, and rewards early action. It encourages improvements in efficiency by allocating according to technology standards, whereas grandfathering may simply reward past inefficiency.

Chinese ETS is moving toward benchmark-based allocation mechanisms. Nevertheless, the proposed outcome for some industries, such as the petrochemical and chemical industry, does not reflect its variety in

terms of energy intensity of the different processes. This generates inconsistencies and hinders the deployment of more efficient technologies.

#### Trading of forward and futures products

China's pilot ETSs still fail to ensure the volume of transactions which are necessary to provide an explicit price signal to the market. The lack of liquidity, affecting all pilot trading platforms, hinders the price discovery process which is critical to the functioning of the market.

Established platforms in the EU ETS, such as the European Climate Exchange, enjoy high levels of market liquidity as a result of a high volume of transactions. This liquidity is vital for price discovery and has been mostly supplied to the market by trading of forward and futures contracts.

Since allowances are needed for submission only once a year under pilot ETS rules, there is little advantage for investment to keep them for the whole year. However, companies could take required positions in the futures market during the year and switch those positions as requirements of allowances materialise. This kind of flexibility is achieved with derivatives trading rather than in a spot market.

#### Foreign entity trading

Allowing foreign entities to be members and active traders in the platforms of the various pilot ETSs and the future national ETS will generate a number of benefits for both the schemes and the entities. A trading company utilises consolidated tools and processes in order to monitor exposure and minimise risks. The possibility of exploiting its centralised tools and processes, including when trading on the various Chinese platforms, will guarantee cost optimisation, better control of operational risk and compliance, consistent trading strategies and more effective risk management.

Opening trading to foreign entities will also generate benefits for the Chinese platforms and exchanges. Foreign companies will be able to manage risks more effectively and will therefore be able to be more active in the exchange and to provide more liquidity. The inclusion of highly specialised trading companies will ultimately help all market participants to accelerate their learning curve, both in risk management and in trading strategies.

### Recommendations

- Provide access to complete, unrestricted data on trading, emissions and compliance.
- Improve the policy-making process by involving appropriate stakeholders.
- Increase competition and improve data quality in the validation and verification services market by accrediting DOEs based on merit and experience for participation in the pilot ETS and CCER schemes.
- Promote fair treatment of all ETS participants by adopting allocation methodologies that recognise and reward energy efficiency and adoption of advanced technologies.
- Permit trading of forward and futures products.
- Allow foreign entities to be members and active traders in the platforms of the various pilot ETSs and future national ETS.

Please see page 236 the *Petrochemicals, Chemicals and Refining Position Paper* for Key Recommendation 2 related to the ETS and the chemical industry.

## 2. Develop the National ETS so that it Contributes to Cost-Effective Emission Reductions En Route to a Low-Carbon China

### Concern

China has seven operational ETS pilots as of 2015, and in the coming years a nationwide ETS will be developed. Given the various complexities surrounding this development, it is by no means a given that the national scheme will deliver what it is intended to deliver: a contribution to cost-effective emission reductions that will help China to reach its GHG emissions reduction goals.

### Assessment

In 2014, the emerging Chinese carbon market further matured. Most pilots finished their first year with high compliance rates, the national offset market further developed and the first steps towards the national emissions trading market were set. Through statements released by the NDRC in early 2015, it became clear how the development of the national carbon market is foreseen. In the second half of 2016 or early 2017, the process of establishing a national ETS is expected to begin with the aim of allowing it to become the guiding

and leading GHG mitigation instrument by 2020.

The final objective for the national ETS, as confirmed by the NDRC and as outlined above, can only be supported. A well-designed national ETS for China can ensure that emissions reductions are achieved at the lowest possible cost by putting a clear price on carbon.

However, achieving a nationwide ETS is by no means a given in China considering the various complexities that could impact its development. First, it is key that policy-makers continue to stress that emissions trading is a tool with the primary objective of abating emissions, and not a tool to make money – this distinction is not always clear in the Chinese carbon market. In most of the presentations and materials available on the Chinese ETSs, sound data on emission projections, required reductions and possible resulting prices are not present and a lot of emphasis is put on trade and technicalities. This will only change over time if policy-makers continue to acknowledge and stress that the fundamental goal of ETSs is to mitigate emissions.

Second, it is vital that the design of the national ETS is consistent with the recent pledges by the Chinese Government to achieve its CO<sub>2</sub> emissions peak by 2030 at the latest. The cap-setting process—based on either absolute or intensity-based cap-setting principles—should be founded on sound and transparent data on the development of emissions in the various sectors of the economy and it should include a clear vision on the necessary abatement. If this is combined with data on the costs of abatement in the various sectors included in the ETS, as well as non-ETS sectors, where offset mechanisms could be applied, it will help to create a market where the prices are explainable in terms of the short- and long-term policy goals as well.

Third, economic development in China varies significantly between its different regions. This can affect their ability to take up the abatement costs and to ensure institutional capacity required for establishing the infrastructure for a successful trading scheme. This could hamper the development of a well-functioning ETS and could result in lengthy discussions on, for example, the fairness of the distribution of the abatement burden.

Moreover, the scheme should be consistent with existing policies. Interaction with other policies could easily affect the effectiveness of the ETS as a tool to





deliver low-cost reductions.

Finally, it remains a challenge to let a free, market-based emissions trading policy instrument function amidst regulated market environments, such as the power market, which makes it difficult to pass on the carbon costs through the value chain. It is very important that each of these challenges receive ample consideration right from the start to give the national ETS the best chance of delivering its full potential.

#### Recommendations

- Acknowledge and stress the fundamental goal of emissions trading, which is to mitigate emissions at the lowest possible cost.
- Determine the cap for the national ETS based on sound and transparent data.
- Explicitly couple the ETS design in terms of cap-setting with China's pledge to peak emissions as soon as possible.
- Link the design, in terms of cap-setting and offset use, to mitigate costs in the ETS and—via the offset mechanisms—to the non-ETS sectors.
- Give ample consideration to other key fundamental issues surrounding the national ETS design, such as the link to other existing policies, the existence of a regulated power market in China and the significant differences within China in terms of economic development, structure and institutional capacity.

### 3. Urge Governments along with Civil Society and the Private Sector to Work Together to Reach a New International Climate Change Agreement by 2015

#### Concern

Although the 2014 Intergovernmental Panel on Climate Change's (IPCC's) report<sup>15</sup> states that it is still possible to limit a global average temperature rise to 2°C, effective mitigation will not be achieved if individual agents continue to advance their own interests independently.

<sup>15</sup> Edenhofer, O., R. Pichs-Madruga, Y. Sokona, E. Farahani, S. Kadner, K. Seyboth, A. Adler, I. Baum, S. Brunner, P. Eickemeier, B. Kriemann, J. Savolainen, S. Schl.ner, C. von Stechow, T. Zwickel and J.C. Minx (eds.), *IPCC, 2014: Summary for Policymakers, In: Climate Change 2014, Mitigation of Climate Change. Contribution of Working Group III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change*, Cambridge University Press, Cambridge and New York, 2014, p. 5.

#### Assessment

International climate change negotiations have traditionally been driven at a national level, only recently has it been recognised that an important role can and should be played by local governments, cities, the private sector and civil society.<sup>16</sup> Climate change requires collective action on a global scale, because most GHGs accumulate over time and mix globally. Moreover, emissions by any agent—individuals, communities, companies or countries— affect other agents. Recognising the proactive role and responsibilities that other stakeholders such as European businesses operating in China have, the European Chamber applied for observer status to the UNFCCC in 2015.

The 2014 IPCC report states that even if all countries continue their current emissions reduction commitments and contributions, we are far from a pathway that limits a global average temperature rise to 2°C above pre-industrial levels. In fact, in the absence of efforts beyond those that are already in place, the global average surface temperature could increase from 3.7°C to 4.8°C above pre-industrial levels. In this context, the aggregated effects of the ambitious INDCs<sup>17</sup> that are being disclosed ahead of the Conference of the Parties (COP) in December 2015 in Paris are essential to keep the world on a low-emissions pathway.

Last year's IPCC report says that the adoption of aggressive measures that rapidly reduce emissions is both technically and physically feasible. However, shifting to a low-emissions pathway requires large-scale transformation. Therefore, the IPCC report was a "wakeup call for entrepreneurs".<sup>18</sup> It strengthens the argument that businesses need to increase the pace of action and to call upon governments to lead and cooperate with the private sector and civil society in order to prevent dangerous climate change.

<sup>16</sup> Incoming COP 21/CMP 11 President Laurent Fabius, Foreign Minister of France, suggested at the opening of the Climate Change Conference in Bonn (1<sup>st</sup> – 11<sup>th</sup> June, 2015) that the role and contributions of non-state actors is one of the four pillars that will underpin success in Paris, <<http://www.iisd.ca/vol12/enb12629e.html>>

<sup>17</sup> The first seven INDCs were submitted to UNFCCC by Switzerland on 27<sup>th</sup> February, by the EU on 6<sup>th</sup> March, by Norway on 26<sup>th</sup> March, by Mexico on 30<sup>th</sup> March, by the US on 31<sup>st</sup> March, by Gabon and by Russia on 1<sup>st</sup> April. For more information and updates on INDCs and pledges view <<http://unep.org/climatechange/pledgepipeline>>

<sup>18</sup> *UN Climate Report a 'Wakeup' for Entrepreneurs: Kerry, Business Recorder*, 13<sup>th</sup> April, 2014, viewed 24<sup>th</sup> June 2015, <<http://www.brecorder.com/top-news/1-front-top-news/167393-un-climate-report-a-wakeup-for-entrepreneurs-kerry.html>>







European Chamber  
中国欧盟商会

Many leading businesses are already well aware of the need for collective action. For example, at the Business and Climate Summit in Paris in May 2015, there was an unprecedented mobilisation of 25 worldwide business networks representing over 6.5 million companies from more than 130 countries pledging to lead the global transition to a low-carbon, climate-resilient economy. Moreover, on 19 May, 2015 11 forward-thinking international leaders from 12 states and provinces spanning seven countries signed an agreement to commit to either reducing their GHG emissions between 80 to 95 per cent below 1990 levels by 2050, or to achieve a per capita emissions target of less than two metric tonnes by the same date.<sup>19</sup>

### Recommendations

- Encourage the EU to stick to its binding emissions target of at least 40 per cent domestic reduction of greenhouse gas (GHG) emissions by 2030, compared to 1990 levels in order to continue its leadership in tackling climate change while boosting innovation and economic growth.
- Incentivise China to reduce its emissions per unit of GDP by 60 to 65 per cent from 2005 levels, and increase the share of non-fossil fuels as part of its primary energy consumption to about 20 per cent by 2030, in line with submitted INDCs while putting China on a low carbon pathway.
- Recognise the need for a proactive role of non-state actors including local governments, civil society and the private sector to work together towards transformative and ambitious actions that provide practical solutions commensurate with the challenge of climate change.

## Abbreviations

CAI	Comprehensive Agreement on Investment
CNY	Chinese Yuan
CO <sub>2</sub>	Carbon Dioxide
CCER	Chinese Certified Emission Reduction
COP	Conference of the Parties
DOE	Designated Operational Entity
ETS	Emissions Trading Scheme
EU	European Union
FTZ	Free Trade Zone
FYP	Five-Year Plan
GDP	Gross Domestic Product
GHG	Greenhouse Gas
INDC	Intended Nationally Determined Contributions
IPCC	Intergovernmental Panel on Climate Change
MRV	Measurement, Reporting and Verification
NDRC	National Development and Reform Commission
UNFCCC	United Nations Framework Convention on Climate Change
US	United States

<sup>19</sup> Governor Brown, *International Leaders Form Historic Partnership to Fight Climate Change*, California Governor's Office, 19<sup>th</sup> May, 2014, viewed 24<sup>th</sup> June, 2015, <[http://under2mou.org/?page\\_id=447](http://under2mou.org/?page_id=447)>





## Cosmetics Working Group

### Key Recommendations

#### 1. Revise the Cosmetics Hygienic Management Rules (CHMR)

- Revise the *Cosmetics Hygienic Management Rules (CHMR)* and implement a policy that streamlines administration, to reduce premarket registration and to establish a highly-efficient cosmetics regulation system that is based on risk assessment, focuses on post market supervision, the responsible-person system, social co-governance and takes full account of the actual features of cosmetics products.

#### 2. Improve the Classification Management System for Cosmetics Ingredients

- Improve the risk-based classification management system for cosmetics ingredients based on existing positive and negative ingredients lists, and limit the new ingredient registration to specified, special ingredients with high risk, such as new preservatives, colorants, sun-screening agents and hair dyes.
- Carry out the notification system for other common ingredients where enterprises are responsible for their safe use.

#### 3. Establish a Modern Risk Management System Based on the Product Safety Assessment and Gradually Cease the Mandatory Requirements for Animal Testing

- Issue internationally-applied safety assessment guidelines and improve the training of personnel within cosmetics legislation and inspection departments, and evaluation and testing institutes.
- Establish an institute and an effective mechanism for risk communication.
- Gradually ease the mandatory requirements for animal testing and accept alternative data for notification/registration.

#### 4. Improve Registration and Notification Processes of Cosmetics Products

- Further improve notification procedures for domestic, non-special cosmetics, unify notification standards of each provincial Food and Drug Administration (FDA), optimise the notification system for the convenience of regulators and enterprises, improve training of evaluation institutes at the provincial level on laws and regulations, and establish an enquiry channel with the CFDA to coordinate disputes.
- Identify time limits for obtaining certain administrative permits and make the assessment progress transparent.
- Subject imported, non-special cosmetics to the same notification requirements as domestic, non-special cosmetics.

#### 5. Improve the Management of Efficacy Claims and Labelling

- Establish through provisions regarding efficacy claims, scientific and proper guidance on basic requirements, testing methods, qualifications of efficacy-verification institutes and information disclosure of evaluation reports.
- Adopt ISO24443 test standards and reports.
- Ensure the new labelling management rules are compatible with existing regulatory requirements and





global practices.

- Allow a sufficient transition period for industry to adjust to the amendment of regulations concerning labelling.

## 6. Establish a Well-organised Post-market Surveillance System

- Improve the training of front-line supervisors, so as to ensure standardised enforcement of laws and regulations.
- Define the supervision priorities pursuant to different risk levels, to avoid insufficient or over supervision.
- Standardise the implementation of advertising laws and regulations and clarify the principles for handling any overlap between relevant laws and regulations.
- Revise the *Measures for the Management of Cosmetics Advertising* and the *Measures for the Management of Printed Matter Advertising*.

## 7. Solve Business-related Issues

- Apply the *Notice on Pre-tax Deduction of Advertising and Business Promotion Expenses* equally to enterprises that sell, but do not manufacture their cosmetics products in China; and unify and regulate local authorities' implementation of this notice.
- Maintain the existing consumption tax on skin-care products and reduce or abolish consumption tax on make-up and perfume products.

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.

## Working Group Introduction

The Cosmetics Working Group consists of more than 50 registered member companies with a diverse range of business models, including a large number of international leading cosmetics brands. The majority of the members have established research and development (R&D) and production facilities in China, and are leaders in the industry. Their expertise in the industry is widely recognised by consumers and has contributed significantly to the development of the cosmetics industry in China. Their presence has acted as a catalyst for other major industries, such as fine chemicals, packaging, logistics and advertising industries.

The Cosmetics Working Group aims to:

- represent the interests of European cosmetics enterprises and facilitate information exchange among members, professional associations and regulatory bodies, with the main objective of enabling dialogue between European Chamber members and China's relevant authorities;
- promote healthy and sustainable development of China's cosmetics industry and develop an efficient, fair

- and transparent regulatory environment; and
- protect consumers' safety.

## Recent Developments

The cosmetics industry in China continued to gain momentum in 2014, by virtue of the intense local capital investment and the expansion of marketing channels through the emergence of the e-commerce business model. The sales volume of the cosmetics industry in China exceeded an estimated Chinese Yuan (CNY) 210 billion in 2014, with China remaining the second largest cosmetics consumption market in the world after the United States.

To ensure the safety of cosmetics products, the CFDA continues to deepen reforms in the cosmetics regulatory system. For example, in 2014, the CFDA launched the first revisions of the CHMR since its publication in 1989. The regulations that are currently enforced or in process of being amended include the *List of Used Cosmetics Ingredients*,<sup>1</sup> the *Safety and Technical Standards*

<sup>1</sup> *List of Used Cosmetics Ingredients*, CFDA, 30<sup>th</sup> June, 2014, viewed 20<sup>th</sup> July, 2015, <<http://www.sda.gov.cn/WS01/CL0087/102178.html>>





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> Say?	What is the reality?	Status
<p>I. ... 3. Economic system reform is the focus of deepening the reform comprehensively. The underlying issue is how to strike a balance between the role of the government and that of the market, and let the market play the decisive role in allocating resources and let the government play its functions better. It is a general rule of the market economy that the market decides the allocation of resources. We have to follow this rule when we improve the socialist market economy. We should work hard to address the problems of market imperfection, too much government interference and poor oversight.</p>	<p>The post-market supervision system needs to be further improved to make it more risk-focused.</p>	
	<p>It is good to see the concept of 'responsible-person system' introduced in the current draft of <i>CHMR</i>. The working group is looking forward to seeing its implementation, as it is the basis of streamlining administration and decentralising authority.</p>	
<p>IV. ...15. Fully and correctly performing government functions. We will further streamline the administration and delegate more power to lower levels, deepen the reform of the system concerning matters subject to government examination and approval, and reduce the central government's administration in micro affairs to the greatest extent. We will cancel all administrative approval procedures for economic activities under the effective regulation of the market mechanism. We will manage matters that require administrative approval according to procedures and with high efficiency. We will transfer large-scale and widely-participated-in social and economic projects to local and community-level management for convenience and efficiency.</p>	<p>The domestic, non-special cosmetics notification system has been welcomed by the industry and worked well in a lot of provinces. However, in some provinces registration requirements still apply.</p>	
	<p>Imported, non-special cosmetics are required to be registered with the CFDA before entering the Chinese market. Complicated review and approval procedures are inefficient, and the policy for delegating powers to lower-levels of government has not been implemented.</p>	

of *Cosmetics* (call for comments),<sup>2</sup> *The Labelling Management Rules* (call for comments),<sup>3</sup> the *Efficacy Verification Guidance* (draft), the *Safety Assessment Guidance* (draft), *The Cosmetics Manufacturing Licence Guidance* (tentative) and the *Inspection Key Points of Cosmetics Manufacturing Licence* (tentative).<sup>4</sup> Meanwhile, several government departments have responded to the policy of deepening economic reforms and have published much guidance, and tentative regulations for free trade zones (FTZs) and e-commerce development, much of which will impact the cosmetics

industry. These emerging changes have already exerted a far-reaching influence on the industry, both in terms of business and law enforcement.

Over the past year, the Cosmetics Working Group has not only devoted efforts to promoting the development of the cosmetics industry, it has also assisted the government to establish a forward-thinking regulatory system to build a well-ordered and innovation-orientated market environment.

The Cosmetics Working Group paid great attention to the Third Plenum and the developments that took place following the promulgation of the *Decision*.<sup>5</sup> In the Third

<sup>2</sup> *Safety and Technical Standards of Cosmetics (call for comments)*, CFDA, 19<sup>th</sup> October, 2014, viewed 20<sup>th</sup> July, 2015, <<http://www.sda.gov.cn/WS01/CL0781/66177.html>>

<sup>3</sup> *Labelling Management Rules (call for comments)*, CFDA, 15<sup>th</sup> November, 2014, viewed 20<sup>th</sup> July, 2015, <<http://www.sda.gov.cn/WS01/CL0781/109234.html>>

<sup>4</sup> *Safety Assessment Guidance (draft), The Cosmetics Manufacturing Licence Guidance (tentative) and the Inspection Key Points of Cosmetic Manufacturing Licence (tentative)*, CFDA, 17<sup>th</sup> March, 2015, viewed 20<sup>th</sup> July, 2015, <<http://www.sda.gov.cn/WS01/CL0781/115740.html>>

<sup>5</sup> *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform*, Xinhua, 15<sup>th</sup> November, 2013, viewed 3<sup>rd</sup> July, 2015, <[http://news.xinhuanet.com/2013-11/15/c\\_118164235.htm](http://news.xinhuanet.com/2013-11/15/c_118164235.htm)>



Plenum Reality Check table, the working group provides a review of developments that have taken place since, from the perspective of the cosmetics industry.

## Key Recommendations

### 1. Revise the Cosmetics Hygienic Management Rules (CHMR)

#### Concern

As the only administrative law for the cosmetics industry, the *Cosmetics Hygienic Management Rules (CHMR)*, which are “concerned more about licensing instead of supervision”, is now unable to satisfy the demands of scientific supervision and will hinder the technical innovation and sustainable development of the cosmetics industry.

#### Assessment

The working group suggests revising the *CHMR* by taking the following steps:

- Distinguish the responsibilities between enterprises and the government and ensure the fulfillment of their respective duties.
- Optimise the supervision of products and ingredients: Maintain the relative stability of the definitions and classification of cosmetics products, define some marginal products and implement a risk-based classification management system.
- Enhance the in- and post-market supervision system: Establish Good Manufacturing Practice (GMP) for the cosmetics industry, a post-market system for detection of undesirable effects on human health of cosmetics products, an in-market inspection system and a product recalling system.
- Publish internationally-accepted safety assessment procedures, improve the training of relevant government institutes and gradually cease animal testing.
- Establish a unified standard management system for cosmetics, delete and integrate repeated standards and adopt advanced international standards.
- Improve the labelling and advertising management systems, such as unifying the labelling management rules, formulating basic principles on efficacy claims of cosmetics and maintaining a management mode mainly based on self-discipline of the industry and market supervision.

#### Recommendation

- Revise the *Cosmetics Hygienic Management Rules (CHMR)* and implement a policy that streamlines administration, to reduce premarket registration and to establish a highly-efficient cosmetics regulation system that is based on risk assessment, focuses on post market supervision, a responsible-person system, social co-governance and that takes full account of the actual features of cosmetics products.

### 2. Improve the Classification Management System for Cosmetics Ingredients

#### Concern

The existing registration management system for new cosmetics ingredients has hindered technical innovation and development of the industry.

#### Assessment

Unlike foods and pharmaceuticals, cosmetics ingredients and products are mainly used on the skin with relatively low exposure and low risk to human safety. With the fast and sound growth of the cosmetics industry in recent years, tens of thousands of cosmetics ingredients have been safely introduced on the basis of a safety assessment. The *International Nomenclature of Cosmetics Ingredients (INCI)* dictionary (2014 version) recently published by the Personal Care Products Council, includes about 21,000 ingredients. The *List of Used Cosmetics Ingredients*, published in June 2014 by the CFDA, only included 8,783 ingredients, though, which means a lot of internationally-accepted cosmetics ingredients cannot be used in China unless they pass administrative registration. However, registration of new ingredients usually takes a long time.

Furthermore, the requirements on data are far too strict, and this has resulted in only 13 new ingredients being approved since the publication of *CHMR* in 1989. This demonstrates the extent to which the existing registration system for new cosmetics ingredients has failed to promote technical innovation.

#### Recommendations

- Improve the risk-based classification management system for cosmetics ingredients based on existing positive and negative ingredients lists, and limit the new ingredient registration to specified, special ingredients with high risk, such as new preservatives, colorants, sun-screening agents and hair dyes.
- Carry out the notification system for other common



ingredients where enterprises are responsible for their safe use.

### 3. Establish a Modern Risk Management System Based on a Product Safety Assessment and Gradually Cease the Mandatory Requirements for Animal Testing

#### Concern

Animal testing in China's cosmetics industry is still mandatory for proving the safety of products and no alternative testing data is currently accepted by regulators. So far, China has not published an internationally-accepted safety assessment guideline and there is no effective risk communication institute or mechanism in the cosmetics industry.

#### Assessment

The general modern principle and methodology of toxicology, such as the weight of evidence principle, and the threshold of toxicological concern (TTC) approach, are used internationally for safety assessments of cosmetics ingredients and products. However, they have not become part of the existing registration of cosmetics ingredients and products in China, mainly because there has been no internationally-accepted safety assessment guidance issued in China. Meanwhile, the training of cosmetics legislation and inspection departments, product evaluation and testing institutes is currently insufficient.

There has been an international trend of banning animal testing for cosmetics. More and more countries and regions have joined the list, including the European Union (EU), India, Israel, South Korea, Australia, Vietnam, New Zealand and Taiwan.

Since the safety of cosmetics products has consistently drawn media focus, the CFDA should endeavour to establish a suitable mechanism and qualified institutes capable of guiding the media to clarify any confusion arising from consumers in the event of the occurrence of public safety crises.

#### Recommendations

- Issue internationally-applied safety assessment guidelines, and improve the training of personnel within cosmetics legislation and inspection departments, and evaluation and testing institutes.
- Establish an institute and an effective mechanism for

risk communication.

- Gradually ease the mandatory requirements for animal testing, and accept alternative data for notification/registration.

### 4. Improve Registration and Notification Processes of Cosmetics Products

#### 4.1 Notification Processes of Domestic, Non-special Cosmetics

#### Concern

Different provincial FDAs have different implantation standards for the notification of domestic, non-special cosmetics – some provinces apply complicated registration processes making it impossible to fully implement the notification of these products.

#### Assessment

There is no detailed implementation standard for the notification of domestic, non-special cosmetics. Therefore local officials have interpreted relevant laws and regulations differently, which has led to imperfect implementation of the notification system.

#### Recommendation

- Further improve notification procedures for domestic, non-special cosmetics, unify notification standards of each provincial Food and Drug Administration (FDA), optimise the notification system for the convenience of regulators and enterprises, improve training of evaluation institutes at the provincial level on laws and regulations, and establish an enquiry channel with the CFDA to coordinate disputes.

#### 4.2 Time Limits and Procedures of Administrative Permits

#### Concern

Problems concerning certain administrative permits mainly focus on the absence of time limits and the non-transparent progress of review procedures: enterprises do not have a clear understanding of the whole review process, which has led to unnecessary economic losses in manufacturing and through trying to remain legally compliant with a system that lacks clarity.

#### Assessment

Some administrative permits required by the CFDA, such as those for changing registration, renewing applications and improving documentation, lack time



limits for reviewing and are not transparent in terms of approval progress. Approval processes for some cases take a very long, which is contrary to the original intention of the CFDA to handle “within a certain time limit” and handle “transparently”.

#### Recommendation

- Identify time limits for obtaining certain administrative permits and make the assessment progress transparent.

### 4.3 Registration of Imported Non-special Cosmetics

#### Concern

The current approval process for registering imported, non-special cosmetics before they can access the Chinese market is time-consuming and complicated.

#### Assessment

The Cosmetics Working Group supports the CFDA's proposal to delegate the notification of imported, non-special cosmetics to the provincial FDA. Given the good safety record of non-special cosmetics, it is advisable to carry out the same notification management for imported, non-special cosmetics at the provincial FDA, as those for domestic, non-special cosmetics. It will not only enhance the efficiency of administrative supervision, but will also reflect the policy of “streamlining administration and decentralisation” endorsed by the State Council.

#### Recommendation

- Subject imported, non-special cosmetics to the same notification requirements as domestic, non-special cosmetics.

## 5. Improve the Management of Efficacy Claims and Labelling

### 5.1 Management of Efficacy Claims

#### Concern

There is presently no clear and unified guidance for the management of efficacy claims.

#### Assessment

Efficacy claims should be scientific and rational, following the guidance below:

- Clarification of the basic requirements: the efficacy claim should be based on adequate scientific

experiments or evaluation data.

- Management of verification methods: it is advisable to formulate the guidance for methodological demonstration while drafting the method guidance, so as to introduce new methods. However, the guidance should not be regarded as standards in operation.
- Management of efficacy verification institutes: there is no need to manage efficacy verification institutes through administrative approval. Furthermore, foreign laboratories shall be accepted.
- Management of evaluation reports: supervision and management departments may require enterprises to show evaluation reports in the process of in-market inspections. It should not be necessary to publish the details of evaluation reports on a website.

#### Recommendation

- Establish through provisions regarding efficacy claims, scientific and proper guidance on basic requirements, testing methods, qualifications of efficacy-verification institutes and information disclosure of evaluation reports.

### 5.2 Unify Testing Methods of Sunscreen Products

#### Concern

So far the internationally-accepted ISO24443 Ultra Violet A (UVA) sunscreen protection measurement (vitro method) has not been accepted in China.

#### Assessment

The International Organisation for Standardisation (ISO) has issued three standards for sunscreen tests, which have been accepted by Europe, Japan, Australia and many other countries. In China, both ISO24442 and ISO24444 have been referenced and quoted, but ISO24443, regarding UVA protection measurement (in vitro), has not.

#### Recommendation

- Adopt ISO24443 test standards and reports.

### 5.3 Management of Labelling

#### Concern

Labelling requirements in some call for comments drafts are not compatible with features of cosmetics and are therefore difficult to implement.



### Assessment

Cosmetics products in China still need to follow multiple compulsory regulations such as GB 5296.3<sup>6</sup> and the *General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) Cosmetics Labelling Administration Rules*.<sup>7</sup> Specifically for imported products, labelling must also comply with the regulatory requirements of the countries/regions of origin. Frequent changes to labelling requirements may increase the burden of enterprises and cause unnecessary waste of packaging materials.

### Recommendation

- Ensure the new labelling management rules are compatible with existing regulatory requirements and global practices.
- Allow a sufficient transition period for industry to adjust to the amendment of regulations concerning labelling.

## 6. Establish a Well-organised Post-market Surveillance System

### 6.1 Standardise Post-market Surveillance

#### Concern

There exist some problems in post-market surveillance, such as non-standardised law enforcement and a lack of rationality regarding targets under supervision.

#### Assessment

In 2014, supervision departments at the local level were established to implement the policy of strengthening supervision of cosmetics. However, some supervisors from Administration for Industry and Commerce (AIC), the FDA and the China Entry-Exit Inspection and Quarantine Bureau (CIQ) have no experience in the supervision of cosmetics which has led misjudgements, unnecessary confusion and economic losses to enterprises.

Moreover, supervision priorities are not determined on the basis of risk level. For example, in recent years, no severe safety incident has occurred due to excessive heavy metal residue, yet some local supervision departments still put much emphasis on trace levels of heavy metals contained in cosmetics. Consequently,

6 *Instruction for Use of Consumer Products – General Labelling for Cosmetics GB 5296.3*, MOFCOM, 11<sup>th</sup> September, 2012, viewed 20<sup>th</sup> July, 2015, <<http://policy.mofcom.gov.cn/export/cosmetic2012/a2.action>>

7 *The Cosmetic Labelling Administration Rules*, AQSIQ, 27<sup>th</sup> August, 2014, viewed 20<sup>th</sup> July, 2015, <[http://www.aqsiq.gov.cn/xxgk\\_13386/jlgg\\_12538/zjl/20072008/200708/20070831\\_239313.htm](http://www.aqsiq.gov.cn/xxgk_13386/jlgg_12538/zjl/20072008/200708/20070831_239313.htm)>

cosmetics enterprises have to spend much time and energy clarifying the safety of their products and compliance with relevant laws.

### Recommendations

- Improve the training of front-line supervisors, so as to ensure standardised enforcement of laws and regulations.
- Define the supervision priorities pursuant to different risk levels, to avoid insufficient or over supervision.

### 6.2 Specify Advertising Laws and Standardise Related Law Enforcement

#### Concern

Multiple supervision regulations concerning cosmetics advertising have resulted in inconsistent criteria for law enforcement: law enforcement officials are often left to interpret and enforce the regulations based on their personal understanding of the situation, resulting in a wide variation of penalties handed down to enterprises.

#### Assessment

There are four main laws and regulations that relate to the advertising of cosmetics, including the Advertising Law (the newly-revised law coming into effect on 1<sup>st</sup> September, 2015),<sup>8</sup> *Measures for the Management of Cosmetics Advertising*,<sup>9</sup> *Measures for the Management of Printed Matter Advertising*<sup>10</sup> and the Anti-unfair Competition Law.<sup>11</sup> These laws and regulations mandate different penalties for the same violations and do not clearly state some conceptual provisions. The interpretations of such provisions by local AIC bureaus are not exactly the same, leaving a lot of room for subjective interpretation and discretion in enforcement.

### Recommendations

- Standardise the implementation of advertising laws and regulations and clarify the principles for handling any overlap between relevant laws and regulations.
- Revise the *Measures for the Management of Cosmetics*

8 *The Advertising Law of People's Republic of China*, National People's Congress (NPC) Standing Committee, 5<sup>th</sup> November, 2012, viewed 20<sup>th</sup> July, <[http://www.gov.cn/fwxw/bw/spypjgj/content\\_505656.htm](http://www.gov.cn/fwxw/bw/spypjgj/content_505656.htm)>

9 *Measures for the Management of Cosmetic Advertising*, State Administration of Industry and Commerce, 13<sup>th</sup> July, 1993, viewed on 20<sup>th</sup> July, 2015, <<http://www.scfda.gov.cn/CL2476/76912.html>>

10 *Measures for the Management of Printed Matter Advertising*, 13<sup>th</sup> January, 2000, viewed 20<sup>th</sup> July 20<sup>th</sup>, 2015, <[http://www.gov.cn/gongbao/content/2000/content\\_60349.htm](http://www.gov.cn/gongbao/content/2000/content_60349.htm)>

11 *The Anti-unfair Competition Law*, NPC Standing Committee, 1<sup>st</sup> December, 1993, viewed 20<sup>th</sup> July, 2015, <[http://www.gov.cn/banshi/2005-08/31/content\\_68766.htm](http://www.gov.cn/banshi/2005-08/31/content_68766.htm)>





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中国欧盟商会

*Advertising and the Measures for the Management of Printed Matter Advertising.*

## 7. Solve Business-related Issues

### Concern

Due to gaps between the wording of laws and their practical implementation, cosmetics sales enterprises (non-manufacturing enterprises) have not actually benefited from the *Pre-tax Deduction of Advertising and Business Promotion Expenses*, which is very unfair. Moreover, since 1994, some cosmetics have been listed as luxury consumer goods and levied with heavy consumption tax of up to 30 per cent, which has hampered the development of the cosmetics industry.

### Assessment

According to the *Notice on Pre-tax Deduction of Advertising and Business Promotion Expenses*,<sup>12</sup> jointly issued by the Ministry of Finance (MOF) and the State Administration of Taxation (SAT), advertising fees coming from the cosmetics manufacturing and sales companies can be tax-deductible if they account for less than 30 per cent of the annual sales revenue of the company. According to the explanation from the MOF's Department of Taxation, this regulation is also applicable to companies that sell cosmetics within Chinese territory, but do not manufacture in China. But since the SAT has not provided a clear confirmation of this, in actual operation local taxation departments have excluded these enterprises from the scope of this policy. Therefore, these enterprises are unable to benefit from this policy, which has caused unfair competition.

Moreover, with the increase of income and consumption capacity of Chinese consumers, cosmetics have become indispensable daily consumer goods and China has become the second largest cosmetics market in the world. This would tend to suggest that the consumer tax of up to 30 per cent on make-up and perfume is obviously outdated.

### Recommendations

- Apply the *Notice on Pre-tax Deduction of Advertising and Business Promotion Expenses* equally to enterprises that sell, but do not manufacture their cosmetics products in China; and unify and regulate

local authorities' implementation of this notice.

- Maintain the existing consumption tax on skin-care products and reduce or abolish consumption tax on make-up and perfume products.

## Abbreviations

AIC	Administration for Industry and Commerce
AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
CFDA	China Food and Drug Administration
CIQ	China Entry-Exit Inspection and Quarantine Bureau
CHMR	Cosmetics Hygienic Management Rules
EU	European Union
FDA	Food and Drug Administration
FTZ	Free Trade Zones
ISO	International Organisation for Standardisation
MOF	Ministry of Finance
NPC	National People's Congress
R&D	Research and Development
SAT	State Administration of Taxation
TTC	Threshold of Toxicological Concern
UVA	Ultra Violet A (short-wave ultra violet radiation)

<sup>12</sup> *The Notice on Pre-tax Deduction of Advertising and Business Promotion Expenses*, MOF & SAT, 14<sup>th</sup> June, 2012, viewed 20<sup>th</sup> July, 2015, <[http://www.gov.cn/zwqk/2012-06/14/content\\_2160925.htm](http://www.gov.cn/zwqk/2012-06/14/content_2160925.htm)>





# Energy Working Group

## Key Recommendations

### 1. Unconventional Oil and Gas

#### 1.1 Improve Upstream Acreage and Data Access to Foster Shale Gas Development

- Strengthen acreage governance and make more quality acreage available for future public bidding by the Ministry of Land and Resources (MOLAR).
- Work out a timeline and specific rules on how foreign investors may participate in shale gas exploration and development through, for example, direct bidding or production sharing contracts (PSCs).
- Establish a model Shale Gas PSC or issue relevant guidelines as soon as possible.
- Introduce a data sharing mechanism to allow companies, including foreign companies with appropriate qualifications, to access oil and gas data.

### 2. Gas Infrastructure and Price

#### 2.1 Progressively Develop Third Party Access (TPA)

- Promote a full, transparent and non-discriminatory TPA regime for all gas midstream infrastructure, including transmission pipelines (at national and regional levels), liquefied natural gas (LNG) receiving terminals and underground storage.
- Create independent operators and provide incentives for infrastructure holders to share their gas infrastructure with other players.
- Ensure the visibility of the capacities of such infrastructure to the regulator and other market players.
- Develop clear definitions and processes for pricing, fairness, resolution of conflicts, definition of surplus capacity, and the role and power of the regulator.

#### 2.2 Accelerate the Development of Underground Gas Storage

- Develop a clear assessment of the market value of underground storage to attract private and foreign investment in this sector, and reflect it in the end-users' regulated tariffs.
- Facilitate the aggregation of storage needs and capacities at the regional level.
- Give access to underground geological data to non-national oil companies to accelerate the development of new storage capacities.

#### 2.3 Disclose a Clear Scheme for Natural Gas Pricing Reform

- Reflect the real cost of supply for each category of end users and avoid cross subsidies.
- Recognise the real value offered by natural gas to the China energy mix (flexibility, high efficiency through combined generation, low carbon emissions).
- Properly remunerate the different segments of the gas chain so as to attract investments in necessary new infrastructure, in particular storage.
- Help end users to manage their expectations and deal with risks over time.

#### 2.4 Revise the National Gas Standard to Suit Today's Industrial Needs, and Promote Energy Metering

- Revise the national gas standard to suit today's industrial needs.
- Promote energy metering.

### 3. Clean Coal

#### 3.1 Promote Clean Coal to Improve Air Quality and Energy Efficiency





- Establish a transparent, stable, long-term policy framework for clean coal development while allowing the market to play its determining role.
- Clarify the definition of demonstration projects in coal conversion as well as its link with the *Foreign Investment Industry Guidance Catalogue*.
- Clarify the role of each administration that is involved in clean coal in order to avoid an overall lack of coordination.
- Establish transparent and measurable industry standards for clean coal applications to encourage and reward best-in-class technologies in terms of sulphur oxides (SO<sub>x</sub>), nitrogen oxides (NO<sub>x</sub>), particles emissions, water utilisation and energy efficiency, and enhance the supervision of the application of such standards.
- Incentivise, promote and finance pilot projects to improve the environmental footprint of coal-based chemical products by applying, for example, carbon capture utilisation and sequestration (CCUS) with enhanced oil recovery (EOR), and open such incentives to European companies.

#### ▶ 4. Competitive and Diversified Power Market

##### 4.1 Make Dispatching Rights of Grid Companies Transparent and Access to the Power Grid Open and Fair

- Assess and adjust power transmission tariffs by setting up a reasonable price-setting mechanism.
- Open up access to the power grid and allow more electricity retailers to enter the market and introduce reasonable regional competition.
- Establish a transparent power dispatching system and a clear on-grid principle which are available to guide proper on-grid access.

##### 4.2 Ensure Rigorous Emissions Policies in the Coal-fired Power Sector and Introduce a Carbon Price and Peak-shaving, On-grid Tariff

- Enforce rigorous emissions policies to pave the way for developing an efficient and less emission-intensive power industry.
- Introduce a reasonable, peak-shaving, on-grid tariff as well as a carbon price to reflect fuel and environmental costs.
- Make environmental impact assessments (EIAs) for new coal power projects more stringent.
- Ensure that all monitoring systems are operational and methodologies are consistent with the new regulations.

##### 4.3 Develop Gas Power Generation Appropriately

- Increase the average utilisation of gas power and drive future demand growth in the next few years by applying a peak shaving tariff, carbon emissions trading and other preferential tax policies.
- Deepen the reforms related to the natural gas industry to reflect real market price levels and further deregulate gas access.

#### ▶ 5. Transportation Fuel Quality

##### 5.1 Improve Fuel Quality Standards by Enforcing Their Implementation, Opening Imports and Banning Polluting Vehicles

- Enforce the implementation of National IV & V fuel standards (GB 19147-2013).
- Spread the implementation of pilot projects to test the implementation of National IV & V fuel standards.
- Open imports of National V fuel standard oil supplies, where oil companies are unable to meet demand because of delays in refinery upgrade investments.
- Incentivise the adoption of natural gas vehicles by increasing the price of gasoline and especially diesel at pump stations.
- Ban heavily-polluting vehicles.





- Develop sufficient quality control measures that stop the blending of diesel with refined, used lubricant oil and fuel oil.
- Publish an open access policy that enables third parties to use wholesale logistics with demonstrable spare capacity at competitive market rates.
- Accelerate oil refinery enterprises' upgrades including SOx, NOx, dust removal and hydrogen conversion technologies.
- Open the investment modalities to include mergers and acquisitions (M&A) equity investments.
- Reinforce and introduce strict controls along the whole supply chain down to stations' fuel tanks in order to enforce and control actual supply of National IV & V fuels.

### **5.2 Develop Quality Standards for LNG to Allow the Automotive Industry to Develop Efficient Engines**

- Develop quality standards for LNG to allow the automotive industry to develop efficient engines.
- Increase cooperation with the European Small-Scale Liquefied Natural Gas (SSLNG) industry in order to establish international standards

### **5.3 Develop and Promote Clear Standards and Codes for the Design and Operation of SSLNG Technologies**

- Develop and promote, in partnership with experienced European industry players, clear standards and codes for the design and operation of SSLNG technologies, such as small liquefaction plants, LNG storage, fuelling stations for trucks and buses, and bunkering stations for ships.

## **6. Energy Equipment**

### **6.1 Ensure a Level Playing Field for the Introduction of Energy Equipment in the Market**

- Open access and ensure a level playing field for all market players in the energy equipment market.
- Treat foreign-invested enterprises (FIEs) in China the same as domestic Chinese enterprises so that they can enjoy fair treatment in the bidding process and can compete for business opportunities in China.
- Reduce the government's influence and encourage open and fair competition in the supply chain of energy equipment.
- Encourage collaboration between foreign companies and domestic companies for technology transfer and upgrading.

 Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.

## **Introduction to the Working Group**

The Energy Working Group is comprised of more than 50 member companies with a combined total cumulative investment in 2014 of around euros (EUR) 25 billion, and a collective employment of more than 150,000 employees in China. The largest European energy and equipment manufacturing companies as well as industrial energy consumers are active members of the working group. The working group seeks to establish an effective and constructive dialogue on energy policies with appropriate Chinese regulators, in order to:

- provide input for energy policy work in China by sharing issues and concerns as well as sharing best practices of European energy industries operating in

China;

- create fair and transparent conditions for competition between foreign and Chinese companies; and
- promote the development and integration of clean and renewable energies.

In addition, in 2009, the Renewable Energy Sub-Working Group was created and, in early 2010, the Smart Grid Sub-Working Group was established.

## **Recent Developments**

### **Unconventional Oil and Gas**

On 17<sup>th</sup> April, 2015, the Ministry of Finance (MOF) and the National Energy Administration (NEA) issued the





*Circular Regarding Financial Subsidy of Shale Gas Development.*<sup>1</sup> It states that the subsidies for shale gas development will be extended beyond 2015.<sup>2</sup> However, the subsidies for shale gas development will be cut to Chinese Yuan (CNY) 0.3 per cubic metre over the 2016-2018 period and to CNY 0.2 per cubic metre from 2019-2020.

On 23<sup>rd</sup> December, 2014, Sinopec announced that it had completed 75 test wells in its Fuling Shale Gas Field project and increased its production capacity by two billion cubic metres (BCM).<sup>3</sup> Sinopec aims to reach a production volume of 3.5 BCM by 2015<sup>4</sup> and a production capacity of five BCM by then in the Fuling Shale Gas Field. Moreover, it seeks to have a production capacity of 10 BCM by 2017. This project is the largest shale gas development project in China and its success is encouraging for European companies involved in this business.

On 19<sup>th</sup> November, 2014, China published its *Energy Development Strategy Action Plan (2014-2020) (Action Plan)*, setting targets for shifting to a lower-carbon energy mix led by gas and renewable energy.<sup>5</sup> The *Action Plan* set a target of producing 30 billion cubic metres per annum (BCMA) of shale gas by 2020. This is lower than the previous target of 60-100 BCMA set in the *Shale Gas 12<sup>th</sup> Five-Year Plan (FYP)* published in 2012.

On 1<sup>st</sup> June, 2014, the *Technical Specifications for Shale Gas Resources / Reserves Calculation and Evaluation (DZ/T0254-2014)*, issued by the Ministry of Land and Resources (MOLAR), entered into force.<sup>6</sup> This is the first shale gas technical standard in China.

In addition to the developments in exploration and production, the government also made significant

progress in gas price reforms and infrastructure access policy with the publication on 13<sup>th</sup> February, 2014, of the *Measures for Supervision of Opening Up Oil and Gas Pipeline Facilities in a Fair Manner* by the NEA, in order to encourage and facilitate shale gas development in China.<sup>7</sup>

### Gas Infrastructure and Price

On 5<sup>th</sup> January, 2015, the establishment of a natural gas exchange platform in the China (Shanghai) Pilot Free Trade Zone (CSPFTZ) was approved by the Shanghai Municipal Government.<sup>8</sup> This exchange platform, where key Chinese gas players jointly invest, will facilitate the trading of natural gas within and outside of China as soon as a Third Party Access (TPA) regime is in place.

On 28<sup>th</sup> February, 2014, the National Development and Reform Commission (NDRC) issued the *Management Measures of Natural Gas Infrastructure Construction and Operation*, subsequently coming into effect on 1<sup>st</sup> April, 2014, which addressed the issue of underground gas storage by requesting natural gas sales enterprises to establish natural gas reserves.<sup>9</sup> These measures demonstrate that China recognises the importance of underground storage for the development of the Chinese gas industry and is now inviting all concerned parties to participate in such activities with certain minimum obligations of storage quantities.

Published on 13<sup>th</sup> February, 2014, the NEA circular on the *Issuance of the Measures for Supervision of the Fair Opening of Oil and Gas Pipeline Facilities (for Trial Implementation)*<sup>10</sup> introduced the concept of TPA to unoccupied gas pipelines and related facilities (gas storage and LNG terminals) in a fair and non-discriminatory manner.

### Clean Coal

On 23<sup>rd</sup> March, 2011, the *Notice on Regulating the Orderly Development of the Coal Chemical Industry* was

1 *Circular regarding Financial Subsidy of Shale Gas Development*, MOF and NEA, 17<sup>th</sup> April, 2015, viewed 26<sup>th</sup> May, 2015, <[http://jjs.mof.gov.cn/zhengwuxinxi/zhengcefaquli/201504/t20150427\\_1223392.html](http://jjs.mof.gov.cn/zhengwuxinxi/zhengcefaquli/201504/t20150427_1223392.html)>  
2 *UPDATE 1-China cuts subsidy for shale gas development for 2016-2020*, Reuters, 29<sup>th</sup> April, 2015, viewed 26<sup>th</sup> May, 2015, <<http://af.reuters.com/article/commoditiesNews/idAFL4N0XQ31120150429>>  
3 *Sinopec Adds 2 Billion Cubic Meters Capacity to Fuling Shale Gas Field*, Sinopec, 23<sup>rd</sup> December, 2015, viewed 26<sup>th</sup> May, 2015, <[http://www.sinopecgroup.com/group/en/Sinopecnews/20150104/news\\_20150104\\_743887717236.shtml](http://www.sinopecgroup.com/group/en/Sinopecnews/20150104/news_20150104_743887717236.shtml)>  
4 *Sinopec, PetroChina Plan 40% Growth In Shale Output To Meet Goal*, Bloomberg, 17<sup>th</sup> September, 2014, viewed 26<sup>th</sup> May, 2015, <<http://www.ugcenter.com/sinopec-petrochina-plan-40-growth-shale-output-meet-goal-627566>>  
5 *Energy Development Strategy Action Plan (2014-2020)*, State Council, 19<sup>th</sup> November, 2014, viewed 20<sup>th</sup> May, 2015, <[http://www.gov.cn/zhengce/content/2014-11/19/content\\_9222.htm](http://www.gov.cn/zhengce/content/2014-11/19/content_9222.htm)>  
6 *Technical Specifications for Shale Gas Resources / Reserves Calculation and Evaluation*, MOLAR, 21<sup>st</sup> April, 2014, viewed 20<sup>th</sup> May, 2015, <[http://www.mlr.gov.cn/zwgk/zytz/201404/t20140421\\_13113335.htm](http://www.mlr.gov.cn/zwgk/zytz/201404/t20140421_13113335.htm)>

7 *Measures for Supervision of Opening Up Oil and Gas Pipeline Facilities in a Fair Manner*, NEA, 13<sup>th</sup> February, 2014, viewed 20<sup>th</sup> May, 2015, <<http://www.jdsupra.com/legalnews/encouraging-gas-development-in-china-w-66927/>>  
8 *Shanghai Free Trade Zone to Build the Natural Gas Market Pricing Center in Asia Pacific Area*, Chinabgao, 11<sup>th</sup> February, 2015, viewed 20<sup>th</sup> May, 2015, <<http://www.chinabgao.com/info/79748.html>>  
9 *Management Measures of Natural Gas Infrastructure Construction and Operation*, NDRC, 28<sup>th</sup> February, 2014, viewed on 20<sup>th</sup> May, 2015, <[http://www.gov.cn/zhengce/2014-03/20/content\\_2642222.htm](http://www.gov.cn/zhengce/2014-03/20/content_2642222.htm)>  
10 *Circular of the National Energy Administration on the Issuance of the Measures for Supervision of the Fair Opening of Oil and Gas Pipeline Facilities (for Trial Implementation)*, NEA, 2014, viewed 10<sup>th</sup> June, 2014, <[http://zfxgk.nea.gov.cn/auto92/201402/t20140224\\_1768.htm](http://zfxgk.nea.gov.cn/auto92/201402/t20140224_1768.htm)>





published by the NDRC.<sup>11</sup> The threshold for domestic coal chemical project access and approval was greatly raised, with such a substantial obstruction to project approvals bringing almost all projects to a standstill. Fifteen demonstration projects<sup>12</sup> were approved under the 12<sup>th</sup> FYP.<sup>13</sup>

The approval of projects began to loosen as of 2013. Within the month of March 2013, 10 coal chemical projects received the NDRCs preliminary approval to carry out various studies on a potential project over a short period and the call for possible commercialisation of mature coal transformation (CTX) technologies became louder.<sup>14</sup> Further encouraged by regions rich in coal, many national, regional and private coal, oil and gas, and power companies joined this new CTX wave, and some companies started construction without waiting for final approval from the NDRC.<sup>15</sup>

In 2014, China's over-investment trend halted. Modern coal chemical projects were removed from the *Catalogue of Encouraged Industries for Western Regions*, and the NEA issued the *Notice on Orderly Development of Coal to Liquid and Coal to Synthetic Natural Gas Industry*<sup>16</sup> followed by the *Energy Development Strategy Action Plan (2014-2020)*.<sup>17</sup> The market interpreted this notice as a sign of change for the modern coal chemical industry. Regulatory uncertainty and changes in policy support are puzzling investors. Obtaining financing to start new projects and for projects under construction also became increasingly difficult. But the industry believes that China still needs to rely on coal as a primary source of energy in the mid-term and considers coal-based coal chemicals as clean coal utilisation.

11 *Notice on Regulating the Orderly Development of Coal Chemical Industry*, NDRC, 23<sup>rd</sup> March, 2011, viewed 26<sup>th</sup> May, 2015, <[http://www.sdpc.gov.cn/fzggzj/gjyf/zcfcg/201104/t20110412\\_405044.html](http://www.sdpc.gov.cn/fzggzj/gjyf/zcfcg/201104/t20110412_405044.html)>

12 *Modern Coal Chemical Industry Planning to Release 15 Demonstration Projects Approved Under the 12<sup>th</sup> 5-year Plan*, *Xinhua*, 3<sup>rd</sup> July, 2012, viewed 27<sup>th</sup> May, 2015, <[http://news.xinhuanet.com/energy/2012-07/03/c\\_123361114.htm](http://news.xinhuanet.com/energy/2012-07/03/c_123361114.htm)>

13 *Modern Coal Chemical Industry Planning to Release, Project Approval Started to Relax*, *Ebnews*, 22<sup>nd</sup> March, 2013, viewed 27<sup>th</sup> May, 2015, <<http://market.ebnews.com/mhgfb/>>

14 *Ten New Coal Chemical Projects Received Lutiao from DRC*, *Cnenergy*, 7<sup>th</sup> April, 2013, viewed 27<sup>th</sup> May, 2015, <[http://www.cnenergy.org/mt/mzh/201304/t20130407\\_187634.html](http://www.cnenergy.org/mt/mzh/201304/t20130407_187634.html)>

15 *New Opportunities and Technological Revolution of New Coal Chemical Industry*, State Council, 23<sup>rd</sup> April, 2015, viewed 27<sup>th</sup> May, 2015, <[http://www.gov.cn/zhuanti/2015-04/23/content\\_2852080.htm](http://www.gov.cn/zhuanti/2015-04/23/content_2852080.htm)>

16 *Notice on Orderly Development of Coal to Liquid and Coal to Synthetic Natural Gas Industry*, NEA, 17<sup>th</sup> July, 2014, viewed 20<sup>th</sup> May, 2015, <[http://zftxgk.nea.gov.cn/auto83/201407/t20140722\\_1828.htm](http://zftxgk.nea.gov.cn/auto83/201407/t20140722_1828.htm)>

17 *Energy Development Strategy Action Plan (2014-2020)*, State Council, 19<sup>th</sup> November, 2014, viewed 20<sup>th</sup> May, 2015, <[http://www.gov.cn/zhengce/content/2014-11/19/content\\_9222.htm](http://www.gov.cn/zhengce/content/2014-11/19/content_9222.htm)>

### Competitive and Diversified Power Market

On 13<sup>th</sup> April, 2015, following the Shenzhen and Inner Mongolia power reform pilots, Anhui, Hubei, Ningxia, and Yunnan also began conducting transmission and distribution pricing reform pilots.<sup>18</sup> The prices paid to the transmission and distribution operator are currently based on historical transmission and distribution rates but will gradually be switched to reflect the underlying costs using a cost-plus, regulated-return basis.

On 15<sup>th</sup> March, 2015, the State Council released the *Opinions on Deepening the Reform of the Electricity System*.<sup>19</sup> It contains new policy suggestions for deepening reforms of the electricity market. The policy suggestions include several important goals. The government aims to allow multiple parties, including industrial parks, social capital investment companies, water and gas utilities, energy services companies (ESCOs) and generators to compete as electricity retailers. Moreover, it seeks to change the revenue model for China's grid operators by setting transmission and distribution prices based on a cost and reasonable profit basis.

On 31<sup>st</sup> December, 2014, the NDRC released a policy related to the gas and gas-fired tariff linkage mechanism, targeting a differentiated tariff mechanism for combined-cycle gas turbine (CCGT) and gas-fired projects, and encouraging on-grid tariffs to be determined by the power generator and end-users.<sup>20</sup>

On 23<sup>rd</sup> October, 2014, the NDRC, the NEA and the Ministry of Housing and Urban-Rural Development (MOHURD) released the *Notice on Detailed Implementation for Gas Distributed Energy Demonstration Projects* (NDRC Energy No. 2014/2382).<sup>21</sup> It includes detailed rules related to such demonstration projects.

### Transportation Fuel Quality

On 28<sup>th</sup> April, 2015, the State Council introduced new measures to accelerate the quality upgrading of refined

18 *Notice on Accelerating the Reform of the Transmission and Distribution Electricity Prices*, NDRC, 13<sup>th</sup> April, 2015, viewed 20<sup>th</sup> May, 2015, <[http://jgs.ndrc.gov.cn/zcfcg/201504/t20150416\\_688233.html](http://jgs.ndrc.gov.cn/zcfcg/201504/t20150416_688233.html)>

19 *Opinions on Deepening the Reform of the Electricity System*, State Council, 15<sup>th</sup> March, 2015, viewed 20<sup>th</sup> May, 2015, <[http://www.chinasmartgrid.com.cn/news/20150323/600488.shtml?utm\\_source=Azure+Cleantech+Update&utm\\_campaign=bd583fb020-Azure\\_China\\_Cleantech\\_Update7\\_3\\_2014&utm\\_medium=email&utm\\_term=0\\_6bc3c93c4c-bd583fb020-216350441](http://www.chinasmartgrid.com.cn/news/20150323/600488.shtml?utm_source=Azure+Cleantech+Update&utm_campaign=bd583fb020-Azure_China_Cleantech_Update7_3_2014&utm_medium=email&utm_term=0_6bc3c93c4c-bd583fb020-216350441)>

20 *Notice on Regulating Gas-fired Power Tariffs*, NDRC, 31<sup>st</sup> December, 2014, viewed 20<sup>th</sup> May, 2015, <[http://www.sdpc.gov.cn/zcfcg/zcfcg/201501/t20150114\\_660176.html](http://www.sdpc.gov.cn/zcfcg/zcfcg/201501/t20150114_660176.html)>

21 *Notice on Detailed Implementation for Gas Distributed Energy Demonstration Projects*, NDRC, NEA, MOHURD, 23<sup>rd</sup> October, 2014, viewed 20<sup>th</sup> May, 2015, <<http://www.china-gas.org.cn/tzgg/2014-10-31/786.html>>





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
We must put in place a modern market system in which enterprises enjoy independent management and fair competition ... products and factors of production flow freely and are exchanged on an equal basis, strive to remove market barriers and raise the efficiency and fairness of resource allocation.	Foreign investors in China are excluded from direct bidding in shale gas licence rounds, and rules on indirect access through PSCs are unclear. In addition, technical data are not readily available to foreign and private investors to allow an independent technical evaluation of the resource potential.  Discriminatory barriers, such as localisation for demonstration projects, prevent China from establishing an equal and transparent market to achieve China's long-term clean coal strategy.	
We must actively and in an orderly manner promote market-oriented reform in width and in depth, greatly reducing the government's role in the direct allocation of resources, and promote resources allocation according to market rules, market prices and market competition, so as to maximise the benefits and optimise the efficiency.	Although China has started with reforming national gas pricing, there is still a need for a clear scheme for this reform. Any such scheme should include a pricing structure that rewards gas for the value it offers, while simultaneously discouraging the use of coal.	
Both the public and non-public sectors are key components of the socialist market economy, and are important bases for the economic and social development of China [and] ... We will continue to break up all forms of administrative monopoly.	The power grid and the gas network are monopolised by a few state-owned grid companies that are not subject to appropriate supervision and transparency requirements. This makes China's on-grid system opaque for foreign companies and in this way adds market access barriers.  Some local manufacturers and service suppliers can receive subsidies and preferential treatment in certain segments of the energy equipment market. Moreover, the E-drive compressor market is dominated by one Chinese SOE, whereas the main associated components are also dominated by SOEs.	
We will establish and improve an environmental protection system that strictly supervises the emission of all pollutants, and independently conduct environmental supervision and administrative law enforcement.	Enforcement of the advanced fuel standards—National IV and V—which would improve the quality of transportation fuels, is lacking.	

gasoline. As of 2016, all vehicles in the 11 provinces and municipalities of eastern China should use fuels, including gasoline and diesel, that adhere to the National V standard. Fuels in line with the standard should be supplied nationwide as early as January 2017.<sup>22</sup>

On 8<sup>th</sup> June, 2013, the Standardisation Administration of China (SAC), under the General Administration

of Quality Supervision, Inspection and Quarantine (AQSIQ), issued the *National V Diesel Technical Standard 34*, which will be implemented on 31<sup>st</sup> December, 2017.<sup>23</sup>

#### Energy Equipment

On 8<sup>th</sup> April, 2015, the NEA published the *Special Programme for 2015 Indigenous Energy Innovation and*

<sup>22</sup> China speeds up fuel quality upgrading for better air, *Xinhua*, 29<sup>th</sup> April, 2015, viewed 13<sup>th</sup> May, 2015, <<http://en.people.cn/n1/2015/0429/c90882-8884997.html>>

<sup>23</sup> China V Diesel Technical Standard, SAC, 8<sup>th</sup> June, 2013, viewed on 13<sup>th</sup> June, 2014, <<http://www.sac.gov.cn/gjbjzgg/201308/>>



*Energy Equipment.*<sup>24</sup> Seventy projects passed the initial review by the China Machinery Industry Federation (CMIF) and the China Electrical Equipment Industrial Association (CEEIA). According to the programme, these kind of projects will enjoy subsidies amounting to 10 to 15 per cent of the investment.

**Negotiations on the EU-China Comprehensive Agreement on Investment (CAI)**

Regarding the EU-China CAI negotiations, the Energy Working Group would like to emphasise the following issues:

- Discriminatory barriers should be eliminated to achieve China's long-term clean coal strategy.
- Foreign investors in China should get access to direct bidding in shale gas licence rounds.
- There is a lack of transparency in and supervision of the on-grid system due to the fact that the power grid and the gas network are monopolised by a few state-owned grid companies.
- Preferential treatment in certain segments of the energy equipment market should be addressed.

**Key Recommendations**

**1. Unconventional Oil and Gas**

**1.1 Improve Upstream Acreage and Data Access to Foster Shale Gas Development**

**Concern**

A fast and healthy development of the shale gas industry needs competition and participation of a large number of capable upstream players, yet, to date, foreign investors in China are excluded from direct bidding in shale gas licence rounds, and rules on indirect access through PSCs are unclear. In addition, technical data are not openly available to foreign and private investors to allow an independent technical evaluation of the resource potential.

**Assessment**

Despite the huge resource potential, China recently halved its shale gas production target to 30 BCMA by 2020, as a result of inadequate investment in exploration and development.

Among all the issues, the following three may be the

key ones that could significantly boost the shale gas industry's development, if adequately addressed.

**1. Quantity and quality of shale gas acreage available for public bidding**

In China, private companies have been generally excluded from upstream access. Most oil and gas blocks are held by National Oil Companies (NOCs). While they have been heavily investing in conventional resources development to ensure supply to domestic market, they do not have sufficient capital to thoroughly explore long-term unconventional resources, such as shale gas, across all their existing acreage. As a result, much promising acreage for shale gas lacks exploration activities, a major cause of China halving its 2020 shale gas production target.

Realising the situation and limitations of China's NOCs, and in order to accelerate development of shale gas, the MOLAR made shale gas an independent mineral resource in 2011, and introduced a public bidding system for shale gas licensing. This is a significant step towards breaking the monopoly of the upstream sector. However, the first two licence rounds held in 2011 and 2012 only awarded a limited number of blocks (2 and 19) with prospectivity generally less attractive than those blocks held by NOCs. During 2013-2014, there had been rumours about a potential third shale gas licence round, but so far it has not yet been launched. One of the major reasons for this delay is said to be lack of quality blocks to offer.

**2. Upstream access to foreign energy companies**

In addition to the quantity and quality of available acreage, limited access for foreign-invested enterprises (FIEs) is another major hindrance to shale gas development. In the first two licence rounds FIEs were not allowed to directly bid, but were able to participate through joint ventures (JVs) with a Chinese partner. However, worldwide experience shows that a JV is not the most suitable business model for upstream investment, which requires flexibility for high-risk exploration activities. In addition, there would be insufficient time to physically create a JV during the time period stipulated in licence rounds after the block's<sup>25</sup> information is released.

Under conventional oil and gas regulations, FIEs can

<sup>24</sup> Special Programme for 2015 Indigenous Energy Innovation and Energy Equipment, NEA, 8<sup>th</sup> April, 2015, viewed 28<sup>th</sup> May, 2015, <[http://zfxxgk.nea.gov.cn/auto83/201504/120150408\\_1901.htm](http://zfxxgk.nea.gov.cn/auto83/201504/120150408_1901.htm)>

<sup>25</sup> 'Block' is a term used in the oil and gas industry which refers to a specified area that is licensed to a company for upstream activities.





access acreage through signing PSCs with NOCs. But for shale gas, the regulatory framework is lacking. There is no clarity on whether PSCs can be signed for blocks awarded through licence rounds, or what the relevant process or requirements are.

In fact, no International Oil Companies (IOCs) have signed any PSCs on shale gas blocks awarded during the two licence rounds (due to all the reasons stated above). However, almost all IOCs in China have tried or have been trying to access shale gas blocks held by NOCs through the PSC model. Unfortunately, negotiations have been challenging and only one FIE managed to sign up a PSC, which is the first and only shale gas PSC in China. A major difficulty constitutes the lack of a widely-recognised model shale gas PSC that addresses the special characteristics of unconventional resources. As a result, NOCs tend to offer terms developed from conventional PSCs, which may not be appropriate for shale gas and/or commercially attractive to IOCs.

Limited access to acreage and huge capital requirements combined with uncertain commerciality have deterred IOCs from making investment decisions. In fact, some European companies have exited or are considering withdrawing from shale gas investment in China, particularly due to the current low price of oil and industry-wide capital reductions.

### 3. Industry-wide data sharing system

Unlike in many countries where oil and gas data are easily available to producers, such data are usually owned by NOCs in China and considered as commercial secrets or even state secrets. Information sharing is rare in the industry, even among NOCs. This often leads to an overlap of drilling activities and less-efficient deployment of investment capital. Moreover, it restricts the whole industry from developing a deep and thorough understanding of subsurface of relevant basins or regions, a critical factor for unconventional resource development which usually requires thousands of development wells across a large area.

The lack of an industry-wide data sharing system also poses a barrier to IOCs, which are interested in shale gas exploration and developments. The reason is that they can only negotiate data purchases through a bilateral cooperation agreement with an NOC, and this process is often long and complicated.

### Recommendations

- Strengthen acreage governance and make more quality acreage available for future public bidding by the MOLAR.
- Work out a timeline and specific rules on how foreign investors may participate in shale gas exploration and development through, for example, direct bidding or PSCs.
- Establish a model Shale Gas PSC or issue relevant guidelines as soon as possible.
- Introduce a data sharing mechanism to allow companies, including foreign companies with appropriate qualifications, to access oil and gas data.

## 2. Gas Infrastructure and Price

### 2.1 Progressively Develop TPA

#### Concern

The current gas infrastructure is not as efficient as it should be due to unused capacities, attempts to duplicate basic infrastructure, lack of flexibility and inadequate price signals, and this limits the penetration of gas and offers insufficient flexibility to adequately supply the market.

#### Assessment

The opening up of the market with the decision to progressively implement TPA and the recent establishment of a natural gas exchange platform in the CSPFTZ will certainly create more favourable conditions for a market-oriented gas price reform. However, a successful marketplace cannot merely be the result of a political decision, but is instead the direct consequence of the existence of a deep, liquid and transparent market. In such a market, traders of all kinds and nationalities, including gas producers, gas users, gas shippers, banks, and other financial institutions, can find the conditions to trade and exchange their products with a minimum of constraints.

The successful development of such a platform depends on four prerequisites, which still need to be implemented:

- The possibility for the market to interact very closely with a physical gas system over a given region, to be operated by an independent transmission system operator (TSO) under a fully TPA system. In fact, little progress has been achieved over the last year for the definition of clear and practical rules (regulated pricing of infrastructure, fairness, and resolution of



conflicts, definition of surplus capacity, and the role and power of the regulator), and there is not yet an independent regulatory authority to monitor the proper implementation of such rules.

- Liquidity: to be efficient, a marketplace needs to operate within parameters that are big enough in terms of volume and number of actors. But the current market is still dominated by a few gas suppliers.
- Transparency and clear rules are a must.
- Utilisation of the right Information Technology (IT) tools.

#### Recommendations

- Promote a full, transparent and non-discriminatory TPA regime for all gas midstream infrastructure, including transmission pipelines (at national and regional levels), LNG receiving terminals and underground storage.
- Create independent operators and provide incentives for infrastructure holders to share their gas infrastructure with other players.
- Ensure the visibility of the capacities of such infrastructure to the regulator and other market players.
- Develop clear definitions and processes for pricing, fairness, resolution of conflicts, definition of surplus capacity, and the role and power of the regulator.

### 2.2 Accelerate the Development of Underground Gas Storage

#### Concern

As demand for natural gas increases across the country, there is an urgent need for additional gas storage capacity.

#### Assessment

Issued by the NDRC on 28<sup>th</sup> February, 2014, and coming into effect on 1<sup>st</sup> April, 2014, the *Management Measures of Natural Gas Infrastructure Construction and Operation*, address this issue by requesting natural gas sales enterprises to establish natural gas reserves.

Underground gas storage currently under development by NOCs is far from meeting market needs and new potential players—private or public downstream operators, gas sellers or shippers—which are now allowed to invest in this infrastructure, have little or no incentive to do so. While the economic value of

underground storage for the sound development of the gas market is obvious, current regulated gas tariffs do not reflect such costs and do not recognise its value.

Underground gas storage interconnected with the midstream high pressure gas transmission systems are certainly more cost effective methods for addressing regional/municipal modulation needs than local, LNG-based, peak-shaving solutions. Incentives should therefore be given to midstream and downstream operators to invest in such storage facilities, including the right to access aquifer or oil- and gas-depleted porous structures (often part of hydrocarbons exploration permits, today exclusively owned by upstream NOCs).

#### Recommendations

- Develop a clear assessment of the market value of underground storage to attract private and foreign investment in this sector, and reflect it in the end-users' regulated tariffs.
- Facilitate the aggregation of storage needs and capacities at the regional level.
- Give access to underground geological data to non-national oil companies to accelerate the development of new storage capacities.

### 2.3 Disclose a Clear Scheme for Natural Gas Pricing Reform

#### Concern

Natural gas is an energy vector cleaner than coal: it is an energy of transition that offers high flexibility, reduced atmospheric pollution, decreased carbon emissions, enabling peak power generation as well as highly efficient combined generation of heat, cooling and power, and unlocking intermittent renewable penetration. The gas pricing structure should therefore reward gas for the value it brings, while simultaneously discouraging the use of coal.

#### Assessment

Gas prices should:

- be linked to international gas prices, as China is more and more dependent on import;
- clearly identify and reflect the costs associated with the supply of each type of consumer (molecule, transmission costs, storages costs, distribution costs);
- prevent cross subsidies and market distortions (subsidisation of certain categories of end



- users, if needed, should be done by other social mechanisms); and
- enjoy policies (feed-in tariffs, emission trading mechanisms etc.) that recognise the environmental benefits of natural gas.

As the establishment of a liquid and competitive market in the gas sector will be a very long process, most of the distributed gas will have to remain regulated, with a price structure that more accurately reflects and remunerates the different components of the gas chain.

#### Recommendations

- Reflect the real cost of supply for each category of end users, and avoid cross subsidies.
- Recognise the real value offered by natural gas to the China energy mix (flexibility, high efficiency through combined generation, low carbon emissions).
- Properly remunerate the different segments of the gas chain so as to attract investments in necessary new infrastructure, in particular storage.
- Help end users to manage their expectations and deal with risks over time.

### 2.4 Revise the National Gas Standard to Suit Today's Industrial Needs, and Promote Energy Metering

#### Concern

Gas quality variations in China are going to increase due to diversification of gas sources—especially LNG—increased interconnections and development of trading activities.

#### Assessment

The national natural gas standard GB17820-2012, effective since 1<sup>st</sup> September, 2012, is now outdated and cannot meet today's needs. The two main issues of the natural gas standard include:

- a lack of definition of the components of natural gas; and
- a heating value scope that is too large and affects the exchange of gases from different sources and areas, and prevents interconnections between regional and national pipelines, which could damage the operation of certain gas users.

In addition energy metering is a must for trading activities and fair invoicing of clients.

#### Recommendations

- Revise the national gas standard to suit today's industrial needs.
- Promote energy metering.

## 3. Clean Coal

### 3.1 Promote Clean Coal to Improve Air Quality and Energy Efficiency

#### Concern

Policy orientation on coal utilisation and modern coal chemicals has been changing back and forth significantly, creating confusion for businesses involved in clean coal. Discriminatory barriers, such as localisation for demonstration projects, also prevent China from establishing an equal and transparent market to achieve China's long-term, clean-coal strategy.

#### Assessment

As the largest and still one of the fastest growing economies worldwide, China faces significant challenges in terms of energy demands and environmental issues. Therefore, China consistently focuses on limiting its imports of strategic feedstock, such as crude oil, while improving the air quality in dense and highly-polluted Eastern China by replacing coal with natural gas. China has chosen to leverage its abundant resources of coal in order to produce synthetic natural gas, clean fuels and polyolefin.

Awareness about environmental issues has grown significantly in China and for a number of years the Chinese Government has been trying to contain environmental damage. However, there is sometimes an overlap and a lack of coordination in terms of the policies released by different administrations.

The critical balance between energy security and mitigating environmental impact is not only set, but also apply and supervise rigorously, the world-class utilisation ratios for precious natural resources such as water and coal, and to strive for the lowest environmental footprint in terms of water, coal and waste per energy equivalent output.

European companies have the ability to introduce technical solutions that integrate best available technologies to its customers in China. But coherent energy policies, transparent selection criteria and a



proper incentive scheme are needed to build a mid-term, clean-coal strategy for China during its energy transition period. The current CTX project approval process is complex and arbitrary and involves different ministries, such as the NEA and the Ministry of Environmental Protection (MEP), as well as local governments. Incentives or penalties should therefore be clear and unambiguous. This way, investments in the modern coal chemical industry can be rationalised and aligned with China's long-term energy strategy.

#### Recommendations

- Establish a transparent, stable, long-term policy framework for clean coal development while allowing the market to play its determining role.
- Clarify the definition of demonstration projects in coal conversion as well as its link with the *Foreign Investment Industry Guidance Catalogue*.
- Clarify the role of each administration that is involved in clean coal in order to avoid an overall and lack of coordination.
- Establish transparent and measurable industry standards for clean coal applications to encourage and reward best-in-class technologies in terms of SO<sub>x</sub>, NO<sub>x</sub>, particles emissions, water utilisation and energy efficiency, and enhance the supervision of the application of such standards.
- Incentivise, promote and finance pilot projects to improve the environmental footprint of coal-based products by applying, for example, CCUS with EOR, and open such incentives to European companies.

## ▶ 4. Competitive and Diversified Power Market

### 4.1 Make Dispatching Rights of Grid Companies Transparent and Access to the Power Grid Open and Fair

#### Concern

The power grid network is monopolised by a few state-owned grid companies, which creates a lack of transparency in, and a lack of supervision of, the on-grid system.

#### Assessment

Clean air mandates are tightening to address severe air pollution across the country. Coal use is a primary target in reducing conventional pollutant emissions. The ongoing diversification away from coal and the recent presidential pledge to cap carbon emissions by 2030 are accelerating renewable and CCHP deployment.

However some CCHPs, such as Beijing South Station's CCHP, had been unable to access the local power grid, rendering the project idle for six years. Efficient and environmentally-friendly power such as CCHP should be encouraged by applying transparent on-grid principles and guaranteeing them with reasonable utilisation hours.

The Shenzhen and Inner Mongolia power reform pilots are the first two pilots that intend to set power transmission tariffs separately and allow direct power transaction between generators and large power users. As the reforms are ongoing and with the central government planning to launch it nationally, an orderly and transparent grid-access principle is essential.

#### Recommendations

- Assess and adjust power transmission tariffs by setting up a reasonable price-setting mechanism.
- Open up access to the power grid and allow more electricity retailers to enter the market and introduce reasonable regional competition.
- Establish a transparent power dispatching system and a clear on-grid principle which are available to guide proper on-grid access.

### 4.2 Ensure Rigorous Emissions Policies in the Coal-fired Power Sector and Introduce a Carbon Price and Peak-shaving, On-grid Tariff

#### Concern

There are uncertainties over achieving ultra-low-emissions by retrofitting in coal-fired power plants, such as whether the emissions, particularly carbon dioxide (CO<sub>2</sub>) emissions, will be in line with gas-fired emission standards in the long-run.

#### Assessment

An alternative option for using China's abundant coal resource base in a much cleaner way has taken centre stage. It is called 'ultra-low emissions' or 'near-zero emissions', which would effectively transfer China's emissions standards for gas-fired CCGTs to the coal-fired power sector.

This option requires coal-fired power plants to deploy advanced pollutant mitigation technology and reduce emissions to levels similar to gas-fired CCGTs. The application of relevant technologies has yet to be tested in China on a large scale and it will take time



to prove that all plants can consistently achieve the ultra-low emissions standards across the country. In the meantime, China's regional carbon market pilots are progressing steadily, but future development of the market is still uncertain.

#### Recommendations

- Enforce rigorous emissions policies to pave the way for developing an efficient and less emission-intensive power industry.
- Introduce a reasonable, peak-shaving, on-grid tariff as well as a carbon price to reflect fuel and environmental costs.
- Make EIAs for new coal power projects more stringent.
- Ensure that all monitoring systems are operational and methodologies are consistent with the new regulations.

### 4.3 Develop Gas Power Generation Appropriately

#### Concern

In 2012, the proportion of installed gas-fired capacity in the world's major developed countries was above 30 per cent in Europe, 43 per cent in the United States (US), and 28 per cent in Japan, while the figure for China was only 3.24 per cent: China's gas-power installed capacity increased, but utilisation decreased to only two per cent in its 2014 power mix.

#### Assessment

Gas-fired power remains a small share in the power sector, accounting for only four per cent of the total installed capacity and only two per cent of the power generation in 2014, as on-grid tariffs for gas-fired power generally do not cover costs. With the continued growth of domestic gas production, including the long-term prospect of unconventional gas, as well as increasing volumes of gas supply becoming available in the international market, it is believed that China's gas-fired power plants will have access to greater gas supplies in the coming years. But gas-fired power, including distributed CCHPs, will need more financial support for development. The higher cost of gas-fired power can be offset or partially offset by government-provided financial support, such as allocating a margin or incentive to gas-fired power from alternative, cheaper supply options, such as hydro and coal-fired power sectors.

#### Recommendations

- Increase the average utilisation of gas power and drive future demand growth in the next few years by applying a peak shaving tariff, carbon emissions trading and other preferential tax policies.
- Deepen the reforms related to the natural gas industry to reflect real market price levels and further deregulate gas access.

## 5. Transportation Fuel Quality

### 5.1 Improve Fuel Quality Standards by Enforcing Their Implementation, Opening Imports and Banning Polluting Vehicles

#### Concern

Despite the introduction of advanced National IV and V fuel standards (GB 19147-2013), which are set to improve the quality of transportation fuels, enforcement of their implementation is lacking. Furthermore, there is a distinct lack of clear timelines and strict guidelines for their implementation across China, which demonstrates a clear need for greater governance.

#### Assessment

On the 8<sup>th</sup> June, 2013, the SAC, under the AQSIQ, issued the *National V Diesel Technical Standard 34* for implementation on 31<sup>st</sup> December, 2017. Despite this, only a few municipalities (Beijing and Shanghai) are showing signs of implementation planning for the National V fuel standard, although a lack of persistency has also been observed in these municipalities.

A recent survey shows that the municipalities which strictly implemented the National IV accounted only for 54 per cent. Many large domestic refineries have the technical capacity to produce National IV standard gasoline and diesel, which required implementation by 31<sup>st</sup> December, 2014, and some refineries have the technical capacity to produce National V standard fuels. In addition to that, a strong determination to reform fuel distribution would be required. In general, there is a lack of clear timelines and strict guidelines for implementation of National IV and V fuels supply and distribution.

#### Progress

A greater focus on governance would provide the necessary level of scrutiny that would significantly improve the overall delivery and implementation of these standards. The Chinese Government has



been working on the action plan to speed up the fuel standards based on a market-led approach.

The working group anticipates that the government will scale up the implementation of the National V standard up to 11 provinces and municipalities to cover the whole eastern region. It has been rumoured that the government will also enforce the mandatory supply of all vehicle gasoline and diesel, including B5 bio diesel, to be in compliance with the National V standard in the whole eastern region from the beginning of 2016, as part of its efforts to counter air pollution in the urban cities.

To scale up the implementation of the National V standard at a national level, the government is planning to advance the timetable and allocate increased budget and subsidies to support the upgrading of refinery plants to produce the right fuel standards. The government is also formulating the targets for ensuring adequate clean fuel production and supply capacity by 2019, to have concrete milestones for banning the sales of vehicle gasoline and diesel below the National V standard.

Even though the government has demonstrated strengthened commitment to enforcement in the past few months, the Energy Working Group believes that reaching the National IV standard in all Chinese refineries by the end of 2015 will be difficult. However, it is likely that the implementation of the National V standard for gasoline will start in the Beijing-Tianjin-Hebei region by the end of 2015, as part of the clean air action plan in the region.

At the moment, minor and local refineries are still struggling to produce National II and National III fuel standards. This incentivises the use of cheap 'home-made' diesel, which keeps pump prices low. At the same time, it discourages the uptake of natural gas and LNG-fuelled vehicles, although those fuels can lead to significant greenhouse gas (GHG) emission reductions.

As part of the governance measures, the banning of sales of fuels and vehicles below National IV and V plays a crucial role. This could imply a strong control of implementation not only at the refinery level, but also and mainly at distribution/pump levels. Heavy polluting vehicles, which are mostly diesel engines, are a key challenge to improving air quality and require an improved government policy response to enforce and

incentivise their reduction. Although approximately 25 per cent of China's road vehicles are diesel trucks, they account for nearly 80 per cent of its total GHG emissions from vehicles.

#### Recommendations

- Enforce the implementation of National IV & V fuel standards (GB 19147-2013).
- Spread the implementation of pilot projects to test the implementation of National IV & V fuel standards.
- Open imports of National V fuel standard oil supplies, where oil companies are unable to meet demand because of delays in refinery upgrade investments.
- Incentivise the adoption of natural gas vehicles by increasing the price of gasoline and especially diesel at pump stations.
- Ban heavily-polluting vehicles.
- Develop sufficient quality control measures that stop the blending of diesel with refined, used lubricant oil and fuel oil.
- Publish an open access policy that enables third parties to use wholesale logistics with demonstrable spare capacity at competitive market rates.
- Accelerate oil refinery enterprises' upgrades including SO<sub>x</sub>, NO<sub>x</sub>, dust removal and hydrogen conversion technologies.
- Open the investment modalities to include M&A equity investments.
- Reinforce and introduce strict controls along the whole supply chain down to stations' fuel tanks in order to enforce and control actual supply of National IV & V fuels.

#### 5.2 Develop Quality Standards for LNG to Allow the Automotive Industry to Develop Efficient Engines

##### Concern

China has a huge potential to use LNG as a fuel for the transportation industry (trucks, buses, ships), but due to the lack of LNG quality standards, engine manufacturers are being faced with difficulties in developing efficient LNG engines.

##### Assessment

Today, China has a large potential to develop and promote LNG as fuel for trucks. However, due to a lack of quality standards for LNG as a fuel, engine manufacturers have difficulties developing performing engines for the market. Contrary to diesel, LNG as a fuel does not emit SO<sub>x</sub> and cuts emissions of CO<sub>2</sub>



and NOx by as much as 20 per cent and 80 per cent respectively.<sup>26</sup>

Moreover, there is a big interest from fleet owners in LNG, as it not only exceeds the European emission standard Euro 6, but also costs less at the pump than diesel. Although an LNG vehicle costs more than a diesel vehicle, the lower fuel costs result in a pay-back time of approximately five years.

In terms of the lack of LNG quality standards, Europe is dealing with the same problem. As China possesses by far the largest LNG potential, it could take the lead on this issue for the Chinese market and in a later stage at the global level.

#### Recommendations

- Develop quality standards for LNG to allow the automotive industry to develop efficient engines.
- Increase cooperation with the European SSLNG industry in order to establish international standards

### 5.3 Develop and Promote Clear Standards and Codes for the Design and Operation of Small-Scale LNG Technologies

#### Concern

Currently, no specific rules exist for the operation of filling and operating LNG at fuelling stations for buses, trucks and ships, including the integration of compressed natural gas (CNG) and LNG distribution installations in multi-service stations and bunkering stations.

#### Assessment

There is a slowdown in the development of SSLNG technologies due to a lack of proper standards and codes for the operation of those technologies and due to market uncertainty, especially in terms of the bunkering of inland and short-sea vessels. Clear standards and the development of codes and rules would give a boost to the further development of SSLNG. It would also increase equal treatment throughout the country.

#### Recommendation

- Develop and promote, in partnership with experienced European industry players, clear standards and codes

<sup>26</sup> *Environmental and Climate Change Issues in the Shipbuilding Industry*, OECD Council Working Party on Shipbuilding (WP6), November 2010, p. 30, <<http://www.oecd.org/sti/ind/46370308.pdf>>

for the design and operation of SSLNG technologies, such as small liquefaction plants, LNG storage, fuelling stations for trucks and buses, and bunkering stations for ships.

## 6. Energy Equipment

### 6.1 Ensure a Level Playing Field for the Introduction of Energy Equipment in the Market

#### Concern

Some local manufacturers and service providers can receive subsidies and preferential treatment in certain segments of the energy equipment market, meaning that the companies using energy equipment or services in those segments have limited access to alternative and world-class technologies as a result.

#### Assessment

Some local manufacturers and service suppliers enjoy strong support from the government and industrial associations in the energy equipment market. On 8<sup>th</sup> April, 2015, the NEA issued the *Special Programme for 2015 Energy Indigenous Innovation and Energy Equipment*<sup>27</sup> to support the development of local manufacturers and service providers. But beyond the subsidies listed in the programme, those local manufacturers and service suppliers receive additional preferential treatment.

In addition, the government and industrial associations sometimes endorse market restrictions to foreign companies in certain segments of the energy equipment market. Foreign companies, even those that invest and manufacture in China, are excluded from the bidding process and even from domestic components procurement, such as in the projects of long-distance natural gas pipelines.

Those local companies that are protected and supported dominate the market. The domination closes the door to leading technologies from foreign companies and to innovation from emerging local companies. The domination does not satisfy the diversified demand emerging from the developing market, nor does it stimulate technological innovation.

<sup>27</sup> *Special Programme for 2015 Energy Indigenous Innovation and Energy Equipment*, NEA, 8<sup>th</sup> April, 2015, viewed 28<sup>th</sup> May, 2015, <[http://zfxgk.nea.gov.cn/auto83/201504/t20150408\\_1901.htm](http://zfxgk.nea.gov.cn/auto83/201504/t20150408_1901.htm)>





### Case Study

#### Closed Market for E-Drive Compressor Units Used in Chinese Long-Distance Gas Pipeline Projects

The E-drive compressor market is dominated by one Chinese state-owned enterprise (SOE): Shenyang Blower Works Group Corporation (SBWGC). Furthermore, the main associated components that go into the manufacture of E-drive compressors are also dominated by SOEs, such as Harbin Electric, Shanghai Electric and frequency converters Anshan Rongxin and SVA Technologies.

The above-mentioned SOEs, including compressor suppliers, motor sub-suppliers and frequency converter sub-suppliers, formed a consortium and receive specific advantages in the gas pipeline E-drive compressor unit bidding process; consequently, other vendors are not able to participate.

Meanwhile, domestic motor and frequency converter suppliers in the above-mentioned consortium are reluctant to quote to compressor suppliers outside the consortium, including foreign compressor manufacturers, even if they are based in China through JVs. So China's E-drive compressor units used in long-distance gas pipeline projects is not an open market.

#### Recommendations

- Open access and ensure a level playing field for all market players in the energy equipment market.
- Treat FIEs in China the same as domestic Chinese enterprises so that they can enjoy fair treatment in the bidding process and can compete for business opportunities in China.
- Reduce the government's influence and encourage open and fair competition in the supply chain of energy equipment.
- Encourage collaboration between foreign companies and domestic companies for technology transfer and upgrading.

### Abbreviations

AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
BCM	Billion Cubic Metres
BCMA	Billion Cubic Metres per Annum
CAI	Comprehensive Agreement on Investment
CCGT	Combined-Cycle Gas Turbine
CCHP	Combined Cooling, Heat and Power
CCUS	Carbon Capture Utilisation and Sequestration
CEEIA	China Electrical Equipment Industrial Association
CMIF	China Machinery Industry Federation
CNG	Compressed Natural Gas
CNY	Chinese Yuan
CO <sub>2</sub>	Carbon Dioxide
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
CTX	Coal Transformation
EIA	Environmental Impact Assessment
EOR	Enhanced Oil Recovery
EUR	Euro
FIE	Foreign-Invested Enterprise
FYP	Five-Year Plan
GHG	Greenhouse Gas
IOC	International Oil Companies
IT	Information Technology
JV	Joint Venture
LNG	Liquefied Natural Gas
M&A	Mergers and Acquisitions
MEP	Ministry of Environmental Protection
MOF	Ministry of Finance
MOHURD	Ministry of Housing and Urban-Rural Development
MOLAR	Ministry of Land and Resources
NDRC	National Development and Reform Commission
NEA	National Energy Administration
NOC	National Oil company
NOx	Nitrogen Oxide
PSC	Production Sharing Contract
SSLNG	Small-Scale Liquefied Natural Gas
SOx	Sulphur Oxide
SAC	Standardisation Administration of China
SBWGC	Shenyang Blower Works Group Corporation
SOE	State-Owned Enterprise
TSO	Transmission System Operator
TPA	Third Party Access
US	United States





# Healthcare Equipment Working Group

## Key Recommendations

### 1. Streamline Laws and Regulations on the Registration of Medical Devices

#### 1.1 Increase Know-How to Evaluate the Safety and Effectiveness of Medical Devices Based on Clinical Evaluations

- Increase the number of medical devices exempted from clinical trials.
- Provide training on the *Guiding Principles on Evaluation of Clinical Trials for Medical Devices (Guiding Principles)* and reach consensus between the industry and regulatory authorities on the required implementation levels of the *Guiding Principles*.
- Specify the methodology of clinical evaluations and criteria that will be accepted.
- Harmonise requirements of documentation of clinical evaluations in China with internationally-accepted requirements.

#### 1.2 Improve the Efficiency of Acceptance, Review and Approval of Applications for Registration

- Increase efficiency of review and approval processes, and improve communication between the industry and regulators.
- Participate in the discussion and test-run of the Regulated Product Submission (RPS) programme of the International Medical Device Regulators Forum (IMDRF), implementing the results of this research project in specific action plans within the comprehensive reform of evaluation and approval processes for medical devices.
- Provide internal guidelines on the new regulations for all levels of market supervision and product evaluation departments.
- Accelerate the publication of guidelines for manufacturers on the requirements for registration and clinical trials of different product groups.
- Grant manufacturers a sufficient transition period after publishing new regulations and guidelines.
- Refer to the United States Food and Drug Administration's (USFDA's) system of performance evaluation regarding review efficiency and quality, as well as communication between reviewers and applicants.
- Improve online tracking of the registration process, ensure that all information in the whole process from acceptance to approval is correct and traceable.

#### 1.3 Promote Good Refurbishment Practice (GRP)

- Build and strengthen awareness of the difference between safe and effective remanufactured medical imaging equipment and second-hand equipment with unknown quality.
- Form a taskforce across multiple ministries, including the National Health and Family Planning Commission (NHFPC), the China Food and Drug Administration (CFDA), the Ministry of Industry and Information Technology (MIIT), the Ministry of Commerce (MOFCOM), the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) and other relevant authorities, to initiate formulation of possible policies on remanufactured medical equipment.
- Establish a pilot programme for specific healthcare equipment, such as X-ray Computed Tomography (CT), to evaluate the benefits of remanufacturing by original equipment manufacturers (OEMs), including safety, energy saving and better utilisation of resources.
- Amend current regulations to clarify that a CFDA-approved medical device covers both a newly



manufactured and a remanufactured medical device, as both devices are required to meet the same specification.

## **2. Contribute to the Establishment of Good Supply Practice (GSP) and an Efficient Supervision System of Medical Devices in Clinical Use**

### **2.1 Establish a Regulatory Framework for Supervision of Medical Devices in Clinical Use**

- Take the initiative to exchange experience with competent European Union (EU) bodies in the field of supervision of medical devices in use, with the target of harmonising legislation.
- Coordinate the efforts of the CFDA and the NHFPC to improve management of third-party medical device maintenance providers.
- Restrict the application of medical devices other than their specified use, especially restricting the recycling of medical devices designed for single use.

### **2.2 Establish a System of GSP**

- Publish a notice that medical devices manufactured during the validity of the registration certificate are officially recognised as being “products with a valid registration certificate”.
- Publish detailed rules on implementation and examination of the regulation on GSP.

## **3. Promote Legislation to Facilitate In Vitro Diagnostic (IVD) Products’ Access to Market**

### **3.1 Introduce Price Differentiation between Diagnostic Reagents Used in Testing Items**

- Approve at least two methodologies for diagnostics, i.e. one of advanced technology, high sensitivity, high specificity; another of lower sensitivity and specificity, allowing exceptions for special requirements.

### **3.2 Reclassify Diagnostic Reagents**

- Refer to international rules of classification and reclassify low-to-moderate risk IVD products into Class I or II.

### **3.3 Develop Industry Standards for IVD Products**

- Give priority to generally-adopted standards when defining industrial standards.
- Develop general technical standards, thereby taking into consideration the technical characteristics and risk requirements of IVD products, and develop mandatory and recommended industry standards based on experience and conventions of national standards.
- When writing new standards, consider views and suggestions from the industry, adopt scientific and effective validation mechanisms and establish transparent management.

### **3.4 Add IVD Products to the Catalogue of Medical Devices Exempted from Clinical Trials**

- Add those IVD products that have been in use for a long time with no record of incorrect diagnosis to the *Catalogue of Medical Devices Exempted from Clinical Trials*.

## **4 Promote the Reform of Centralised Procurement and Bidding for High Value Consumable Medical Devices at Provincial Level**

- Develop a scientific and standardised procurement catalogue and criteria for product classification and quality evaluation to ensure the clarity and predictability of centralised procurement of medical consumables, and encourage innovation of technologies, materials and techniques when



developing assessment indicators.

- Publish the envisaged date of calls for bids, the procedures and rules for adding new products to centralised procurement; ensure timely updates and improve the pool of professional reviewers to ensure that it always maintains a sufficient number of specialists that have a corresponding professional background and knowledge of medical devices.
- Simplify requirements on qualifications, streamline approval mechanisms and establish an e-procurement platform.
- Implement centralised procurement procedures across all of China's provinces, disclose the legal basis for, and amount of, procurement-related fees and reduce non-predictable charges.
- Provide equal opportunities and an environment of fair competition, regardless of domestic or imported products, and give patients the right to choose among different suppliers of high-value medical consumables.

## 5. Recognise Medical Devices Manufactured by Companies in China with Foreign Investors as Domestic Products

- Define 'domestic-made products'.
- Recognise medical devices manufactured in China as 'domestic-made products', independent of the location of the investor or owner of the production facilities.
- Grant joint ventures (JVs) and wholly foreign-owned enterprises (WFOEs) equal treatment in China.

## 6. Initiate an Open and Transparent Discussion about the Regulations and Standards for Health Information Technology (IT), Allow and Encourage the Efficient Use of Health Information Technology

- Implement the State Council's *Reform Concept for Deepening Standardisation*, give priority to international interoperable standards, avoid political criteria in standardisation processes, encourage companies engaged in health information technology, health institutions and non-governmental organisations to develop standards and maintain a cautious attitude to promoting administrative compliance tests.
- Discuss health information regulations and standards openly and transparently, and allow all stakeholders to make good use of health information technology while ensuring privacy and data protection.
- Encourage the EU-China Health IT Expert Roundtable to become a platform for China and Europe to exchange solutions on the aforementioned issues, share technical know-how and organise training for relevant personnel.

## Working Group Introduction

The European Chamber's Healthcare Equipment Working Group consists of 82 member companies developing and manufacturing indispensable, life-saving and disease-reducing diagnostic and therapeutic technologies. The working group members maintain this commitment by investing in modern Chinese research and production facilities as well as in the education of Chinese doctors and healthcare professionals.

The working group has established regular contacts with major stakeholders both in China and Europe. The Healthcare Equipment Working Group organises regular meetings with the China Food and Drug Administration (CFDA) to get first-hand information of regulatory developments in China and to present concerns and suggestions of the European medical device industry.

To enhance international cooperation, as early as 2007, the working group established contacts with the



European Coordination Committee of the Radiological, Electro-medical, and European Coordination Committee of the Radiological, Electro-medical and Healthcare IT Industry (COCIR), a major medical technology industry association based in Europe.

In March 2014, the European Chamber founded the Medical Consumable Advisory Committee with 12 Chinese subsidiaries of international manufacturers of Consumable and Disposable Medical Devices (CDMD). The Advisory Committee has founded three subgroups—Regulatory Affairs (RA), Government Affairs (GA) and In Vitro Diagnostics (IVD)—to facilitate the development of this sub-group of the medical device industry.

The Healthcare Equipment Working Group wishes to further engage in a continuous and constructive dialogue with all relevant government agencies, both on a national and a provincial/local level in China.

In both China and Europe, the Healthcare Equipment Working Group has established relations with international industry organisations with the aim of further harmonising the regulatory environment.

## Recent Developments

In line with the *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform (Decision)*, the reform of China's healthcare system was accelerated in 2014, including the regulatory system, financing of hospitals as well as an industry policy aimed at promoting the development of the domestic Chinese medical industry.<sup>1</sup> Reform of the healthcare system is a giant task and the process of reforms will continue for the next few years to come.

With the experience accumulated during decades of healthcare reforms in different European countries, the Healthcare Equipment Working Group is pleased to offer some valuable comments and suggestions for the future development of medical devices in China.

### The Third Plenary Session of the 18<sup>th</sup> Central Committee of the Communist Party of China

<sup>1</sup> *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform* (in Chinese), approved 15<sup>th</sup> November 2013, viewed 22<sup>nd</sup> June, 2015, <[http://news.xinhuanet.com/2013-11/15/c\\_118164235.htm](http://news.xinhuanet.com/2013-11/15/c_118164235.htm)>

Deepening the healthcare reform is one of the key points outlined in the *Decision*, which was adopted on 12<sup>th</sup> November, 2013. Article 46 of the *Decision* states:

“We will proceed with a comprehensive reform in medical security, medical care, public health, and the medicine supply and regulatory system. We will deepen the comprehensive reform of grass-roots medical and healthcare institutions, and improve the network of urban and rural basic medical and healthcare services. We will accelerate the reform of public hospitals, ensure the government shoulders its responsibilities in this regard, and set up a scientific medical treatment assessment mechanism and a personnel training and salary system suited to the characteristics of this sector. We will improve the rational modes of graded diagnosis and treatment, establishing a service contract between community doctors and residents. We will make full use of information means to promote the downward flow of high-quality medical sources, and strengthen the regional integration of public medical service resources. We will abolish the practice of raising medicine prices to make up for the shortfall in hospital funds, rationalise the prices of medical services and medicines, and establish an appropriate compensation mechanism. We will reform the methods of insurance payouts, and extend the medical insurance system to all the people. We will speed up the completion of the medical insurance and medical assistance system against fatal and serious diseases ... We will encourage private funds to flow to medical services, first supporting them to flow to not-for-profit medical institutions. We will allow private funds to invest directly in services that are short of resources or are to meet diverse demands, and to participate in the reform and restructuring of public hospitals in various forms. We will allow ... private medical institutions to be included in designated medical insurance institutions...”

In addition, Article 45 states a requirement to institute “a fairer and more sustainable social security system”, while the whole of section IX is dedicated to promoting the rule of law.<sup>2</sup>

The members of the Healthcare Equipment Working Group welcome the targets laid down in the *Decision* and offer to share the expertise accumulated by the industry. While acknowledging that the huge

<sup>2</sup> *Ibid*



task of medical reform cannot be achieved without encountering problems, the working group emphasises the need to strengthen communication with all stakeholders and allow time to adjust to new policies.

### Regulatory Environment

Following Order 650, *The Regulations on Supervision and Administration of Medical Devices (The Regulations)*<sup>3</sup> which became effective on 1<sup>st</sup> June, 2014, a series of new regulations have been published by the CFDA, most of which became effective on 1<sup>st</sup> October, 2014.

With this new set of regulations China moved closer to international regulatory practices as (among other countries) adopted by the EU. One notable example is the revised handling of risk class I products which in the future will no longer need to undergo a technical evaluation. The validity of registration certificates has been extended from four to five years, alleviating the pressure for the costly and time-consuming re-registration of products.

On the downside, the time between the publishing of new regulations and their effective date is still too short, in many cases just three months, so that manufacturers don't have sufficient time to adapt to the new regulations.

After promulgation of the new set of regulations, there has been a lack of implementation rules and guidelines, so that submission of registration dossiers by manufacturers became a form of trial and error.

The Healthcare Working Group is concerned that as a consequence of introducing a new regulatory system, with different responsibilities falling to different levels of authorities, there is a risk that there will be different interpretations of the regulations by different government agencies, including the CFDA and FDAs at the local level.

Though one target of the reforms is to speed up the registration process, long waiting times and a registration time that takes much longer than in Europe, or other main medical markets, are still a daily reality. This leads to slow market access for newly-developed products, with the consequence that Chinese patients' access to the best possible treatment is delayed due to regulatory barriers.

<sup>3</sup> *The Regulations on Supervision and Administration of Medical Devices* (in Chinese). State Council Order 650, entered into force 1<sup>st</sup> June 2014, viewed 22<sup>nd</sup> June, 2015, <<http://www.sfda.gov.cn/WS01/CL0784/97814.html>>

### Post Marketing Surveillance (PMS)

In 2013, China started to improve the post market surveillance system of medical devices with the target of building up a PMS system in line with best practices by 2020. The Healthcare Equipment Working Group welcomes this development, PMS is a cornerstone in guaranteeing the safety of patients and the EU has developed an elaborate system of implementing efficient PMS measures.

In July 2013, the eighth revision of MEDDEV<sup>4</sup> 2.12-1, *Guidelines on a Medical Device Surveillance System* became effective.<sup>5</sup> The new revision covers IVD and requires that medical device manufacturers, medical institutions and others report indirect adverse events. For example a failure of a diagnostic device resulting in a delay of treatment is regarded an indirect adverse event.

It is essential during establishment, implementation and execution of the improved post-market surveillance system that a common understanding of the applicable requirements exists among all stakeholders, starting with hospitals, manufacturers and authorities at different levels and in different departments.

### Hospital Financing

The NHFPC is considering how to reform the charging system of China's medical institutions. While up until now medical institutions charge patients or medical insurances companies based on the amount of drugs and medical devices administered, in the future charging shall be case-based, an approach called diagnostic-related groups (DRG). Such an approach has successfully been introduced in several European countries and the Healthcare Equipment Working Group welcomes a development in this direction. The old charging system has frequently led to over-medication, resulting in waste and even endangering the health of patients. However, considering the difficulties in funding hospitals, there is a danger that patients will not receive optimal treatment if the refund per case is too low. A case-based charging systems needs assurance that all necessary treatments are covered by the refund the hospital receives.

<sup>4</sup> The European Commission provides a range of guidance documents to assist stakeholders in implementing directives, related to medical devices. The guidance documents are called 'MEDDEVs'. European Commission, viewed 22<sup>nd</sup> July 2015, <[http://ec.europa.eu/growth/sectors/medical-devices/guidance/index\\_en.htm](http://ec.europa.eu/growth/sectors/medical-devices/guidance/index_en.htm)>

<sup>5</sup> *Guidelines on a Medical Device Surveillance System, Eighth edition*, European Commission, entered into force July 2013, viewed 23<sup>rd</sup> June 2015, <[http://ec.europa.eu/health/medical-devices/files/meddev/2\\_12\\_1\\_ol\\_en.pdf](http://ec.europa.eu/health/medical-devices/files/meddev/2_12_1_ol_en.pdf)>





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
We will proceed with a comprehensive reform ... [of] the regulatory system.	The reform has been started, and it is underway.	
We will accelerate the reform of public hospitals, ensure the government shoulders its responsibilities in this regard, and set up a scientific medical treatment assessment mechanism and a personnel training and salary system suited to the characteristics of this sector.	Research projects are underway, realisation has not started yet.	
We will reform the methods of insurance payouts, and extend the medical insurance system to all the people. We will speed up the completion of the medical insurance and medical assistance system against fatal and serious diseases.	Research projects are underway, realisation has not started yet.	
We will make full use of information means to promote the downward flow of high-quality medical sources, and strengthen the regional integration of public medical service resources.	In the planning phase, trials ongoing, no role-out on a large scale yet.	
We will encourage private funds to flow to medical services, first supporting them to flow to not-for-profit medical institutions. We will allow private funds to invest directly in services that are short of resources or are to meet diverse demands, and to participate in the reform and restructuring of public hospitals in various forms.	In the 2015 <i>Foreign Investment Catalogue</i> , medical institutions are still classified as "restricted". <sup>6</sup>	
We will allow ... private medical institutions to be included in designated medical insurance institutions.	Realised in June 2015.	

Section Three: Trade in Goods

### Medical Insurance

Starting in the 1990s, within little more than 10 years China managed to build-up a mandatory health insurance, which covers the vast majority of the Chinese population, an impressive success story of the reform process. However, while the state medical insurance covers basic health service, most of the expenses for complex and expensive surgery and chronic diseases still have to be borne by the patients, which means that this kind of state-of-the-art medical service is still out of reach for large parts of the population. Improved financing for medical insurance is key to improving access of the entire population to modern healthcare.

### Rule of Law

The rule of law shall protect legitimate interests of patients, medical personnel, healthcare providers as well as the medical industry. In the past unlawful

practices, especially the procurement carried out by hospitals, have severely distorted the market, led to a sub-optimal care for patients and, as a consequence, a climate of mistrust and conflict between medical institutions and medical personnel on one side and patients on the other.

The Healthcare Equipment Working Group welcomes the determination of the *Decision* to promote the rule of law, which is a prerequisite for fair competition and safeguarding patient's rights. While in general the awareness of the rule of law has increased, promoting the rule of law in medical institutions at a local level still needs further improvement.

### Industry Policy / Comprehensive Agreement on Investment

In 2014, Chinese government agencies repeatedly stated that China wants to develop top-class medical companies and that Chinese state-run hospitals should

<sup>6</sup> *Foreign Investment Catalogue (2015 Revision)*, NDRC and MOFCOM, entered into force 10<sup>th</sup> April, 2015, viewed 3<sup>rd</sup> July, 2015, <[http://www.sdpc.gov.cn/gzdt/201503/t20150313\\_667334.html](http://www.sdpc.gov.cn/gzdt/201503/t20150313_667334.html)>





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preferably source medical devices from local Chinese brands.<sup>7</sup> This policy, however, does not include medical equipment made in China by European-invested factories.

While projects to stimulate development of certain industries are common practice worldwide, sourcing by medical institutions should not be part of the industry policy.

The EU has no concept of 'foreign-invested enterprises'. Any company of any nationality, including Chinese-invested enterprises, legally registered in any EU Member State, are considered European companies and have access to all stimulus programmes offered by the EU and their Member States.

The outlined 'buy China' policy discriminates against and discourages new investments by European companies in China.

China and the EU are in the process of negotiating a Comprehensive Agreement of Investment (CAI) that shall comprise market access. The Healthcare Equipment Working Group appeals to China and the EU to ensure that European-invested factories enjoy equal treatment, especially equal market access in China.

## Key Recommendations

### 1. Streamline Laws and Regulations on the Registration of Medical Devices

#### 1.1 Increase Know-How to Evaluate the Safety and Effectiveness of Medical Devices Based on Clinical Evaluations

##### Concern

Evaluating the safety and effectiveness of medical devices based on clinical evaluations has always been a challenge, both for manufacturers and for regulatory bodies.

##### Assessment

According to *The Regulations on Supervision and Administration of Medical Devices*, medical products may be exempt from clinical trials if one of the following three conditions is fulfilled:

- (1) Medical devices with a clearly-defined working principle, mature design and fully-developed manufacturing technology. Equivalent devices have been used in the clinical praxis for several years without severe adverse events. No essential modification of the intended application.
- (2) Safety and effectiveness of medical devices can be proved through evaluation without clinical data.
- (3) Safety and effectiveness of medical devices can be proved through analysis and evaluation of data obtained through clinical trials or clinical applications of equivalent medical devices.<sup>8</sup>

For the regulatory authorities in China, the establishment of review and approval procedures for medical devices based on clinical evaluations is a new requirement. Assessment of clinical evaluations is a challenge, both for manufacturers and regulatory bodies.

The targets of the working group are to:

- identify additional criteria through which medical devices may obtain market approval based on clinical evaluation without the necessity to perform clinical trials;
- update the CFDA's catalogue of medical devices exempted from clinical trial;
- develop methods and generally-acknowledged criteria for acceptance of clinical evaluations; and
- to broaden the knowledge of industry professionals and the regulatory authorities about clinical applications of specific medical devices, imparting know-how on methodology and generally-accepted criteria of clinical evaluations.

Currently only a very limited range of products is included in the CFDA's list of medical devices exempted from clinical trials. The working group suggests referring to the regulatory practice in International Medical Device Regulators Forum (IMDRF) member countries and, as far as possible, include all products which fulfil condition (1) in the above mentioned conditions for exemption from clinical trials.

The working group encourages the CFDA and the Centre for Medical Device Evaluation (CMDE) to provide training and guidance on the *Guiding Principles*

<sup>7</sup> Meng, Jianguo, *Current Status and Policies of Medical Equipment in China*, China Association of Medical Equipment, December 2014, p20ff.

<sup>8</sup> *Regulations on Supervision and Administration of Medical Devices*, CFDA, entered into force on 1<sup>st</sup> June, 2014, viewed 22<sup>nd</sup> June, 2015, <<http://www.sfda.gov.cn/WS01/CL0784/97814.html>>



on *Evaluation of Clinical Trials for Medical Devices*<sup>9</sup> in order to increase the enterprises' know-how and subsequently improve the quality of clinical evaluations. To avoid misinterpretation of the *Guiding Principles*, the working group would like to have an opportunity for further communication with the CFDA in order to achieve consensus between the industry and the regulatory authorities.

#### Recommendations

- Increase the number of medical devices exempted from clinical trials.
- Provide training on the *Guiding Principles* and reach consensus between the industry and regulatory authorities on the required implementation levels of the *Guiding Principles*.
- Specify the methodology of clinical evaluations and criteria that will be accepted.
- Harmonise requirements of documentation of clinical evaluations in China with internationally-accepted requirements.

### 1.2 Improve the Efficiency of Acceptance, Review and Approval of Applications for Registration

#### Concern

Following the series of new registration regulations, which became effective in 2014, there still remains room for improvement in terms of clear interpretation of the regulations and build-up of the necessary know-how to fulfil the requirements of the regulations.

#### Assessment

The working group is pleased that China has started a comprehensive reform of the evaluation and approval process of medical devices, and that China will participate in the Regulated Product Submission (RPS) project of the IMDRF. The working group expects that such a move will lead to a harmonisation of China's Table of Contents (ToC) for submission with those of other RPS member countries, acceleration of the review of submissions in the member countries and an increase of the overall efficiency of registration.

The new regulations specify in detail the requirements for administrative and technical documentation, however, specific guidelines detailing how registration dossiers

shall be compiled and which document should exactly cover which content have not yet been promulgated. As a result, there are discrepancies in the interpretations of the requirements of certain documents, not only between the industry and the regulatory authorities, but also between different departments within the regulatory authorities, between different administrative levels within the same department, and even between different officers responsible for evaluation. Submission and approval has become a process of trial and error, especially for first submissions of new products. Repeated consultation and internal discussion have consumed considerable resources originally assigned for product evaluation, having a negative impact on efficiency, and eventually resulting in the delay of product launches, which is contrary to the interests of patients in China.

The working group suggests that the responsible authorities provide internal guidelines on the new regulations for all levels of market supervision and product evaluation departments. For example, it should be clarified which modifications of product properties not listed in the registration certificate or its attachments require involvement of the regulatory authorities.

In May 2015, the CFDA promulgated the *Registration Fees for Pharmaceutical Products and Medical Devices* (Notification 53/2015).<sup>10</sup> The working group is pleased to know that the CFDA plans to use the income generated by the registration fees to increase the resources for review of applications and accelerate the registration process.

Nevertheless, the working group would like to emphasise that based on international practices, a well-working fee structure shall also have mechanisms in place to make sure that fees charged tally with the promised regulatory improvement, such as shorter processing times and providing more opportunities for industry to consult with regulators.

The working group recommends the adoption of specific and measurable goals for the timeline of product registration, review and approval since fees are imposed. The United States (US) and Japan have made such commitments a part of their charging policy. For example, the US Food and Drug Association

<sup>9</sup> *Guiding Principles on Clinical Assessment Technology for Medical Devices*, CFDA, 19<sup>th</sup> May, 2015, viewed on 3<sup>rd</sup> June, 2015, <<http://www.cfda.gov.cn/WS01/CL0087/119643.html>>

<sup>10</sup> *Registration Fees for Pharmaceutical Products and Medical Devices* (Notification 53/2015), China Food and Drug Administration, entered into force 27<sup>th</sup> May, 2015, viewed 23<sup>rd</sup> June, 2015, <<http://www.sda.gov.cn/WS01/CL0087/120201.html>>





(USFDA) has given a commitment to achieve specific performance targets, for example processing 510(k) applications within 90 days, premarket approval (PMA) applications without review by an expert team within 180 days and those with review by an expert team within 320 days. The working group encourages the CFDA to make similar commitments.

### Recommendations

- Increase efficiency of review and approval processes, and improve communication between the industry and regulators.
- Participate in the discussion and test-run of the RPS programme of the IMDRF, implementing the results of this research project in specific action plans within the comprehensive reform of evaluation and approval processes for medical devices.
- Provide internal guidelines on the new regulations for all levels of market supervision and product evaluation departments.
- Accelerate the publication of guidelines for manufacturers on the requirements for registration and clinical trials of different product groups.
- Grant manufacturers a sufficient transition period after publishing new regulations and guidelines.
- Refer to the USFDA's system of performance evaluation regarding review efficiency and quality, as well as communication between reviewers and applicants.
- Improve online tracking of the registration process, ensure that all information in the whole process from acceptance to approval is correct and traceable.

### 1.3 Promote Good Refurbishment Practice (GRP)

#### Concern

The ban of imported remanufactured medical devices is still in place, and there is not yet a regulation to supervise and regulate medical equipment remanufactured within China.

#### Assessment

##### Remanufacturing of medical devices

Remanufacturing of medical imaging equipment is a globally well-established process which allows hospitals to upgrade to newer generation technologies and to return the older equipment to the manufacturer.

Remanufacture of medical devices combines repair, calibration, possible software updates and replacement

of spare parts, based on the premise that the original product design has not been modified, ensuring that the remanufactured equipment has the same safety and effectiveness as a new device.

However, in China second-hand devices are an unregulated market without guarantee of quality and safety.

#### Benefits of remanufacturing

Remanufacturing allows the re-use of high-quality medical imaging equipment with guaranteed quality, requiring less investment capital.

Remanufacturing medical equipment is a practise recognised by the most developed countries, including the EU, the US, Japan and South Korea. The target is to optimise the use of limited resources and at the same time reduce environmental pollution. For example, compared to manufacturing a new X-ray device of a similar type, the process of remanufacturing an X-ray medical device will, on average, consume 73 per cent less energy.

Industry leaders have established and follow Good Refurbishment Practice (GRP)<sup>11</sup> rules to facilitate the delivery of safe and effective remanufactured medical equipment. The baseline of GRP is the rule that a remanufactured product must meet the same requirements as a new one. Remanufactured devices are typically 20-50 per cent cheaper than new ones, and the availability of remanufactured medical devices would result in improved access to healthcare for Chinese citizens.

#### Assessment of the ban on remanufactured medical devices

The ban on imported remanufactured medical devices and the non-existence of regulations for remanufacturing within China limits access to affordable, advanced medical technology for Chinese doctors and patients. Valuable healthcare equipment is disposed before the end of its lifespan, causing unnecessary pollution and waste, which is against the principles of sustainability. An unregulated market of second-hand equipment of questionable quality has evolved, possibly endangering the safety of citizens.

<sup>11</sup> *Good Refurbishment Practice*, COCIR, 2009, viewed 1<sup>st</sup> June, 2015, <[http://www.cocir.org/fileadmin/6.1\\_Initiatives\\_Refurbishment/Good\\_Refurbishment\\_Practice\\_V2.pdf](http://www.cocir.org/fileadmin/6.1_Initiatives_Refurbishment/Good_Refurbishment_Practice_V2.pdf)>



The need for strengthening environmental protection and resource efficiency was emphasised in the 12<sup>th</sup> Five-Year Plan for the healthcare industry issued by the Ministry of Industry and Information Technology (MIIT). An amendment to the Environmental Protection Law<sup>12</sup> came into force in early 2015, which explicitly requires recycling of resources.

With the shrinking of global resources and increasing prices, mastering the remanufacturing process is going to become a key technology and economic driver in the near future. By banning import of remanufactured equipment there is no market incentive for research and investment in this field. Yet with beneficial regulations China could become a regional hub for remanufactured equipment, a market that on a global stage has already reached a considerable volume (in the US several billion US-dollars) and that is expected to see steep growth rates.

#### Recommendations

- Build and strengthen awareness of the difference between safe and effective remanufactured medical imaging equipment and second-hand equipment with unknown quality.
- Form a taskforce across multiple ministries, including the NHFPC, the CFDA, the MIIT, the MOFCOM, the AQSIQ and other relevant authorities, to initiate formulation of possible policies on remanufactured medical equipment.
- Establish a pilot programme for specific healthcare equipment, such as CT, to evaluate the benefits of remanufacturing by OEMs, including safety, energy saving and better utilisation of resources.
- Amend current regulations to clarify that a CFDA-approved medical device covers both a newly-manufactured and a remanufactured medical device, as both devices are required to meet the same specification.

## 2. Contribute to the Establishment of Good Supply Praxis (GSP) and an Efficient Supervision System of Medical Devices in Clinical Use

### 2.1 Establish a Regulatory Framework for Supervision of Medical Devices in Clinical Use

<sup>12</sup> Environmental Protection Law, Standing Committee of NPC, came into force on 1<sup>st</sup> January 2015, viewed 1<sup>st</sup> June, 2015, <[http://www.gov.cn/zhengce/2014-04/25/content\\_2666434.htm](http://www.gov.cn/zhengce/2014-04/25/content_2666434.htm)>

#### Concern

Although the draft *Administrative Measures for Quality Supervision of Medical Devices in Use*<sup>13</sup> (*Measures*) were compiled by the CFDA and made public for consultation in April 2014, they are still under discussion, the industry has not received any further call for comments and the timeline for promulgating and implementing a binding version of the *Measures* is unknown.

#### Assessment

The *Regulations for Supervision and Administration of Medical Devices* (Order No. 650) emphasises regular supervision and presents supervision measures. Medical devices in use in medical institutions are so far not included in the supervision by the regulatory authorities. To close this gap the *Measures* have been drafted and the final version will provide the future legal basis.

The effectiveness and safety of medical devices in use depends mainly on the environment in the medical institution and only to a lesser part on the quality of the products itself.

While clearly specifying responsibilities and requirements to manufacturers and users, the draft *Measures* do not regulate third parties providing maintenance for medical devices. The working group suggests that manufacturers should have the duty to train third-party maintenance and service agencies and approve or authorise them. These third-party service providers will then bear responsibility for the safety of the medical equipment. Manufacturers cannot bear responsibility for service by third parties.

Some medical institutions reuse disposable medical devices not designed for recycling. There are no clear measures for restricting and regulating reuse of disposable medical devices by users or third parties. Close cooperation between the CFDA and the NHFPC is needed to establish an effective supervision system for medical devices in use, curbing use of medical devices not in line with the specification and the instructions for use.

<sup>13</sup> *Call for Comments on Administrative Measure for Quality Supervision of Medical Device in Use*, CFDA, 2014, viewed on 1<sup>st</sup> June, 2015, <<http://www.cfda.gov.cn/WS01/CL0779/97947.html>>



## Recommendations

- Take the initiative to exchange experience with competent EU bodies in the field of supervision of medical devices in use, with the target of harmonising legislation.
- Coordinate the efforts of the CFDA and the NHFPC to improve management of third-party medical device maintenance providers.
- Restrict the application of medical devices other than their specified use, especially restricting the recycling of medical devices designed for single use.

## 2.2 Establish a System of GSP

### Concern

In 2014, the CFDA promulgated regulations targeting the supply chain of medical devices: in July the *Administrative Measures on Medical Device Supply*<sup>14</sup> and in December the *Medical Device Good Supply Practices*.<sup>15</sup> These two regulations have laid the regulatory basis for supervision of medical device import, logistics and storage, marketing and sales, however, there remain many questions that need clarification.

### Assessment

The abovementioned regulations reflect the determination of the CFDA to enforce strict supervision through the entire life cycle of medical devices from registration over supply to use in medical institutions, but key definitions (e.g. definition of products with a valid licence) and requirements in daily operational remain unclear. As a result, there are discrepancies in the interpretation of regulations by different regulatory authorities. This has created new difficulties for the import and legal handling of medical devices.

According to Article 53, Chapter 9 of the *Administrative Measures on Medical Device Registration* (CFDA Order [2004] No. 16),<sup>16</sup> “all medical devices are considered a product with a valid licence that are *manufactured* within the validity period specified on the medical device registration certificate”, implying that medical devices may be imported and distributed after the date of expiry

<sup>14</sup> *Administrative Measures on Medical Device Supply*, CFDA, entered into force on 1<sup>st</sup> October, 2014, viewed on 23<sup>rd</sup> June, 2015, <<http://www.cfda.gov.cn/WS01/CL0053/103760.html>>

<sup>15</sup> *Good Medical Device Supply Practice*, CFDA, entered into force on 12<sup>th</sup> December, 2014, viewed on 23<sup>rd</sup> June, 2015, <<http://www.cfda.gov.cn/WS01/CL0087/110920.html>>

<sup>16</sup> *Administrative Measures on Medical Device Registration*, CFDA, entered into force on 9<sup>th</sup> August, 2004, viewed on 23<sup>rd</sup> June, 2015, <<http://www.sda.gov.cn/WS01/CL0053/25844.html>>

of the registration certificate. This definition was valid for 10 years. However, the definition of “products with a valid registration certificate” is missing in the updated version (CFDA Order [2014] No. 4), causing confusion on how to determine whether a product can be legally distributed, for example at customs inspection or during hospital stock replenishment. Some government agencies still acknowledge the original definition, while others may bar medical devices from import and distribution.

This different interpretations have in some cases interrupted the supply resulting in economic losses for European manufacturers.

The regulation on GSP describes requirements in detail, such as how wholesalers or retailers of Class III medical devices should keep sales records, how suppliers should maintain their IT systems and make sure that all products can be traceable. Such requirements are reasonable and reflect a high regulatory standard.

The notice on GSP was published on 12<sup>th</sup> December, 2014, and became effective the same day. It was a tremendous challenge for both the industry and supervisors to implement such completely new regulations without any transitional period.

Criteria on how to examine the implementation of GSP are not yet developed. As long as these detailed regulations remain unpublished enterprises cannot be sure whether they fulfil the regulations and whether or not there is a risk of discretionary enforcement.

### Recommendations

- Publish a notice that medical devices manufactured during the validity of the registration certificate are officially recognised as “products with a valid registration certificate”.
- Publish detailed rules on implementation and examination of the regulation on GSP.

## 3. Promote Legislation to Facilitate In Vitro Diagnostic (IVD) Products' Access to Market

### 3.1 Introduce Price Differentiation Between Diagnostic Reagents Used in Testing Items

#### Concern

The National Development and Reform Commission's



(NDRC's) 2012 *National Pricing Guidelines for Medical Service* discourages the development and application of advanced diagnostic and treatment methods: it cannot be guaranteed that cheap technologies provide reliable data for diagnosis and treatment and as a consequence the overall costs for treatment of a disease may increase.

#### Assessment

In different stages of a disease, doctors need to diagnose the condition of a patient based on different diagnostic methods, for example at a general health-check, during monitoring of treatment results or during the recovery process. Being restricted to just one diagnostic method may affect the accuracy of the diagnosis. Specific and highly-sensitive testing methods may play an important role in monitoring the effect of the therapy, or for adjusting or ending the therapy. This cannot be achieved by just one 'mainstream' diagnostics method. If different methods are available for testing one parameter, the doctor can apply the most appropriate method based on the individual condition of the patient.

Efficiency, speed and the level of automation are important factors to consider when purchasing diagnostics equipment. The *Criteria for the Evaluation of Hospitals*<sup>17</sup> and the *Administrative Regulations for Clinical Laboratories of Medical Institutions*<sup>18</sup> of the NHFPC, require a maximum time for obtaining diagnostics reports in emergency cases. In Article 4.16.1.1.2(3) of the *Criteria for Evaluation of Class III Hospitals* published in April 2011, it is specifically stated that "the time for issuing a report in emergency cases shall be clearly specified. It shall be less than 30 minutes (including) clinical diagnostics and less than two hours (including) biochemical and immunity tests. Moreover, while the workload in hospital laboratories increases by over 20 per cent annually, the personnel in hospital does not increase at the same rate. Highly-automated equipment is necessary to reduce the workload of laboratory staff and provide more accurate data for doctors and a better service to patients.

17 *Criteria for Evaluation of Class III Hospitals (2011)*, NHFPC, 18<sup>th</sup> April, 2011, viewed 1<sup>st</sup> June, 2015, <<http://www.nhfpc.gov.cn/zyygj/s3585u/201104/c6fa4cc981d4429ba8caa7666aa13710.shtml>> and *Criteria for Evaluation of Class II Hospitals (2012)*, NHFPC, 30<sup>th</sup> December, 2012, viewed 1<sup>st</sup> June, 2015, <<http://www.nhfpc.gov.cn/zyygj/s3586q/201201/b8dda05b1d23413c94150b5c17b5cc6f.shtml>>

18 *Administrative Regulations for Clinical Laboratories of Medical Institutions*, NHFPC, entered into force 1<sup>st</sup> June, 2006, viewed 23<sup>rd</sup> June, 2015, <<http://www.nhfpc.gov.cn/zyygj/s3577/200804/d3281df051d44badbd45cf12fe95a28e.shtml>>

In addition there are other factors to consider: the level of economic development, the level of the hospitals and expertise of personnel, there is no one ideal solution that fits very different conditions.

#### Recommendation

- Approve at least two methodologies for diagnostics, i.e. one of advanced technology, high sensitivity, high specificity; another of lower sensitivity and specificity, allowing exceptions for special requirements.

### 3.2 Reclassify Diagnostic Reagents

#### Concern

China puts diagnostic reagents in higher risk classes than other countries.

#### Assessment

The Healthcare Equipment Working Group supports the CFDA's revision of the registration regulations for IVD products. However the risk classification of part of the diagnostic reagents' classification is still not in line with international standards. After seven years trial implementation the classification principles used in the trial version of the *Regulation on IVD Reagents Registration* (No. 229 document of SFDA in 2007) are still adopted, no progress of legislation can be seen – some diagnostic reagents with moderate risk are still classified as high risk products, contrary to the accepted principles of risk management. For instance, according to the rules promoted by the Global Harmonisation Task Force (GHTF), diagnostic reagents listed below, should be classified as moderate risk Class II medical devices, instead of Class III high-risk products:

- Reagents used in connection with anaesthetics, anti-psychotic pharmaceuticals and toxic drugs for medical treatment.
- Reagents related to examination of the therapeutic effect of drugs.
- Reagents that are mostly related to the detection of tumour markers.
- Reagents related to allergic responses (allergens).

#### Recommendation

- Refer to international rules of classification and reclassify low-to-moderate risk IVD products into Class I or II.



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### 3.3 Develop Industry Standards for IVD Products

#### Concern

Many IVD products are not defined by Chinese national standards or industry standards, which hampers market access and endangers the supply of products with consistent quality. In addition, some existing standards are not scientifically sound, some specifications are contradictory and some test methods laid down in these standards cannot be carried out.

#### Assessment

Chinese standards have only been defined for a relatively small fraction of IVD products available on the international market, which does not reflect the needs of different types of hospitals and hampers the development of the IVD industry in China. At the same time, too-narrow standards restrict the market access of many IVD products. Specific product characteristics and specifications that are not vital for diagnostic results should fall under the responsibility of the industry, allowing fair competition between different manufacturers.

Chinese regulations or industrial standards require that standardised reference substances must be used for type testing and during market supervision. However in many cases the Chinese Central Test Institute cannot provide these standard substances and they are not available on the Chinese market.

#### Recommendations

- Give priority to generally-adopted standards when defining industrial standards.
- Develop general technical standards, thereby taking into consideration the technical characteristics and risk requirements of IVD products, and develop mandatory and recommended industry standards based on experience and conventions of national standards.
- When writing new standards, consider views and suggestions from the industry, adopt scientific and effective validation mechanisms and establish transparent management.

### 3.4 Add IVD Products to the Catalogue of Medical Devices Exempted from Clinical Trials

#### Concern

In 2014, the CFDA published *Catalogue of Class II<sup>19</sup> Medical Devices Exempted from Clinical Trials* and *Catalogue of Class III Medical Devices Exempted from Clinical Trials*,<sup>20</sup> neither of which include IVD products.

#### Assessment

The CFDA formulated the *Guiding Principles on Clinical Trial Application of IVD Reagents*, which became effective in October 2014.<sup>21</sup> However a catalogue of IVD products exempted from clinical trials has not been published.

Most IVD methods and imported products are mature and have been in clinical use for many years, a sound proof of their reliability. To conduct clinical trials on such methods or products in China will not further enhance the reliability of such methods or products.

#### Recommendation

- Add those IVD products that have been in use for a long time with no record of incorrect diagnosis to the *Catalogue of Medical Devices Exempted from Clinical Trials*.

### 4 Promote the Reform of Centralised Procurement and Bidding for High Value Consumable Medical Devices at Provincial Level

#### Concern

The *Working Procedures for Centralised Procurement of High Value Medical Consumables (trial implementation) (Working Procedures)*<sup>22</sup> needs to be improved to take into consideration the variety of high-value medical consumables.

#### Assessment

On 15<sup>th</sup> January, 2013, the NHFPC published the *Working Procedures*, a move that was welcomed by

19 *Catalogue of Class II Medical Devices Exempted from Clinical Trials*, CFDA, entered into force on 1<sup>st</sup> October, 2014, viewed 23<sup>rd</sup> June, 2015, <<http://www.sda.gov.cn/WS01/CL0087/105224.html>>

20 *Catalogue of Class III Medical Devices Exempted from Clinical Trials*, CFDA, entered into force on 1<sup>st</sup> October, 2014, viewed 23<sup>rd</sup> June, 2015, <<http://www.sda.gov.cn/WS01/CL0087/105225.html>>

21 *Guiding Principles on Clinical Trial Application of IVD Reagents*, CFDA, entered into force on 1<sup>st</sup> October, 2014, viewed 23<sup>rd</sup> June, 2015, <<http://www.sda.gov.cn/WS01/CL0087/105225.html>>

22 *Working Procedures for Centralized Procurement of High Value Medical Consumables (trial implementation)*, entered into force on 17<sup>th</sup> December, 2012, viewed on 23<sup>rd</sup> June, 2015, <<http://www.moh.gov.cn/mohghcws/s3578/201301/d9b4637a63b641aa953baf2a6499b760.shtml>>



the Healthcare Equipment Working Group. However, considering the variety of high-value medical consumables, the working group hopes that relevant rules can be further refined, giving priority to quality and fostering a reasonable pricing system by developing a set of standard, fair and transparent bidding procedures.

Difficulties that foreign-invested enterprises (FIEs) face due to the centralised procurement of high value medical consumables include:

- Procurement catalogue and innovative products: Due to the unique characteristics of the medical device market, in recent years the industry developed many new technologies and products. The *National Catalogue for Centralised Procurement of High-Value Medical Consumables*,<sup>23</sup> formulated in 2008, can no longer meet clinical demands and needs to be updated and refined;
- Procurement procedures: When publishing calls for tenders, the provinces do not disclose important information such as the quantity of products to be procured or the payment time, making it difficult for the industry to submit qualified offers based on the specific conditions of the tender;
- Procurement period: All provinces stipulate that the procurement period for centralised bidding is two years. Consequently, access of patients to new products will be delayed;
- Bidding fees: Currently there are a variety of fees relating to centralised procurement, including deposits, administrative fees, bidding fees, bid-winning fees, contract guarantees etc. There are no regulations for imposing these fees, which increase the burdens on bidding enterprises; and
- Price control: As medical devices are a very specialised product, the price of medical devices cannot be controlled based on production costs. For example, the responsibility of manufacturers of implanted or interventional medical consumables is not restricted to manufacture of the implant, they must also monitor post-surgery conditions of the patient. Simply focusing on price and repetitive price negotiations will not be beneficial for product innovation and quality improvement, and it is also against the principle formulated by the NHFPC in the *Working Procedures*

to focus on quality and develop a reasonable pricing system to achieve a proper cost performance ratio.

Imported products may face restrictions because of specific clauses in the procurement catalogue.

As stated in Chapter 1 Article 5 of the *Working Standards*, “centralised procurement shall be carried out based on the principle of transparency, open and fair competition, clean administration, scientificity and integrity to ensure that all medical consumables manufacturing enterprises can participate on an equal basis. All types of local protection shall be prohibited.” However, in recent years there are emerging restrictions on import enterprises to participate in centralised procurement.

#### Recommendations

- Develop a scientific and standardised procurement catalogue and criteria for product classification and quality evaluation to ensure the clarity and predictability of centralised procurement of medical consumables, and encourage innovation of technologies, materials and techniques when developing assessment indicators.
- Publish the envisaged date of calls for bids, the procedures and rules for adding new products to centralised procurement; ensure timely updates and improve the pool of professional reviewers to ensure that it always maintains a sufficient number of specialists that have a corresponding professional background and knowledge of medical devices.
- Simplify requirements on qualifications, streamline approval mechanisms and establish an e-procurement platform.
- Implement centralised procurement procedures across all of China’s provinces, disclose the legal basis for, and amount of, procurement-related fees and reduce non-predictable charges.
- Provide equal opportunities and an environment of fair competition, regardless of domestic or imported products, and give patients the right to choose among different suppliers of high-value medical consumables.

### 5. Recognise Medical Devices Manufactured by Companies in China with Foreign Investors as Domestic Products

#### Concern

Since May 2014, the central and local governments

<sup>23</sup> Ministry of Health’s Notice on Publicizing the 2008 National Catalogue for Centralized Procurement of High Value Medical Consumables, NHFPC, entered into force on 1<sup>st</sup> October, 2008, viewed on 23<sup>rd</sup> June, 2015, <<http://www.moh.gov.cn/mohghcws/s3574/200809/37658.shtml>>



have promoted the development of the Chinese medical industry by competitions, promotional meetings, product announcements and other means, however, medical devices that are manufactured in China by multinational enterprises are not included in this promotion.

### Assessment

In December 2014, China Association of Medical Equipment (CAME) published the first list of outstanding national equipment, including digital X-ray apparatus, Colour Doppler Diagnostic Ultrasound Systems and Automatic Biochemical Analysers. Products manufactured in China by FIEs were not included in this list.

On 16<sup>th</sup> August, 2014, the NHFPC and the MIIT co-hosted a *Seminar on Promotion of Development and Application of Domestic-Made Medical Equipment* in Beijing. Li Bin, Director of the NHFPC, expressed that “... [we] shall vigorously promote the use of domestic-made medical equipment by medical and family planning institutions, focusing on promoting the use of domestic-made medical equipment at class 3a hospitals.” Miao Wei, Minister of the MIIT also emphasised “promoting and stimulating the use of domestic-made innovative products by medical and healthcare institutions”.<sup>24</sup>

In June 2014, the Shanghai Municipal Commission of Health and Family Planning issued the *Notice on Strengthening the Administration of the Deployment of Large Medical Equipment of Class B*, requiring that “medical institutions at district level shall in principle choose domestic-made, large medical equipment from the 2<sup>nd</sup> unit onward, those at municipal level from the 3<sup>rd</sup> unit onward”.<sup>25</sup> In April 2015, the Anhui HFPC issued the *Notice on Application for Deployment of Domestic-Made Medical Image Diagnosis Equipment*, which specified that “...the applied products shall be chosen from domestic-made equipment.”<sup>26</sup>

Foreign-invested multinational manufacturers are conducting R&D in China, producing low, medium to

high-end medical devices to meet different requirements of patients in China and are selling the products in China and the global market. They pay taxes in China and have created over 10,000 jobs. Therefore, they are a member of the Chinese society even though their products are a brand of an international manufacturer.

From an industry perspective, exclusion of domestic-made products of global brands will not only limit available products, it will also result in domestic enterprises losing their competitiveness and innovation capability under the shelter offered by such policies. Joint ventures and WOFEs will be discouraged from launching hi-tech products due to a lack of equal market access.

Such practices also violate the rules China shall abide by upon entry to the World Trade Organisation (WTO), Article 2, 3, 4 and 5,<sup>27</sup> and relevant regulations on the Anti Unfair Competition Law promulgated by the Chinese Government.<sup>28</sup>

### Recommendations

- Define ‘domestic-made products’.
- Recognise medical devices manufactured in China as ‘domestic-made products’, independent of the location of the investor or owner of the production facilities.
- Grant JVs and WFOEs equal treatment in China.

## 6. Initiate an Open and Transparent Discussion about the Regulations and Standards for Health Information Technology (IT), Allow and Encourage the Efficient Use of Health Information Technology

### Concern

Lack of publicity and transparency in the development of standards for health information technology and concerns over safety and protection of privacy may hamper the use of health information technology and secondary applications.

### Assessment

Health information standards are interoperable standards, they are not related to standards regarding security and monitoring of the environment. The

<sup>24</sup> NHFPC and MIIT Jointly Convened the Seminar on Promotion of Development and Application of Domestic-Made Medical Equipment, NHFPC, 2014, viewed 1<sup>st</sup> June, 2015, <<http://www.nhfpc.gov.cn/guihuaxxs/s3586/201408/71ce8bb4267c4578a2ce169a72bf4c60.shtml>>

<sup>25</sup> Notice on Strengthening the Administration of the Deployment of Large Medical Equipment of Class B, Shanghai HFPC, entered into force 1<sup>st</sup> July, 2014, viewed 1<sup>st</sup> June, 2015, <<http://www.wsjsw.gov.cn/ws/n429/n432/n1487/n1504/u1ai134123.html>>

<sup>26</sup> Notice on Application for Deployment of Domestic-Made Medical Image Diagnosis Equipment, Anhui HFPC, 2015, viewed 1<sup>st</sup> June, 2015, <<http://www.ahwjw.gov.cn/gbxxclzgg/201504/7de4ab97666c45e0a602b2bdd0849e6a.html>>

<sup>27</sup> Agreement on Technical Barriers to Trade, WTO, entered into force 1994, viewed 23<sup>rd</sup> June, 2015, <[https://www.wto.org/english/docs\\_e/legal\\_e/17-tbt\\_e.htm](https://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm)>

<sup>28</sup> Anti Unfair Competition Law, Standing Committee of the NPC, entered into force 1<sup>st</sup> December, 1993, viewed 23<sup>rd</sup> June, 2015, <[http://www.gov.cn/banshi/2005-08/31/content\\_68766.htm](http://www.gov.cn/banshi/2005-08/31/content_68766.htm)>





standards should be developed primarily by health information companies and medical institutions in an open and transparent manner. However, in the past the development of standards took place under an administrative system. As a result, working groups developed standards independently, detached from their practical application. Most of the standards developed in such a way are poor quality and not suitable for actual application or are not interoperable.

Compliance tests developed under these conditions often do not represent the practical environment in which the system shall be used, creating an unnecessary burden for manufacturers and medical institutions.

On 11<sup>th</sup> March, 2015, the State Council promulgated the *Reform Concept for Deepening Standardisation*.<sup>29</sup> This concept requires: Principle one: “relax[ed] administrative interference, administration and openness shall co-exist ... utilise vigorous industrial standards, let the market play the dominant role.”; Principle two: “insist[ing] on being in line with international practices, fit national conditions. Use the advanced experience of developed countries in standardisation.”

Health information and secondary applications are a future trend in healthcare, but issues related to the security of health data and protection of privacy may hamper their development. China has not yet promulgated regulations on data security and the protection of privacy. In May 2014, the NHFPC issued the *Administrative Regulation of Public Health Data (Trial)*,<sup>30</sup> in which data protection, the protection of privacy and possible dissemination of medical data are not clearly regulated. The NHFPC has done research on regulation of the security of health information data and the protection of privacy, as well as on corresponding standards. The working group hopes that the NHFPC will be open to constructive contributions from all stakeholders, and promulgate related detailed regulations and standards as soon as possible.

### Recommendations

- Implement the State Council's *Reform Concept for*

*Deepening Standardisation*, give priority to international interoperable standards, avoid political criteria in standardisation processes, encourage companies engaged in health information technology, health institutions and non-governmental organisations to develop standards and maintain a cautious attitude to promoting administrative compliance tests.

- Discuss health information regulations and standards openly and transparently, and allow all stakeholders to make good use of health information technology while ensuring privacy and data protection.
- Encourage the EU-China Health IT Expert Roundtable to become a platform for China and Europe to exchange solutions on the aforementioned issues, share technical know-how and organise training for relevant personnel.

### Abbreviations

AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
CAME	China Association of Medical Equipment
CFDA	China Food and Drug Administration
CDMD	Consumable and Disposable Medical Devices
CMDE	Centre for Medical Device Evaluation
COCIR	European Coordination Committee of the Radiological, Electromedical and Healthcare IT Industry
CT	X-ray Computed Tomography
DRG	Diagnostic-Related Groups
EU	European Union
FDA	Food and Drug Administration
GA	Government Affairs
GHTF	Global Harmonisation Task Force
GRP	Good Refurbishment Practice
GSP	Good Supply Practice
Health IT	Health Information Technology
IMDRF	International Medical Device Regulators Forum
IT	Information Technology
IVD	In Vitro Diagnostic
JV	Joint Ventures
MEDDEV	The European Commission provides a range of guidance documents to assist stakeholders in implementing Directives, related to Medical Devices. The guidance documents are called “MEDDEVs”

<sup>29</sup> *Reform Concept for Deepening Standardisation*, State Council, 2015, published 11<sup>th</sup> March, 2015, viewed 1<sup>st</sup> June, 2015, <[http://www.gov.cn/zhengce/content/2015-03/26/content\\_9557.htm](http://www.gov.cn/zhengce/content/2015-03/26/content_9557.htm)>

<sup>30</sup> *NHFPC's Notice on Publishing the Administrative Regulation on Health Data of the Population (trial)*, NHFPC, published 5<sup>th</sup> May, 2014, viewed 3<sup>rd</sup> July, 2015 <<http://www.nhfpc.gov.cn/guihuaxxs/s10741/201405/783ec8adebc6422bbebdf9db3868d0b.shtml>>







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MIIT	Ministry of Industry and Information Technology
MOFCOM	Ministry of Commerce
NHFPCC	National Health and Family Planning Commission
OEM	Original Equipment Manufacturer
PMA	Pre-Market Approval
PMS	Post Marketing Surveillance
RA	Regulatory Affairs
RPS	Regulated Product Submission
R&D	Research and Development
SFDA	State Food and Drug Administration <i>It was officially renamed the China Food and Drug Administration CFDA on 22<sup>nd</sup> March, 2013</i>
ToC	Table of Contents
USFDA	United States Food and Drug Administration
WFOEs	Wholly Foreign-Owned Enterprises
WTO	World Trade Organisation





## European Heating Industry Desk

### Key Recommendations

#### 1. Rollout Nationwide Guidelines to Promote Wall-hung Boilers with Energy Efficiency Class 1

- Widen the scope of the regulation *List of Building Materials Which are Promoted, Limited and Prohibited to be Used in Beijing JJF [2015] No.86* to include wall-hung boilers sold in retail channels.<sup>1</sup>
- Rollout the regulation *List of Building Materials Which are Promoted, Limited and Prohibited to be Used in Beijing JJF [2015] No.86* nationwide and modify the industrial standard at an appropriate time.<sup>2</sup>

#### 2. Introduce an Energy-efficiency Scheme for Commercial and Industrial Boilers

- Cooperate closely with international authorities and associations to share lessons learned from energy-efficiency schemes.
- Introduce a transparent energy-labelling scheme for commercial and industrial applications.
- Certify the annualised energy-efficiency checks of boiler systems and tie this to legislative incentives to increase efficiency.

#### 3. Improve the Commercial and Industrial Boiler Safety Technical Supervision Administration Regulation TSG G0001-2012

- Commit resources to a joint feasibility study of the regulation TSG G0001-2012 together with the relevant Chinese authorities: if a partial revision of the standard were to be the result of such a study, the Association of the European Heating Industry (EHI) would be willing to support the drafting of a revised TSG G0001-2012.
- Provide an authorised English translation of the current version of the TSG G0001-2012 standard in order to reach a common understanding.
- Consult with experts to help with drafting and reviewing before releasing future standards for commercial and industrial boilers.

### Introduction to the Desk

The European Heating Industry Desk is comprised of members from the Association of the European Heating Industry (EHI), an organisation that was founded in 2002. The EHI represents and promotes the common interests of 35 market leaders producing thermal comfort equipment and 13 national industrial associations from European Union (EU) Member States.<sup>3</sup> It strives to demonstrate advanced European heating technology and offers the view of the latest trends and developments of the industry.

<sup>1</sup> *List of Building Materials Which are Promoted, Limited and Prohibited to be Used in Beijing JJF [2015] No.86*, Ministry of Housing and Urban Rural Development (MOHURD), 2015, viewed 20<sup>th</sup> May, 2015, <<http://www.bjjs.gov.cn/publish/portal0/tab662/info95736.htm?COLLCC=2958030150&>>

<sup>2</sup> Ibid

<sup>3</sup> EHI website, viewed 23<sup>rd</sup> April, 2014, <<http://www.ehi.eu/>>

Desk members are European manufacturers of heating appliances (e.g. high-efficiency heating boilers), burners, water heaters, renewables (e.g. solar and heat pumps) and industrial components.

The desk seeks to:

- promote European technology relating to eco-friendly heating and hot water systems;
- strengthen the dialogue with Chinese regulators for domestic standards and certifications;
- assist in China's efforts to implement the highest international standards in the heating sector; and
- contribute to sustainable development via appropriate technological training.





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## Recent Developments

In recent years, lawmakers, businesses as well as the general public in Europe and in China have come to recognise the importance of energy efficiency in all sectors of the economy. Because more than 30 per cent of the primary energy consumed in any European country,<sup>4</sup> as well as in China, is used for buildings and heating, raising standards for efficient space heating, hot water preparation and industrial solutions can go a long way towards achieving policies for long-term, energy-saving goals to ensure security of supply and help combat global warming. European countries are increasing investment in the energy-saving industry.

Many heating installations in China are first-time installations, especially in non-traditional heating regions along the Yangtze River and in South China. Hence the importance of using highly efficient, low-NOx (nitrogen oxides) solutions cannot be overemphasised.

In China, sustainability and environmental protection are treated as a legislative priority under the 12<sup>th</sup> Five-Year Plan. The Chinese Government has made progress with regards to environmental protection, and the announcements by the new generation of leaders in Beijing to increase energy efficiency are encouraging. In 2015, a new regulation was issued in Beijing that made it mandatory to use 'condensing' wall-hung boiler technology in all new projects that are built in the city, which will lower pollutants emitted by wall-hung boilers. This regulation is in line with Third Plenum targets where the government promised to implement a system for conservation of energy and to reduce levels of pollution. The European Chamber and the European Heating Industry fully support this new regulation and hope it can be rolled out nationwide in the near future.

With air pollution levels reaching record highs in 2014 and 2015, environmental protection has become one of the government's top priorities. The lively public debate on air pollution and energy saving generates a favourable climate for a shift toward energy efficient heating appliances.

China and the EU have established a number of joint initiatives to help capture the potential of energy efficiency such as the Urbanisation Forum and Energy Dialogue, the EU-China Urbanisation Partnership

<sup>4</sup> *Europe's Energy Security: Options and Challenges to Natural Gas Supply Diversification*, viewed 24<sup>th</sup> May, 2014, <<http://www.fas.org/sgp/crs/row/R42405.pdf>>

and the Europe-China Eco-Cities project.<sup>5</sup> In order to promote advanced European technology in China, this desk has worked particularly closely with Chinese heating associations and makes contributions to the testing standards for heating products in China, such as drafting the new standards for gas-fired domestic heating.

Almost all key members of the EHI are currently active in the Chinese heating market and the association is now widely represented across China. The EHI hopes to continue its partnership with Chinese government agencies. The desk strives to demonstrate the value of European heating best practices to Chinese consumers and legislative bodies.

## Key Recommendations

### 1. Rollout Nationwide Guidelines to Promote Wall-hung Boilers with Energy Efficiency Class 1

#### Concern

Gas-fired, wall-hung boilers with Energy Efficiency Class 2 do not make full use of available energy-saving and pollution-reducing technologies.

#### Assessment

The wall-hung boiler market has evolved rapidly in recent years with Energy Efficiency Class 2 boilers (non-condensing) currently making up the majority of gas-fired heating appliances sold in China. However, common boilers in this category do not make use of the full potential of gas boilers: thermal energy from the combustion process is wasted when hot exhaust gases are emitted into the atmosphere. Using the latest technologies, this energy can be used to increase the overall efficiency of the boiler by using condensing technology which transfers this thermal energy back into the heating cycle. By employing this method, emissions can be reduced to less than 50mg of NOx per cubic metre and the consumption of natural gas can be reduced by 15 per cent.

Local Chinese manufacturers as well as foreign companies now possess the knowledge and technology to produce gas-fired, wall-hung boilers with Energy Efficiency Class 1.

<sup>5</sup> *European Commission bilateral cooperation with China*, <[http://ec.europa.eu/energy/international/bilateral\\_cooperation/china/china\\_en.htm](http://ec.europa.eu/energy/international/bilateral_cooperation/china/china_en.htm)>



In Beijing Municipality a new guideline was put in place prohibiting wall-hung boilers with Energy Efficiency Class 2 and below to be used in new projects. From 1<sup>st</sup> May, 2015, boilers with Energy Efficiency Class 2 will not be permitted in the project business planning phase and from 1<sup>st</sup> October, 2015, they will not be allowed to be installed.

Local and provincial legislators all around China should strive for the development of similar guidelines or incentives for project development companies and end-users to make full use of the significant potential for decreasing pollution levels and saving natural gas.

#### Recommendations

- Widen the scope of the regulation *List of Building Materials Which are Promoted, Limited and Prohibited to be Used in Beijing JJF [2015] No.86* to include wall-hung boilers sold in retail channels.
- Rollout the regulation *List of Building Materials Which are Promoted, Limited and Prohibited to be Used in Beijing JJF [2015] No.86* nationwide and modify the industrial standard at an appropriate time.

## 2. Introduce an Energy-efficiency Scheme for Commercial and Industrial Boilers

#### Concern

There is no official energy-labelling scheme in place for commercial and industrial heating systems, which not only leads to a waste of resources, but also contributes significantly to environmental pollution.

#### Assessment

While energy efficiency labelling has been made mandatory for many consumer goods, among them white goods such as air conditioning units and refrigerators or domestic heating applications such as wall-hung boilers, there is no official energy labelling scheme in place for commercial and industrial heating systems.

Although there is no industry scheme to ensure energy efficiency for large boilers and boiler systems for all fuel types, technology that is already available on the market can contribute to a marked increase in energy efficiency for new and existing installations.

As is the case in other countries, the route to market via highly-specialised sales agents for commercial

and industrial boilers leads to diverging interests between the investor and the specialised sales agent. The investor does not always have the know-how to compare the energy efficiency of two or more systems, relying on the specialised sales-agent for all technical information. This may lead to a purchasing decision based on incomplete information and to increased costs for the investor as well as a waste of resources for the overall economy.

Local and provincial legislators, industry associations and manufacturers should strive for an energy performance scheme for commercial and industrial boiler applications. A goal of such an efficiency scheme would be to provide transparent and comparable information on the energy efficiency of the major components of a boiler system (such as the boiler, burner, economiser, pumps), and provide clear instructions on how to measure the efficiency of the whole system.

Based on the information provided through such a scheme, investors could make informed decisions on the life-cycle energy efficiency and the economic viability of a boiler system. This information is especially important against the background of a long-term increase in global energy prices.

This scheme should not only involve new installations, but should also encompass existing systems. In addition to savings achieved through decreased energy consumption, investors could be guided through government incentives.

#### Recommendations

- Cooperate closely with international authorities and associations to share lessons learned from energy-efficiency schemes.
- Introduce a transparent energy-labelling scheme for commercial and industrial applications.
- Certify the annualised energy-efficiency checks of boiler systems and tie this to legislative incentives to increase efficiency.

## 3. Improve the Commercial and Industrial Boiler Safety Technical Supervision Administration Regulation TSG G0001-2012



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### Concern

The new standard for commercial and industrial boilers TSG G0001-2012 sets out technical requirements for hot-water boilers which do not increase product safety or efficiency, but increase design and equipment costs for Chinese as well as foreign manufacturers.

### Assessment

In recent years, not only have technical requirements for boilers and pressure vessels served to increase commercial and industrial boiler safety in China, they have also levelled the playing field for manufacturers by providing a common technical framework.

The newly adapted TSG G0001-2012 (*Boiler Safety Technical Supervision Administration Regulation*) sets forth clear requirements for the construction and safety requirements of hot-water and steam boilers. The origins of most requirements can be traced from the construction principle of steam boilers. In TSG G0001-2012, many of the specifications stemming from steam-boilers are now applied for hot-water boilers.

This leads to technical requirements which are at times difficult to meet, especially for hot-water boilers with a low-output range. Furthermore, it may be argued that some requirements neither improve the safety nor the efficiency of hot water boilers but significantly increase the construction and manufacturing burden.

### Recommendations

- Commit resources to a joint feasibility study of the TSG G0001-2012 together with the relevant Chinese authorities: if a partial revision of the standard were to be the result of such a study, the EHI would be willing to support the drafting of a revised TSG G0001-2012.
- Provide an authorised English translation in order to reach a common understanding of the current version of the TSG G0001-2012 standard.
- Consult with experts to help with drafting and reviewing before releasing future standards for commercial and industrial boilers.

## Abbreviations

EHI	Association of the European Heating Industry
EU	European Union
NOx	Generic term for the various nitrogen oxides produced during combustion





## Metals and Mining Working Group

### Key Recommendations

#### 1. Reduce Overcapacity in the Steel Sector

- Increase the pace of reducing over-production by closing obsolete capacity.
- Continue implementing strict constraints on the approval of new capacities for both privately-owned enterprises (POEs) and state-owned enterprises (SOEs) and improve capacity-elimination measures.
- Make capacity-elimination decisions on a case-by-case basis rather than through the current blanket consolidation approach.
- Implement a monitoring tool to track capacity elimination.
- Eliminate loopholes for circumventing government measures concerning exports, such as adding chrome to export construction steels in order to obtain a value-added tax (VAT) refund upon export for alloyed steels.
- Discontinue the use of the English term 'export tax rebate' when talking about the VAT refund upon export.
- Equalise VAT-refund upon export for all metal product groups to an equal and even level to live up to the Third Plenum's *Decision on Some Major Issues Concerning Comprehensively Deepening the Reform (Decision)*, in terms of creating an equitable market environment.
- Reduce import duties and import barriers for steel products, so as to expose the domestic market to healthy, international, open-market competition to live up to the *Decision*, in terms of creating an equitable market environment.

#### 2. Encourage Fair Competition in the Metals and Mining Sectors

- Enforce equal compliance with laws, rules and regulations for SOEs, private and foreign-invested manufacturers.
- Ensure equal market access and raw material access at even pricing to create fair competition between SOEs, private and foreign-invested manufacturers.
- Ensure equal, non-discriminatory access to metal exchanges for all market participants.
- Adapt approval processes for new capacity development to local demand data.
- Create a level market environment by removing expressed and implied state-guarantees for SOEs.
- Consider stock-exchange listing of SOEs exceeding the 'blocking minority' shareholding as per Chinese law, in order to strengthen oversight by public shareholders.

#### 3. Open the Mining Industry to Foreign Investment and Improve the Mechanisation of Mining Companies in China

- Remove the mining industry from restricted industries in the *Foreign Investment Industrial Guidance Catalogue* and from the *Special Administrative Measures on the Entry of Foreign Investment into China (Shanghai) Free Trade Zone (2015 Negative List)*.
- Open up the Chinese mining market to foreign mining companies to encourage the introduction of advanced technologies and best practices.

 Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.





- Speed up the mechanisation and modernisation levels of Chinese mining companies by introducing strict policies to promote safe, efficient and environmentally-friendly mining methods.
- Create a market for advanced mining equipment by upgrading mining industry standards.
- Engage more third-party expertise in the design of mining plans in order to safeguard sustainable mining, which is in national interests.
- Review and align certification legislation related to mine safety with leading international industry practices, with a focus on how to address safety concerns.

#### 4. Set up Standards for End Processing of Waste Electrical and Electronic Equipment (WEEE) Fractions

- Guarantee the development of standards and qualification systems for the recycling industry.
- Implement a monitoring tool to track the treatment of WEEE fractions, including dismantling/pre-processing/end-processing.
- Develop end-processing standards for WEEE fractions in China.
- Allow simplified approvals for the trans-provincial movement of WEEE fractions.

### Introduction to the Working Group

The Metals and Mining Working Group was established in 2013, in Shanghai with the integration of the former Non-Ferrous Metals Working Group. Its members include international enterprises who are leaders in their respective industries.

The working group aims to contribute to the development of a sustainable metals and mining industry in China and to further its exchanges with the international market. The working group actively engages with relevant governmental departments and organisations to develop cooperation through constructive dialogues with the overarching aim of creating a level business environment for domestic and foreign market participants in China.

### Recent Developments

In 2014, China continued to suffer from substantial industrial overcapacity in many sectors including steel, cement, electrolytic aluminium, sheet glass and shipping. This overcapacity initially resulted from extensive investments in basic industries aimed at catching up with exponentially growing demand from 2000–2010, but then continued unabated due to the post-financial-crisis 2009 economic support measures.

Despite the peak in domestic consumption of basic

metal materials in 2014, production kept growing. This excess production led to price declines and, in some cases, a dramatic surge in exports to other markets. China's outbound shipments of steel, for instance, jumped by 51 per cent to approximately 94 million tons.<sup>1</sup>

In certain industries, such as seamless steel tubes, the Chinese Government recognised the issue of over-investment as early as 2005. Nevertheless, despite measures launched to tackle these issues, lacklustre implementation has meant that this situation remains unchanged.

The Metals and Mining Working Group recognises the government's significant efforts to counter overproduction and overcapacity problems. Some of these initiatives have been successful. For example, clamping down on excess credit, imposing higher capacity/technology threshold and cancelling value-added tax (VAT) refunds upon export for hot-rolled steels with boron<sup>2</sup> added shows the government's clear determination to disallow low-value-added exports at a high cost to society. On the other hand, some of the policies could be improved. For example, *China's Steel*

<sup>1</sup> *Steel exports rise for record fifth month*, *China Daily*, 10<sup>th</sup> February, 2015, viewed 27<sup>th</sup> April, 2015, <[http://www.chinadaily.com.cn/kindle/2015-02/10/content\\_19543772.htm](http://www.chinadaily.com.cn/kindle/2015-02/10/content_19543772.htm)>

<sup>2</sup> *Notice on Export Tax Rebates Adjustment of Some Products*, SAT & MOF, 31<sup>st</sup> December, 2014, viewed on 27<sup>th</sup> April, 2015, <[http://www.mof.gov.cn/zhengwuxinxi/zhengcefabu/201412/t20141231\\_1175119.htm](http://www.mof.gov.cn/zhengwuxinxi/zhengcefabu/201412/t20141231_1175119.htm)>



*Industry Adjustment Policy* draft (2015 Revision) of the Ministry of Industry & Information Technology (MIIT)<sup>3</sup> lacks numerical targets, a fundamental assignment of tasks and related accountability. Particularly when policies require substantial changes, the working group considers numerical targets, assignment of tasks and accountability vital for implementations of policies, which otherwise will remain little more than expressions of intent.

The working group has noted the rapid recent development of several exchange markets for commodities, and of multiple new physical or paper products by those exchanges. In particular for ore and metals, many new exchanges are being created (the Shanghai Futures Exchange, the Dalian Commodity Exchange, the Zhengzhou Commodity Exchange, the Shanghai International Energy Exchange, the Shanghai Gold Exchange, the Shanghai United Steel Exchange, the Fanya Metal Exchange and the Shanghai Asia Pacific International Commodities Exchange). The working group hopes that these exchanges will be regulated and managed in a transparent way to limit volatility in commodities and allow both domestic and foreign industry players fair access to these exchanges and their clearing houses, both onshore and offshore, whatever the nationality of the legal representative.

The working group is concerned about the Third Plenum's *Decision on Some Major Issues Concerning Comprehensively Deepening the Reform (Decision)*<sup>4</sup> calling for an even and fair market environment, while at the same time calling for a market-leading role for state-owned enterprises (SOEs). The metals and mining industry is a capital intensive industry whereby financing at low interest rates is critical. Since SOEs generally have easier access to credit at more favourable terms than privately-owned enterprises (POEs) of the same size and standing, the working group sees a market-leading role for SOEs as incompatible with the notion of a fair and even market.

The *Decision* also calls for models of mixed ownership. It is the view of the working group, that before the overcapacities are effectively eliminated, no basic

industry will be attractive enough to invite private or public investment.

The government has continued to strongly enforce laws and regulations in the metals and mining industries. While the working group continues recognising the effort, there are still areas where enterprises gain commercial advantages through non-compliance, which leads to environmental and domestic infrastructure damage and unfair competition.

Accidents in China's mining industry are still commonplace. Though the number of deaths related to coal mining accidents has dropped from 7,000 in 2000 to 931 in 2014,<sup>5</sup> the number of casualties is still shockingly high. The working group continues recommending stronger enforcement of safety and environmental standards as well as a higher degree of mechanisation in accordance with applicable standards elsewhere in the world.

## Key Recommendations

### 1. Reduce Overcapacity in the Steel Sector

#### Concern

Growth in steel production far exceeded demand growth in recent years, damaging the industry and its prospects of sustainable development.

#### Assessment

China's crude steel capacity in 2014 was approximately 1.2 billion tons,<sup>6</sup> whereas apparent domestic consumption was around 740 million tons and exports accounted for about 93 million tons (+50 per cent year on year).<sup>7</sup> This suggests an average utilisation rate of domestic steel mills of only about 70 per cent,<sup>8</sup> paired with an unsustainably high export volume. By common standards, disregarding subsidies, steel mills need a utilisation rate of 80 per cent to break-even.

Apparent domestic consumption of crude steel was stagnant in 2014, and is forecast to fall gradually to 650

3 *China's Steel Industry Adjustment Policy draft (2015 Revision)*, MIIT, 20<sup>th</sup> March, 2015, viewed on 27<sup>th</sup> April, 2015, <<http://www.miit.gov.cn/n11293472/n11293832/n12845605/n13916913/16513735.html>>

4 The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.

5 *The Number of Deaths Related to China Coal Mining Accidents has Dropped from 7,000 to 931 within 15 years*, *People's Daily Online*, 8<sup>th</sup> May, 2014, viewed 27<sup>th</sup> April, 2015, <<http://society.people.com.cn/n/2014/0508/c1008-24992581.html>>

6 *Bid Farewell to Heyday of Demand in Steel Industry*, *Gov.cn*, 27<sup>th</sup> January, 2015, viewed 27<sup>th</sup> April, 2015, <[http://www.gov.cn/xinwen/2015-01/27/content\\_2810484.htm](http://www.gov.cn/xinwen/2015-01/27/content_2810484.htm)>


7 *The Operation of the Steel Industry in 2014 and Prospect of 2015*, Ministry of Industry and Information Technology, 5<sup>th</sup> February, 2015, viewed on 27<sup>th</sup> April, 2015, <<http://www.miit.gov.cn/n11293472/n11293832/n11293907/n11368223/16445215.html>>

8 *Steel Companies Plans to Form Several Large Groups*, *Xinhua Net*, 23<sup>rd</sup> March, 2015, viewed 27<sup>th</sup> April, 2015, <[http://www.bj.xinhuanet.com/hbpd/jrpd/jrpd/2015-03/23/c\\_1114729787.htm](http://www.bj.xinhuanet.com/hbpd/jrpd/jrpd/2015-03/23/c_1114729787.htm)>







Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> Say?	What is the reality?	Status
<p><b>II. Adhering to and Improving the Basic Economic System</b></p> <p>“We must unwaveringly consolidate and develop the public economy, persist in the dominant position of public ownership, give full play to the leading role of the state-owned sector, and continuously increase its vitality, controlling force and influence. We must unwaveringly encourage, support and guide the development of the non-public sector, and stimulate its dynamism and creativity.”</p>	<p>The Metals and Mining Working Group has indeed observed China continuing the development of its economy with SOEs playing a leading role. SOEs are in the process of undergoing positive internal reforms. In terms of structural SOE reform, the working group notes positively, that this reform leaves the door open to eventual privatisation, along the lines of CITIC Bank's privatisation.</p> <p>Generally speaking, however, when it comes to metal products such as steel, SOEs tend to only bring their products up to the lowest, widely acceptable quality standard in the market. They are not known to produce their products to the highest possible quality standard, which in turn does not induce higher quality in downstream industries.</p> <p>SOEs tend to compete with private enterprises on price, not on quality, which in turn forces private enterprises to engage in price competition, at the expense of quality and often at the expense of environmental compliance. Notable exceptions from this pattern, such as Baosteel, have not spurred a sustained quality drive in peer SOE steel mills. The next stage of China's economic development will necessitate a quantum leap in quality and productivity, along the development paths that Japan, Korea and Taiwan have taken. As far as metals and mining is concerned, based on market dominance of SOEs such a quantum leap would be unprecedented.</p>	
<p><b>9. Enacting market rules that are fair, open and transparent.</b></p> <p>“We will implement a unified market access system; and on the basis of making a negative list, all kinds of market players may enter areas not on the negative list on an equal basis and according to law. We will explore a management model for foreign investors with pre-entry national treatment plus the negative list .... We will propel reform of our domestic commodity distribution structure while building a business environment under the rule of law.”</p>	<p>The working group recognises this important commitment to a functioning and equitable market environment. There are concerns, resulting from the aspiration for market leadership by SOEs. Market leadership as such carries potential problems to the detriment of functioning, level markets, regardless if in China or elsewhere. The Chinese Government has shown an impressive determination to deal with market-dominating forces, however, the working group is concerned about a high potential for conflict of interests when it comes to state organs dealing with SOEs. The disproportionate number of exits of private enterprises from the SOE-dominated steel market bears witness to such concerns. Another concern is that SOEs deny private, foreign-owned enterprises access to their business, as experienced by working group members.</p>	



million tons by 2025. Government planning suggested reducing capacities to around 1 billion tons until 2025.

In the working group's view, assuming apparent domestic consumption of 650 million tons by 2025 and an assumed-to-be-sustainable export quantity of 50 million tons, based on a minimum utilisation rate of 80 per cent, the domestic steel capacity in China should not exceed 875 million tons by 2025.

Thus the current government planning of reducing crude steel capacity by 200 million tons by 2025 is too little, and the time period of 10 years is too long.

Total European Union (EU) imports of goods from China in 2014 amounted to euro (EUR) 302 billion, of which steel was EUR 3.7 billion or 1.23 per cent. Total EU exports of goods to China in 2014 were EUR 164.7 billion, of which EU steel exports to China were EUR 2.2 billion or 1.34 per cent.

Although steel may appear to make up but a minor part of total EU-China trade (1.2 per cent of exports), China's steel exports to the EU increased by 48 per cent, amounting to a total of almost five million tons in 2014. Steel exports from the EU to China increased by only 2.3 per cent to 1.7 million tons.

In spite of a low EUR/United States Dollars (USD) exchange rate, the working group expects Chinese exports of steel to the EU to disproportionately rise further in 2015, as the pressure on Chinese steel mills to export remains strong. Major non-EU export markets for Chinese steel have locked out Chinese steel imports in 2014, and further trade action of non-EU countries is pending, so Chinese steel will need to be exported to the few principal markets that remain somewhat open to steel imports from China, regardless of price or cost of production, including the EU.

The working group is hopeful after seeing the strong determination of the Chinese Government to deal with over capacity in steel and to counteract exports of that steel, which contribute little or nothing to the addition of value in China, while at the same time the excessive exports undermine domestic market mechanisms in export destination countries.

The working group supports the policy set out in the *Steel Industry Adjustment Policy* draft (2015 Revision)

released by the Ministry of Industry & Information Technology (MIIT), however, lacking numerical targets, assignment of tasks and accountability will make a rigorous implementation of this policy doubtful. Further, it is the working group's opinion, that the envisioned improvements in this policy may only be achieved if supported by gradual, continuous privatisation.

The working group has observed that several foreign steel industry associations (including the German steel association *Wirtschaftsvereinigung Stahl* and the American Iron and Steel Institute (AISI)) along with the Chinese Government and other parties, are at times using the term 'tax rebate' when referring to China's VAT refund upon export. However, 'tax rebate' implies 'subsidy', meaning that the erroneous use of this term is leading foreign industry organisations to allege in their lobbying efforts that China is subsidising the export of steel. Although China likely subsidises the production of steel to an extent, the VAT refund upon export is, in effect, a VAT refund as seen in most European countries, and not a subsidy. The abandonment of this term will go a long way in clarifying this misunderstanding.

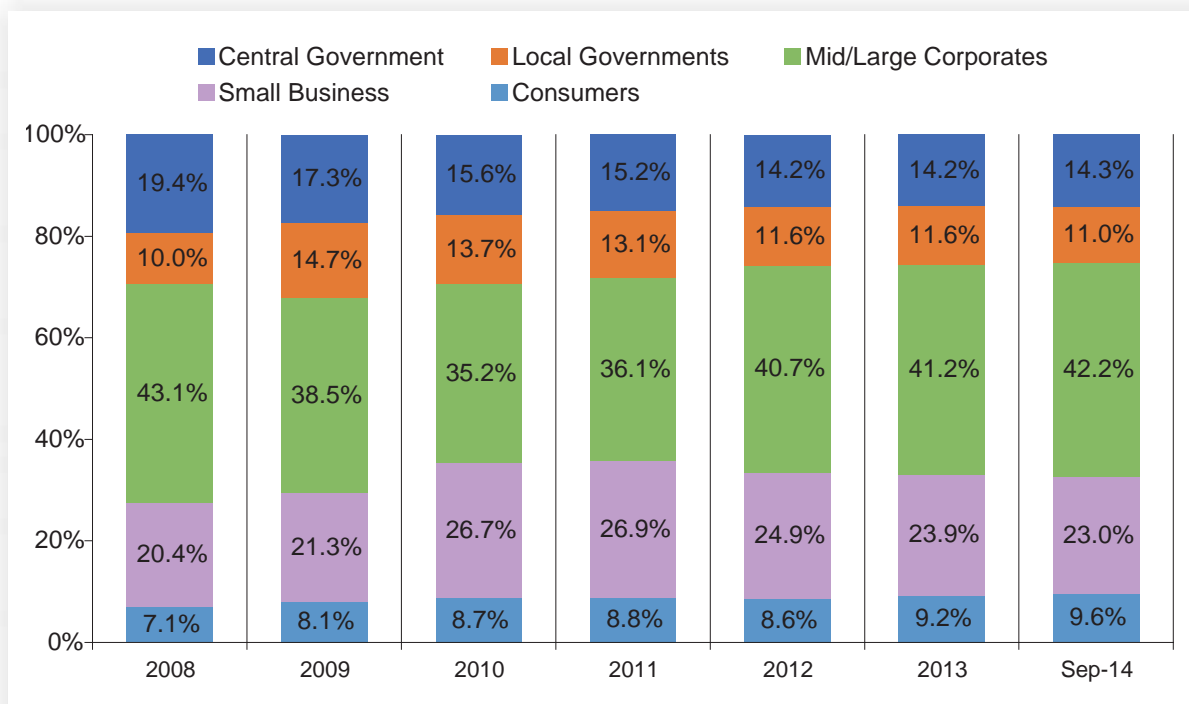
Nevertheless, the working group is concerned about China's approach to domestic and international markets through the discriminatory way in which it applies its VAT refund upon export scheme based on different product groups. While EU countries do have different VAT rates, upon export the full VAT is refunded. China's variable VAT refund rates across product groups China are resulting in uneven influence in the market.

#### Recommendations

- Increase the pace of reducing over-production by closing obsolete capacity.
- Continue implementing strict constraints on the approval of new capacities for both POEs and SOEs and improve capacity-elimination measures.
- Make capacity-elimination decisions on a case-by-case basis rather than through the current blanket consolidation approach.
- Implement a monitoring tool to track capacity elimination.
- Eliminate loopholes for circumventing government measures concerning exports, such as adding chrome to export construction steels in order to obtain a VAT refund upon export for alloyed steels.
- Discontinue the use of the English term 'export tax



**China Total System Leverage Breakdown by Segment (2008 – Sep 2014): Mid/large enterprises' share grew further while small business' shrank**



Source: WIND, CEIC, Leasing Association, ChinaBond.com, Morgan Stanley Research

rebate' when talking about the VAT refund upon export.

- Equalise VAT-refund upon export for all metal product groups to an equal and even level to live up to the Third Plenum's *Decision*, in terms of creating an equitable market environment.
- Reduce import duties and import barriers for steel products, so as to expose the domestic market to healthy, international, open-market competition to live up to the Third Plenum's *Decision*, in terms of creating an equitable market environment.

## 2. Encourage Fair Competition in the Metals and Mining Sectors

### Concern

Unfair market practices in China still have a significant impact in the mining and metallurgy sector – administrative constraints to access to bank loans and the access to low cost capital for SOEs is distorting financing costs of doing business. Ensuring compliance with existing regulations by all operators equally across the industry requires greater emphasis so as to avoid current unbalances that hinder the restructuring of overcapacity

and promotion of best practices.

### Assessment

In the current, excessively-oversupplied domestic steel and mining industry environment, where commodity prices are dropping to historical lows, only SOE steel makers and miners with privileged access to capital and low-interest finance can survive in the long term.

Indeed, facing a downturn, SOE borrowers—considering the implied government guarantee that they benefit from—are being evaluated as a lower risk and therefore have privileged access to capital and credit, which in turn does not contribute to the even market environment envisioned in the Third Plenum's *Decision*.

Recent evolutions of loans according to receiver profile shows this trend that privileges large SOEs.<sup>9</sup>

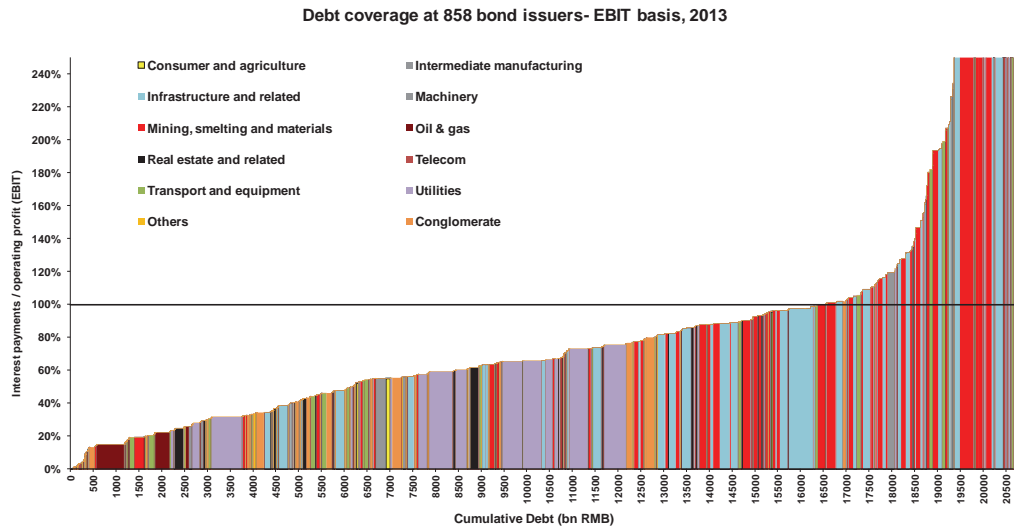
Although this unfair access to low cost capital granted to SOEs is prevalent in all industries in China where SOEs are active, it is particularly impacting the metal and mining

<sup>9</sup> *China Strategy – China Deleveraging – the long, bumpy ride continues*, Morgan Stanley Research, Asia Pacific, 10<sup>th</sup> March, 2015, viewed on 30<sup>th</sup> June, 2015, <<http://www.doc88.com/p-9751909367296.html>>





### A debt curve for China – Interest payments are greater than EBIT at companies holding 20% of the debt in our bond issuer sample



Source: Wind, Company data, Macquarie Research, September 2014

industries, which are heavily leveraged and unable to repay debts (see chart above).<sup>10</sup>

The situation of unfair access to capital to the benefit of SOEs has generally worsened through 2014 and early 2015, as the economic reforms underway are putting pressure on private and foreign-owned mining and metal players.

While the strengthening of SOEs is called for in the Third Plenum's *Decision*, a more even market environment is also called for and this is of great concern.

Another area of concern is that non-compliance with regulations (tax, labour, environment, traffic etc.) by certain Chinese entities, or the irregular enforcement of those regulations, is not uncommonly observed. While these violations take place mostly at small, private entities, similar non-compliance is also observed at certain SOEs that are subcontracting or outsourcing part of their operations to unsupervised small, private entities. This results in practices such as:

- mining, metal or steel operations without a full set of up-to-date licences for operations;
- non-declared cash transactions for the purchase of

raw materials (evading VAT);

- incomplete payment of resource taxes, non-payment (or under-declaration) of social contributions for migrant workers from other poorer provinces;
- excess rejects of waste, emissions and pollutants, handled in violation of environmental regulations; and
- illegal overloading of transportation.

By nature, with these latter practices being illegal, they are not documented or public and thus difficult to identify. And although these are generally sanctioned when becoming public at regional and national level, the endemic nature of such non-compliance and weak enforcement creates an unfair playing field for many international companies which are generally committed to international good practice standards regarding regulations (International Labour Organisation rules; extractive industry initiative).

The situation should undergo an overall improvement in 2014 and 2015, with a combination of 2015's new Environmental Protection Law, and the current, extensive anti-corruption campaign. Nevertheless, the impact of these particular initiatives will be difficult to measure.

#### Recommendations

- Enforce equal compliance with laws, rules and regulations for SOEs, private and foreign-invested

<sup>10</sup> *In the red, tackling China's corporate debt*, Macquarie Commodities Comment, Macquarie Capital Securities Limited, 29<sup>th</sup> September, 2014, viewed 1<sup>st</sup> July, 2015, <[https://www.macquarieresearch.com/rp/d/r/p/\\_OTM1MJQ1?u=MjE1Nzk](https://www.macquarieresearch.com/rp/d/r/p/_OTM1MJQ1?u=MjE1Nzk)>





manufacturers.

- Ensure equal market access and raw material access at even pricing to create fair competition between SOEs, private and foreign-invested manufacturers.
- Ensure equal, non-discriminatory access to metal exchanges for all market participants.
- Adapt approval processes for new capacity development to local demand data.
- Create a level market environment by removing expressed and implied state-guarantees for SOEs.
- Consider stock-exchange listing of SOEs exceeding the 'blocking minority' shareholding as per Chinese law, in order to strengthen oversight by public shareholders.

In a similar way, the China (Shanghai) Pilot Free Trade Zone's (CSPFTZ's) new approach with the *Negative List* for foreign investment, published on 20<sup>th</sup> April, 2015, has not changed the situation and has not led to fair and free access to foreign companies in this area (please refer to the non-official translation below).

Chinese companies currently enjoy open access to foreign mining industries while this access is not reciprocated with regards to foreign investment in China's mining industry. Considering the Chinese Government's clear drive to engage in free-trade and investment treaties, the opening up of this industry should be a top priority.

Mining (note: non-official translation)	
Rare earth and rare ore dressing	<p>9. No Investment in exploration and mining and mineral processing; without permission, it is forbidden to enter or obtain rare earth mining geological data mining, ore samples and production technology.</p> <p>10. Prohibit investment of tungsten, molybdenum, tin, antimony, fluorite exploration and mining.</p> <p>11. Prohibit investment radioactive mineral exploration, mining and beneficiation.</p>
Metal ore and non-metallic ore mining	<p>12. Precious metals (gold, silver, platinum group) exploration and mining are restricted.</p> <p>13. Lithium mining and beneficiation are restricted.</p> <p>14. Graphite exploration and mining are restricted.</p>

### 3. Open the Mining Industry to Foreign Investment and Improve the Mechanisation of Mining Companies in China

#### Concern

While Chinese companies enjoy mostly freely-accessible investment opportunities in the mining industry abroad, China keeps its own mining industry closed to foreign investment, based on a perceived national interest.

#### Assessment

Recent regulations are still limiting, as per the *Foreign Investment Industrial Guidance Catalogue (2015 Revision)*,<sup>11</sup> which lists the following foreign investment restrictions in mining:

- Exploration and mining of tungsten (W), molybdenum (Mo), tin (Sn), antimony (Sb) and fluorite.
- Exploration, mining and ore dressing of rare earth.
- Exploration, mining and ore dressing of radioactive minerals.

In China's mining industry the practices are not optimised and safety and environmental compliance are not measuring up to international standards.

As an illustration, there were still 931 deaths in mining in 2014.<sup>12</sup> Yet this represents a dramatic improvement, considering the 7,000 deaths in coal mining in 2002. Opening up the Chinese mining market to foreign companies would allow the latter to introduce the latest technologies and practices in order to provide support in improving the environmental, safety and performance standards of Chinese mines

#### Recommendations

- Remove the mining industry from restricted industries in the *Foreign Investment Industrial Guidance Catalogue* and from the *Special Administrative Measures on the Entry of Foreign Investment into China (Shanghai) Free Trade Zone (2015 Negative List)*.

<sup>11</sup> *The Foreign Investment Industrial Guidance Catalogue (2015 Revision)*, People.cn, 13<sup>th</sup> March, 2015, viewed 27<sup>th</sup> April, 2015, <<http://politics.people.com.cn/n/2015/0313/c70731-26689941.html>>

<sup>12</sup> *Administration of Work Safety: Coal Mine Accidents in 2014 Killed 931 People*, *China Daily*, 10<sup>th</sup> March, 2015, viewed 27<sup>th</sup> April, 2015, <[http://www.chinadaily.com.cn/micro-reading/dzh/2015-03-11/content\\_13349915.html](http://www.chinadaily.com.cn/micro-reading/dzh/2015-03-11/content_13349915.html)>



- Open up the Chinese mining market to foreign mining companies to encourage the introduction of advanced technologies and best practices.
- Speed up the mechanisation and modernisation levels of Chinese mining companies by introducing strict policies to promote safe, efficient and environmentally-friendly mining methods.
- Create a market for advanced mining equipment by upgrading mining industry standards.
- Engage more third-party expertise in the design of mining plans in order to safeguard sustainable mining, which is in national interests.
- Review and align certification legislation related to mine safety with leading international industry practices, with a focus on how to address safety concerns.

#### 4. Set up Standards for End Processing of Waste Electrical and Electronic Equipment (WEEE) Fractions

##### Concern

Although there is an existing WEEE standard (*Guidelines for WEEE Dismantling and Management 2015*<sup>13</sup>), it does not include the crucial end processing: establishing end-processing standards can help the industry to achieve high recycling efficiency while simultaneously fully respecting EHS (environmental, health, safety).

##### Assessment

More and more WEEE is being generated in modern societies. In China, national WEEE legislation manages the collection and treatment of televisions, refrigerators, washing machines, air conditioners and computers (desktop and laptops). In 2013, in China, 106 qualified dismantlers officially collected and treated around 1.3 million tons of these five types of WEEE, representing 28 per cent of the total. Waste electrical and electronic equipment contain valuable reusable metals which make them 'urban mines' valuable to explore. However, WEEEs may also carry potential hazardous components. Various stakeholders are involved in the WEEE recycling supply chain. The final metal extracting process is crucial to attain the highest level of recycling efficiency. There can be a risk of heavy metal as well as dioxin pollution (for example, low temperature burning causes the emission of dioxins from PVC components),

owing to the lack of suitable technologies and controls. This could potentially result in non-compliance with environmental laws and regulations.

In Europe, the Eurometaux and European Electronics Recyclers Association's WEEE end-processing standard offers the global e-waste recycling industry a good framework and reference of what real end-processing of a crucial part of the electronic waste stream is. It also should give authorities and producers the guarantee that the often most critical WEEE-fractions—both from an environmental as well as an economical perspective—are dealt with in an efficient and sustainable manner.

##### Recommendations

- Guarantee the development of standards and qualification systems for the recycling industry.
- Implement a monitoring tool to track the treatment of WEEE fractions, including dismantling/pre-processing/end-processing.
- Develop end-processing standards for WEEE fractions in China.
- Allow simplified approvals for the trans-provincial movement of WEEE fractions.

#### Abbreviations

AISI	American Iron and Steel Institute
CITIC	China International Trust Investment Company
CSPFTZ	China Shanghai Pilot Free Trade Zone
EU	European Union
EUR	Euro (Currency)
MIIT	Ministry of Industry and Information Technology
POE	Privately-Owned Enterprise
PVC	Polyvinyl Chloride
SOE	State-Owned Enterprise
USD	United States Dollar
VAT	Value-Added Tax
WEEE	Waste Electrical and Electronic Equipment

<sup>13</sup> Guidelines for WEEE Dismantling and Management 2015, Ministry of Environmental Protection and the MIIT, 19<sup>th</sup> December, 2014, viewed 1<sup>st</sup> July, 2015, <<http://www.zhb.gov.cn/gkml/hbb/qt/201412/W020141219501822808852.pdf>>

# Paediatric Nutrition Desk

## Key Recommendations

### 1. Accelerate the Establishment of the Production Access System and Management Measures for Food for Special Medical Purposes (FSMP)

- Introduce a category for FSMP in the Food Production Licensing System.
- Facilitate the drafting and enforcement of management measures for FSMP.

### 2. Establish Unified Technical Specifications for Nationwide Infant and Young children Formula Milk Powder Traceability Systems

- Establish unified technical specifications for a nationwide electronic traceability system for infant and young-children formula milk powder as soon as possible.
- Allow manufacturers to independently establish traceability systems following the national technical specifications.
- Clarify that local traceability systems should comply with the national technical guidance.

### 3. Optimise the Drafting Specifications for National Standards for Testing Methods

- Establish rigorous specifications to regulate the drafting and the validation process of national standards for testing methods, take international standards into consideration and organise extensive training to ensure proper implementation.
- Organise comprehensive and deep discussion for national standards for testing methods for infant and young-children formulas to make sure that they are applicable for all products from different formulations, resources and processes and develop matching testing methods for FSMP.
- Establish communication mechanisms with industry associations, listen to industry voices and take international, advanced experiences into consideration to ensure the rigour, accuracy and credibility of Chinese standards, so that they can be used to regulate product quality, ensure food safety and promote the healthy development of food industry.

### 4. Amend the Administrative Measures on the Sale of Breast Milk Substitutes

- Allow breast milk substitute manufacturers and operators to conduct scientific research, consultation and health education activities with medical and health institutes and their staff.
- Allow medical and healthcare institutes to provide infants who have been diagnosed as receiving insufficient breast milk with breast milk substitutes.
- Accelerate the revision process of the *Administrative Measures on the Sale of Breast Milk Substitutes*, clarify the outstanding issues and implement the new measures as soon as possible.

## Introduction to the Desk

The European Chamber's Paediatric Nutrition (PN) Desk was established in 2009, and currently has seven international companies as members and six domestic manufacturers as local partners. Members and partners of the desk include the major manufacturers of infant formulas who are active in China. The expertise of the members and partners in the infant formula sector is widely recognised by Chinese consumers in providing high-quality PN products and meeting the needs of consumers in health and safety of infants as well as young children. They have contributed significantly to the development of the PN sector in China.

The Paediatric Nutrition Desk represents the interests of its members and partners and promotes dialogue and communication among all relevant stakeholders.

## Recent Development

The melamine incident in 2008 negatively impacted the PN sector in China. Thanks to the joint efforts of the government and industry, the PN market has since recovered steadily and is now on a healthy development track.

In 2014 and 2015, a series of policies and regulations were released which aimed to strengthen supervision in the PN sector, including:

- on 28<sup>th</sup> September, 2014, the State Council General Office (SCGO) released the notice on *Further Strengthening the Construction of Food and Drug Supervision System*;
- on 8<sup>th</sup> January, 2015, the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) released the notice on *Adjusting the Implementation Requirements of Measures for the Supervision and Administration of Inspection and Quarantine of Import and Export of Dairy Products*; and
- on 15<sup>th</sup> March, 2015, the China Food and Drug Administration (CFDA) released the *Administrative Measures on Food Recalls*.

The supervision authorities intend to strengthen regulation along the entire supply chain to ensure the safety of PN products in China. The Paediatric Nutrition Desk welcomes the Chinese Government's determination to promote and enforce food safety.

As infant and young-children formula manufacturers and operators, desk members and partners hope to share their advanced and specialised expertise with the supervisory authorities to help protect Chinese consumers' health.

Most notably, the government finished the revision of the Food Safety Law of the People's Republic of China (Food Safety Law), which will become effective on 1<sup>st</sup> October, 2015. New requirements for the PN sector have been introduced. For example, "The formulation of infant formulas shall be registered with the CFDA. The applicant shall submit a research and development (R&D) report and other materials indicating scientificity and safety of formulation during registration. Infant and young-children formulas are not allowed to be produced by means of sub-packaging."<sup>1</sup> In addition, management measures for Food for Special Medical Purposes (FSMP) are included in the Food Safety Law. For example, "FSMP products shall be registered with the CFDA. The applicant shall submit information as product formulations, production process, labels, manuals and other materials indicating product safety, nutritional adequacy and clinical efficacy of special medical uses at the registration."<sup>2</sup> These requirements will facilitate the future development of this food product category.

In 2015, the government also finished revising the Advertising Law of the People's Republic of China (Advertising Law), which will become effective on 1<sup>st</sup> September, 2015. There are some new requirements in the PN sectors. For example, this law applies to commercial advertising activities in which commodity operators or service providers directly or indirectly introduce commodities or services promoted by them through certain media and other methods within the territory of the People's Republic of China.<sup>3</sup> To protect juveniles, the Advertising Law included the requirement that "Juveniles under the age of 10 are not allowed to be the advertisement spokesperson."<sup>4</sup>

During the revision processes of the Food Safety Law

1 Article 81, The Food Safety Law, National People's Congress (NPC) Standing Committee, 24<sup>th</sup> April, 2015, viewed 8<sup>th</sup> June, 2015, <[http://www.gov.cn/xinwen/2015-04/25/content\\_2852919.htm](http://www.gov.cn/xinwen/2015-04/25/content_2852919.htm)>

2 Article 80, The Food Safety Law, NPC Standing Committee, 24<sup>th</sup> April, 2015, viewed 8<sup>th</sup> June, 2015, <[http://www.gov.cn/xinwen/2015-04/25/content\\_2852919.htm](http://www.gov.cn/xinwen/2015-04/25/content_2852919.htm)>

3 Article 20, The Advertising Law, NPC Standing Committee, 24<sup>th</sup> April, 2015, viewed 8<sup>th</sup> June, 2015, <[http://www.gov.cn/xinwen/2015-04/25/content\\_2852914.htm](http://www.gov.cn/xinwen/2015-04/25/content_2852914.htm)>

4 Article 38, The Advertising Law, NPC Standing Committee, 24<sup>th</sup> April, 2015, viewed 8<sup>th</sup> June, 2015, <[http://www.gov.cn/xinwen/2015-04/25/content\\_2852914.htm](http://www.gov.cn/xinwen/2015-04/25/content_2852914.htm)>





### Third Plenum Reality Check

What did the Third Plenum's <i>Decision</i> <sup>5</sup> say?	What is the reality?	Status
The underlying issue of the economic system reform is how to strike a balance between the role of the government and the market and let the market decide the allocation of resources.	This spirit has been well implemented. The ban on subcontracting and original equipment manufacturers (OEMs) has been removed from the newly-published Food Safety Law, indicating that the government favoured the role of the market over administrative intervention.	

and the Advertising Law, relevant competent authorities improved transparency during the legislation process and several public consultations were organised, and comments and suggestions from the industry were taken into consideration. The industry welcomes this improvement and is looking forward to working together with the ministries during the enforcement of both laws to avoid any discretionary enforcement decisions. The desk welcomes that the competent authorities are following the spirit of the Third Plenum and have given due respect the role of the market during the revision process.

## Key Recommendations

### 1. Accelerate the Establishment of Production Access System and Management Measures for Food for Special Medical Purpose (FSMP)

#### Concern

There are no regulations governing inspection rules for production licenses or management measures for the registration of FSMP products, which has significantly hindered the development of the FSMP industry in China.

#### Assessment

The National Health and Family Planning Commission (NHFPC) published the *GB 25596-2010 National Food Safety Standards Food for Special Medical Purposes Intended for Infants in 2010*. The *GB 29922-2013 National Food Safety Standard General Principles for Food for Special Medical Purposes* and the *GB 29923-2013 National Food Safety Standard Good Manufacturer Practice for Food for Special Medical Purposes* were released in 2013.

<sup>5</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*. The *Decision*, a 60-point reform blueprint, detailed the Party's reform plan for the next six years.

According to the Food Safety Law, food manufacturers in China can only produce food products if they have the relevant production licence. Currently there is neither a specific category in the production licences system nor relevant audit guidelines for production licences for FSMP products. This means that manufacturers in China are not able to obtain a production licence for FSMP products. Therefore, no FSMP products can be produced in China and they can only be imported from abroad. This regulatory barrier is delaying the development of the FSMP sector in China.

In addition, the CFDA requires the registration of the formulations, production processes and labels of FSMP products before entry into the market. Because there are no clear or specific measures available for FSMP products, this might lead to uncertainties and barriers for the production of FSMP in China and the importation of FSMP into China, which might impact the stable supply required to satisfy current demand for FSMP products in China and will greatly impede the healthy development of this sector in China.

#### Recommendations

- Introduce a category for FSMP in the Food Production Licensing System.
- Facilitate the drafting and enforcement of management measures for FSMP.

### 2. Establish Unified Technical Specifications for Nationwide Infant and Young-children Formula Milk Powder Traceability Systems

#### Concern

Local regulators have established their own electronic traceability systems using different systems that are incompatible with each other. Companies need to meet the requirements of these duplicated yet incompatible



electronic traceability systems, which causes a serious waste of resources as well as a heavy burden.

### Assessment

On 27<sup>th</sup> September, 2012, the SCGO proposed "building a national network of electronic traceability systems for infant and young-children formula milk powder and raw milk, which shall achieve real-time tracking control throughout from milking, procurement, production and transportation to sales terminals, to ensure that the authenticity of the product can be quickly identified at any point".<sup>6</sup> Since then, the construction of electronic traceability systems for infant and young-children formula milk powder has become a priority of food safety supervision. Ministries and local governments began to explore the construction of the electronic traceability system for infant and young-children formula milk powder. In June 2013, the SCGO forwarded the notice produced by the AQSIQ, the CFDA, the General Administration of Customs (GAC), the Ministry of Information and Information Technology (MIIT), the Ministry of Commerce (MOFCOM), the Ministry of

Public Security (MPS) and the State Administration for Industry and Commerce (SAIC), the *Action Plan on Further Strengthening the Quality of Infant Formulas* (No. 57, 2013), which outlines the idea to "implement electronic information management of infant and young-children formula milk powder and accelerate the implementation of a product query and traceability mechanism."<sup>7</sup> The establishment of the electronic traceability system for infant and young-children formula milk powder has now reached a productive stage. In 2014, some regions published relevant regulations on traceability and the electronic traceability systems for infant formulas began to take shape, with some local traceability systems even beginning to run. At present, some regions have published specific regulations on the electronic traceability system, such as Gansu, Guangxi and Heilongjiang. However, different provinces have different requirements. Below are some examples:

Province	Regulations	Regulation Targets	Information Needed	Highlights
Gansu	<i>Gansu Management Measures on the Traceability of Food Safety (Trial)</i> <sup>8</sup>	Manufacturers	The main food producers, food information, certificates and invoices, sales accounts and other basic information.	Using an 'electronic pass' to manage the traceability information of food and raw materials.
Guangxi	<i>Guangxi Management Measures on Quality Safety Traceability System for Food Manufacturers</i> <sup>9</sup>	Manufacturers	Purchase inspection, usage of food additives, critical control points in the production process, delivery inspection, sales accounts etc.	The establishment of several critical control points.
Heilongjiang	<i>Heilongjiang Management System on Quality and Safety Traceability of Infant Formula Manufacturers (Trial)</i> <sup>10</sup>	Manufacturers	Raw materials, packaging materials, research and development of the product, production processes, storage and circulation, distribution and sales, consumer inquiries and tracking evaluation.	Detailed record and traceability of the information related to production processes.

6 12<sup>th</sup> Five-Year Plan of National Food Safety Regulatory System, SCGO, 28<sup>th</sup> June, 2012, viewed 8<sup>th</sup> June, 2015, <[http://www.gov.cn/gongbao/content/2012/content\\_2198888.htm](http://www.gov.cn/gongbao/content/2012/content_2198888.htm)>

7 *Action Plan on Further Strengthening the Quality of Infant Formulas* (No. 57, 2013), AQSIQ, CFDA, GAC, MIIT, MOFCOM, MPS, SAIC, 16<sup>th</sup> June, 2013, viewed 8<sup>th</sup> June, 2015, <<http://www.sda.gov.cn/WS01/CL0851/81477.html>>

8 *Gansu Management Measures on the Traceability of Food Safety (Trial)*, Gansu Municipal Government, 10<sup>th</sup> February, 2014, viewed 8<sup>th</sup> June, 2015, <[http://www.gansu.gov.cn/art/2014/2/7/art\\_3723\\_164595.html](http://www.gansu.gov.cn/art/2014/2/7/art_3723_164595.html)>

9 *Guangxi Management Measures on Quality Safety Traceability System for Food Manufacturers (Trial)*, Guangxi Municipal Government, 4<sup>th</sup> April, 2014, viewed 8<sup>th</sup> June, 2015, <<http://www.cnki.com.cn/Article/CJFDTotal-SPZH201409039.htm>>

10 *Heilongjiang Management System on Quality and Safety Traceability of Infant Formula Manufacturers (Trial)*, Heilongjiang Municipal Government, 25<sup>th</sup> December, 2014, viewed 8<sup>th</sup> June, 2015, <<http://www.hljda.gov.cn/show.aspx?newsid=20577&typeid=18>>





To summarise, different regions will have different areas of focus, different requirements for technical regulations and methods when constructing their electronic traceability systems. Although most of the companies have their own traceability systems, it is difficult for them to be plugged into different regional traceability systems. Companies will have to spend a huge amount of money on purchasing new equipment such as computers (or point-of-sales (POS) machines), printers, scanners, data query terminals and digital cameras in order to satisfy the repetitive but incompatible traceability system. The significant increase in costs will inevitably be shifted to consumers and increase their burdens.

It is understood that more provinces will complete their own traceability systems, including Anhui and Jiangsu. The Certification and Accreditation Administration (CNCA) is also working on the electronic traceability system for imported infant and young-children formula milk powder. Companies will be facing more complex traceability system requirements. This conflicts with the intention to "establish a unified, efficient and resource sharing national food security information platform",<sup>11</sup> mentioned in the State Council *Notice on Plans for 2015 Food Safety Key Working Points* (No.10, 2015).

#### Recommendations

- Establish unified technical specifications for a nationwide electronic traceability system for infant and young-children formula milk powder as soon as possible.
- Allow manufacturers to independently establish traceability systems following the national technical specifications.
- Clarify that local traceability systems should comply with the national technical guidance.

### 3. Optimise the Specifications for Drafting National Standards for Testing Methods

#### Concern

At present the specifications for drafting national standards for testing methods in China are out-dated meaning that existing national standards for testing methods are unable to meet market demand, which could impact the quality of products in the Chinese market.

<sup>11</sup> *Notice on Plans for 2015 Food Safety Key Working Points* (No.10, 2015), State Council, 2<sup>nd</sup> March, 2015, viewed 8<sup>th</sup> June, 2015, <[http://www.gov.cn/zhengce/content/2015-03/14/content\\_9531.htm](http://www.gov.cn/zhengce/content/2015-03/14/content_9531.htm)>

#### Assessment

The NHFPC released national standards to establish the basic requirements for drafting national standards for testing methods. This includes, for example, the *GB/T 20001.4-2001 Rules for Drafting Standards, Part 4: Chemical Analysis Methods*. However, this standard was released in 2001, and is now unable to meet the requirements for drafting national standards for testing methods and has not kept pace with industry developments. Specifications for drafting national standards are the guidelines for the national standards for testing methods. The specifications must be controlled, analytical and precise in order to ensure the accuracy of the testing methods and thereby the quality of the products on the market.

The process of developing specifications for the drafting of national standards for testing methods can be analysed as below:

**1) Drafting national standards for testing methods:** the national standards for testing methods for infant and young-children formulas are not applicable to all products from different processes, different base materials and different resources. With the latest knowledge of the importance of breastfeeding for infants and the effects of functional components in breast milk, more and more infant and young-children formula milk powder producers have prioritised their research into the concentration and quality of nutrients in breast milk in order to gradually improve their infant formulations. However, it is apparent that the national standards for testing methods issued in 2010 are not entirely applicable to the process of upgrading these products.

For example, FSMP products are designed for people with special nutritional needs. The formulation of FSMP is much different from other infant and young-children formulations. The existing national standards for testing methods do not apply to FSMP due to their special formulation. The deviation of results due to the use of inappropriate methods leads to the misjudgement and raises false alarms over food safety. Not only does this damage the reputation of the industry and government credibility but also consumers' confidence.

**2) Validation process of testing methods:**

China has released some normative documents to regulate the validation process of testing methods, e.g.



the *Validation Procedures of Professional Chemical Analysis Methods for Food and Cosmetic* and the *Validation Procedures of Professional Biological Analysis Methods*. But in practice it has been found that there are large discrepancies in the implementation and enforcement of these documents in different laboratories, which leads to a large deviation in method validation results. The method validation is an important tool for improving the scientificity and applicability of national standard test methods. Its result can directly affect the scientificity and precision of national standards of testing methods.

#### Recommendations

- Establish rigorous specifications to regulate the drafting and the validation process of national standards for testing methods, take international standards into consideration and organise extensive training to ensure proper implementation.
- Organise comprehensive and deep discussion for national standards for testing methods for infant and young-children formulas to make sure that they are applicable for all products from different formulations, resources and processes and develop matching testing methods for FSMP.
- Establish communication mechanisms with industry associations, listen to industry voices and take international, advanced experiences into consideration to ensure the rigour, accuracy and credibility of Chinese standards, so that they can be used to regulate product quality, ensure food safety and promote the healthy development of food industry.

#### 4. Amend the Administrative Measures on the Sale of Breast Milk Substitutes

##### Concern

The *Administrative Measures on the Sale of Breast Milk Substitutes*, which was promulgated by the then Ministry of Health (MOH) in 1995, no longer matches the development of the Chinese market. In September and October 2013, the NHFPC, the CFDA and other competent authorities issued further documents aimed at regulating the promotion of breast milk substitutes, however, these policies could potentially result in infant malnutrition through a lack of sufficient information to help guide consumers to choose the correct product.

##### Assessment

In 1995, the MOH developed and promulgated the *Administrative Measures on the Sale of Breast Milk Substitutes*. In order to further regulate the marketing of breast milk substitutes, the MOH initiated the revision of the *Administrative Measures on the Sale of Breast Milk Substitutes (China Code)* and released its draft for comments at the end of 2011. Currently, the *China Code* no longer matches the development of the Chinese market. In September 2013, the NHFPC released the *Notice on Prohibiting Healthcare Facilities and Their Staff to Promote Breast Milk Substitutes (National Public Health Authority (2013) No. 10)*.<sup>12</sup> In October 2013, the CFDA, NHFPC and SAIC jointly released the *Notice on Further Regulating the Sale and Advertisement of Breast Milk Substitutes (CFDA (2013) No.214)*.<sup>13</sup> This notice will prevent mothers from obtaining correct and scientific feeding knowledge to choose the most suitable products, which could potentially result in infant malnutrition.

Designing the formulation of infant and young-children formulas, especially those for special medical purposes, usually relies on massive scientific research and clinical evidence. Their production also requires advanced technologies. In practice, different formula products, especially those for special medical purpose, always need to adjust their formulations according to an infants' actual condition. Thus medical and health specialists need to fully understand a specific product's information and communicate with manufacturers about issues during the period of use. It not only helps breast milk substitute manufacturers to improve their formulations, but also helps medical and healthcare specialists instruct on and practice infants' feeding activities in a scientific way. Thus communications aimed at enhancing scientific research between breast milk substitute manufacturers and medical and health specialists will contribute to improving products' quality and their appropriate applications.

In addition, under the condition of not promoting breast milk substitutes, cooperation between manufacturers and medical and health institutes should be permitted in order to promote breast feeding and communicate

<sup>12</sup> *Notice on Prohibiting Healthcare Facilities and their Staff to Promote Breast Milk Substitutes* (National Public Health Authority (2013) No. 10), NHFPC, 17<sup>th</sup> September, 2013, viewed 8<sup>th</sup> June, 2015, <<http://www.moh.gov.cn/fys/s3586/201309/941c7f31cfbc4c86b9f4e54fa2346d65.shtml>>

<sup>13</sup> *Notice on Further Regulating the Sale and Advertisement of Breast Milk Substitutes* (CFDA (2013) No.214), CFDA, NHFPC, SAIC, 29<sup>th</sup> October, 2013, viewed 8<sup>th</sup> June, 2015, <<http://www.sda.gov.cn/WS01/CL1605/93654.html>>





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knowledge related to nutritional issues. These activities should also be permitted in medical institutions based on actual needs. Breast milk substitute manufacturers should be allowed to communicate with 0 to 6-months-old infants' mothers or relatives about information related to formula food nutrition excluding breast milk substitutes.

Lastly, for infants that have been diagnosed by healthcare specialists as being unable to receive breast milk, choosing breast milk substitutes is the scientific and rational choice. It does not conflict with the purpose of supporting breast feeding. Recent policies restrict medical and health institutes' channels to obtain breast milk substitutes and merely allow them to obtain these products through retailers, which fails to meet actual needs.

#### Recommendations

- Allow breast milk substitute manufacturers and operators to conduct scientific research, consultation and health education activities with medical and health institutes and their staff.
- Allow medical and healthcare institutes to provide infants who have been diagnosed as receiving insufficient breast milk with breast milk substitutes.
- Accelerate the revision process of the *Administrative Measures on the Sale of Breast Milk Substitutes*, clarify outstanding issues and implement the new measures as soon as possible.

## Abbreviations

AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
CFDA	China Food and Drug Administration
CNCA	Certification and Accreditation Administration
FSMP	Food for Special Medical Purposes
GAC	General Administration of Customs
MIIT	Ministry of Industry and Information Technology
MOFCOM	Ministry of Commerce
MOH	Ministry of Health
MPS	Ministry of Public Security
NHFPC	National Health and Family Planning Committee
NPC	National People's Congress
PN	Paediatric Nutrition
POS	Point of Sales

R&D	Research and Development
SAIC	State Administration for Industry and Commerce
SCGO	State Council General Office



## Petrochemicals, Chemicals and Refining Working Group

### Key Recommendations

#### 1. Standardise Penalties Imposed on Pollutants in the Chemical Industry

- Provide guidance on how to adjust operations in order to adhere to local emissions standards, and recommend third-party agents to advise on local compliance issues.
- Set up a corresponding punishment mechanism for each specific market, and regulate the environmental services market.
- Examine the Articles 21, 22 and 23 of the Environmental Protection Law (EPL) in terms of its operability, rather than focusing on the macroscopic description.<sup>1</sup>

#### 2. Optimise the Allocation Methodology in China's Emissions Trading Scheme (ETS) to Encourage Advanced Technologies in the Chemical Industry

- Involve industry experts in the detailed definition of China's ETS related to the chemical industry.
- Establish a fair and consistent process—from one region to another, from expansion to new projects—for initial free allocation, reflecting the nature of industries, the energy intensity of installations and technological levels.
- Invite industry experts to work out fuel-specific emissions benchmarks per unit product for the chemical industry so that grandfathering or tons of CO<sub>2</sub> per gross domestic product (GDP) (tCO<sub>2</sub>/CNY 10,000) output can be substituted for free allowances allocation.

#### 3. Reduce Data Requirements on New Chemical Notification for Intermediates in China

- Recognise that intermediates present a lower risk than other regular substances.
- Revise current data requirements on intermediates to treat isolated-intermediates as a special group of substances, and lower their notification requirements.

#### 4. Promote Legislation to Optimise Administration on Hazardous Chemicals (HCs)

- Clarify the administration scope of relevant licence/permit/registration applications—especially for distribution, storage, production and transportation—and publish the corresponding guidelines to ensure regulatory compliance of all industry players.
- Complete supporting documents related to identification of hazardous physical property, and publicise the “Inventory exempted from identification”.
- Adopt international, advanced practices on chemical identification and classification, for example (EC) No. 1272/2008 on Classification, Labelling and Packaging (CLP).
- Accept classification results from companies for pure substances and mixtures based on reliable resources such as Good Laboratory Practice (GLP) laboratories, worldwide authoritative databases and the technical United Nations (UN) calculation principle for the Globally Harmonised System (GHS) of classification.
- Accept compliant material safety data sheets (MSDS) based on the *Safety Data Sheet for Chemical Products* (GB/T 16483-2008), and continue implementing the transition period for the 2013

<sup>1</sup> *Environmental Protection Law of the People's Republic of China*, Ministry of Environmental Protection, 25<sup>th</sup> April, 2014, viewed 29<sup>th</sup> April, 2015, <[http://www.gov.cn/xinwen/2014-04/25/content\\_2666328.htm](http://www.gov.cn/xinwen/2014-04/25/content_2666328.htm)>



*Guidance on Compilation of Safety Data Sheet for Chemical Products (GB 17519-2013).*

- Award appropriate exemptions for the import of low volume hazardous chemicals (HCs) for laboratory and research and development (R&D) usage.

## 5. Take Prudent Steps in Consumption Tax Reform

- Publicise the selection criteria and list of potential categories that may be subject to consumption tax for public opinion.
- Involve experts to discuss the standards and measurement of particular matters (e.g. consumption tax rate, tax production stage or retail stage) according to the current development of the chemical industry in China.
- Involve industry experts to analyse the impact of the draft consumption tax reform on related enterprises and end customers.

## Introduction to the Working Group

The Petrochemicals, Chemicals and Refining (PCR) Working Group represents the leading European companies in the petroleum and chemical industry in China, many of which are global Fortune 500 companies. The aim of the working group is to help our members adapt to the China market by facilitating communication between the member companies and the government as well as Chinese industrial associations, providing up-to-date information and presenting common challenges and making recommendations on regulatory issues.

## Recent Developments

The working group has a continued strategic dialogue with the Chinese Government and relevant institutions, including high-level meetings with Chinese and European authorities, such as: the Ministry of Environmental Protection (MEP); the Ministry of Commerce (MOFCOM); the State Administration of Taxation (SAT); the State Food and Drug Administration (SFDA); the China Petroleum and Chemical Industry Federation (CPCIF); the State Administration of Quality Supervision, Inspection and Quarantine (AQSIQ); and senior European Commission (EC) officials.

The working group greatly appreciates both the constructive dialogue between European industry and Chinese officials, and the market-driven orientation of much of the new domestic legislation regulating the PCR industry.

The Petrochemicals, Chemicals and Refining Working

Group is keen to continue constructive dialogues with all relevant Chinese ministries and institutions and to bring in relevant expertise in terms of the latest technologies, as well as best available techniques, for both industrial practises and regulatory approaches.

## Key Recommendations

### 1. Standardise Penalties Imposed on Pollutants in the Chemical Industry

#### Concern

Local governments are setting stringent local pollutant discharge standards for pollutants not specified in the national pollutant discharge standards, which has created a complex series of emissions standards across different provinces and municipalities.

#### Assessment

According to Article 16 of Environmental Protection Law of the People's Republic of China, the people's governments of provinces, autonomous regions and municipalities directly under the central government may establish their local standards for the pollutant discharge of items not specified in the national pollutant discharge standards and may set local pollutant discharge standards that are more stringent than the national ones.

In light of this clause and their own environmental capacities, provinces and municipalities can create their own legislation for a series of emissions standards of pollutants. For instance, the Shanghai Municipal Environmental Protection Bureau and the Shanghai

Third Plenum Reality Check		
What did the Third Plenum's Decision <sup>2</sup> say?	What is the reality?	Status
<p>We will persist in equality of rights, opportunities and rules, abolish all forms of irrational regulations for the non-public economy, remove all hidden barriers, and adopt specific measures for non-public enterprises to enter franchising fields.</p>	<p>Over the past two years, with the streamlining of government approvals, the scope of projects requiring government approvals has narrowed, and more project approval power is now controlled by local governments. Working group members hope that this will help to shorten the project approval time for their investments, and that the central government will strengthen 'overall balancing' to minimise the risk of overcapacity.</p> <p>The <i>National Layout Plan</i> for seven major petrochemical parks was adopted by the State Council in June 2014. Private firms have been granted more access to invest in refinery, cracker and downstream products in these parks. Working group members hope that the Chinese Government will publicise more details of this plan.</p> <p>In the revised <i>Foreign Investment Industrial Guidance Catalogue</i> promulgated in March 2015, caps on equity ratios for foreign direct investment (FDI) have been removed for sectors like cracker and refinery. Working group members see more opportunities in cracker downstream investments.</p>	
<p>Any price that can be determined by the market must be left to the market, and the government is not to carry out improper interventions. We will push ahead with pricing reforms of water, oil, natural gas, electricity, transportation, telecommunications and some other sectors while relaxing price control in competitive areas.</p>	<p>The price of natural gas increased unexpectedly in 2014. This placed a severe burden on the operations of Petrochemicals, Chemicals and Refining Working Group members' facilities that use natural gas a raw material. On top of that, more factors such as the increased consumption tax on naphtha and other petrochemical feedstocks, increasing costs for hazardous waste treatment, adoption of consumption tax on chemicals like coatings, the introduction of the national emissions trading scheme (ETS) (to be launched in 2016), environmental and carbon taxes, all combine to create additional cost burdens for working group members' investments in China.</p>	
<p>We will encourage non-public enterprises to participate in SOE reform, foster mixed enterprises with non-public capital as the controlling shareholder, and encourage qualified private enterprises to establish the modern corporate system.</p>	<p>Working group members noted positive developments in the reform of 'mixed ownership' in central SOEs, and the promotion of the public-private partnerships (PPP) model in sectors like infrastructure and environmental protection.</p>	
<p>We will have the same laws and regulations on Chinese and foreign investment, and keep foreign investment policies stable, transparent and predictable.</p>	<p>Working group members noted China's progress in adopting negative lists in pilots FTZs and the drafting of Foreign Investment Law.</p>	

<sup>2</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.





Bureau of Quality and Technical Supervision released the *Air Pollutant Emissions Standards in the Printing Industry* (DB 31/872-2015) in the first quarter of this year. They proposed the limitation of the maximum allowable emissions concentration and maximum allowable emissions rate on five types of substances related to the printing industry: benzene, toluene, xylene, non-methane hydrocarbon and particulate matter. These standards are mandatory for any new formulation. Enterprises guilty of discharging pollutants exceeding the standards will incur a penalty of Chinese Yuan (CNY) 8,000 per ton for every day they continue to pollute.

Enterprises are at risk of involuntarily violating local emissions standards due to this complex regional legislation. Also, it can be difficult and costly to adjust operations to local standards whilst trying to supply the entire market. Access to clear and coherent guidance on local emissions standards is not easily accessible making compliance unnecessarily difficult and potentially costly.

#### Recommendation

- Provide guidance on how to adjust operations in order to adhere to local emissions standards, and recommend third-party agents to advise on local compliance issues.
- Set up a corresponding punishment mechanism for each specific market, and regulate the environmental services market.
- Examine the Articles 21, 22 and 23 of the EPL in terms of its operability, rather than focusing on the macroscopic description.

## 2. Optimise the Allocation methodology in China's Emissions Trading Scheme (ETS) to Encourage Advanced Technologies in the Chemical Industry.

#### Concern

The Chinese ETS is underdeveloped in comparison to international equivalents: without properly taking into account the chemical sector's specificities and its sub-sectors' heterogeneity, ETS rules can: (i) introduce undue biases among similar activities; (ii) lead to counter-effective outcomes; and (iii) favour more emitting technologies over efficient ones.

#### Assessment

Under the current rules of China's ETS, allocation of

free allowances is mostly based on historical emissions levels for petrochemical and chemical sectors. Whereas petro-chemical multinational corporations (MNCs) have invested in the most efficient plants with best available technologies (BAT), under current ETS policies based on historical emission levels those players are put at a disadvantage compared to their peers who would have invested in low-cost, less-efficient technologies. This allows historically high-polluting companies to become more competitive while only slightly improving their operations and still emitting more CO<sub>2</sub> than those with BAT. In other words, the grandfathering scheme is not fair.

Moreover, under the current rules, capacity expansions or debottlenecking on existing installations are treated differently (grandfathering) to new projects (benchmarking). This may have a counter-effective impact as it would discourage investment in expansion plans that could improve efficiency.

The working group welcomes the decision to have the Chinese ETS evolve into a 'benchmark' for future allocation methodology. The European Chamber regrets that the current proposed outcome of the benchmarking process (a general output ratio expressed in tCO<sub>2</sub>/RMB) does not accurately reflect the energy efficiency of the production processes within the petrochemical and chemical industry.

Due to the diversity of its industry, the working group is advocating for a benchmark methodology similar to what has been applied in other regions, such as in Europe. Such a benchmark would be done by category of products, thereby differentiating the most energy-intensive sub-sectors (ammonia, ethylene oxide, industrial gases, nitric acid) from the less energy-intensive ones, based on BAT for the available fuel/feedstock (e.g. coal, natural gas). This measure would improve extraction efficiency and create added value from resources.

Petrochemicals and chemicals are by nature energy- and carbon-intensive, but indispensable as a pillar of the economy. Without a fuel-specific benchmark by product, the ETS will not encourage the deployment of energy-efficient and low-emitting technologies, and will limit the development of the necessary industrial infrastructure in China.

The Chinese ETS is in a crucial phase of design and testing. Fair treatment for initial free emissions allowances allocation is fundamental to the long-term success of the scheme. It is also essential that the scheme be applied consistently throughout the country under a clear allocation policy that will guide the implementation within the different regions. Petrochemical, Chemical and Refining Working Group members have rich experience in a wide variety of issues in these fields, both in the EU and globally, and can assist the Chinese Government in this regard.

#### Recommendation

- Involve industry experts in the detailed definition of China's ETS related to the chemical industry.
- Establish a fair and consistent process—from one region to another, from expansion to new projects—for initial free allocation, reflecting the nature of industries, the energy intensity of installations and technological levels.
- Invite industry experts to work out fuel-specific emissions benchmarks per unit product for the chemical industry so that grandfathering or tons of CO<sub>2</sub> per gross domestic product (GDP) (tCO<sub>2</sub>/Chinese Yuan (CNY)<sup>3</sup> 10,000) output can be substituted for free allowances allocation.

### 3. Reduce Data Requirements on New Chemical Notification for Intermediates in China

#### Concern

The data requirements for notifying a new intermediate in China are the most stringent in the world and the time taken for notification is the longest, which puts Chinese intermediate manufacturers at a big disadvantage.

#### Assessment

Chemical intermediates are a common necessity during the synthesis of many products such as pesticides, pharmaceuticals, cosmetics and dyes. Industrial applications usually require intermediates to be produced in high volumes. An intermediate is a chemical substance that is only produced in order to be consumed in a subsequent chemical reaction. As such, an intermediate is only handled in the industrial setting and will—due to its consumption in the reaction—not be used as a direct ingredient in formulations, and the exposure will be very low. For some intermediates there are even dedicated

technical and organisational measures in place to keep the substance contained and controlled. To reduce the data requirements for the registration of intermediates is therefore a process that follows the scientific principle that risk is a function of hazard and exposure. Low exposure lowers the resulting risk. Good regulatory practice benefits from such principles by balancing the regulatory burden through effective provisions in order to protect human health and the environment. That was the reason why reduced registration requirements were introduced into almost all chemical regulations in the world.

The current guidance for New Chemical Notification does not differentiate an intermediate (manufactured or imported in annual quantities greater than one ton (>1t/y)) from a regular substance in terms of notification data requirements, which is unusual when compared to international chemical regulations. The European Chamber hopes the Ministry of Environmental Protection (MEP) can consider the special situation of lower exposure risk of intermediates which will be consumed in further reactions, and difficulties faced by industry in treating isolated-intermediates as a special group of substances, and therefore lower their notification requirements for the companies with proper exposure management measures. Differentiating intermediates from general substances and lowering registration requirements for intermediates will align with the MEP's chemical risk management guidelines, making it more refined and scientific. Enterprises who wish to benefit from reduced registration requirements must provide strict risk management measures to reduce exposure and commit to implementing them. Reduced registration requirements can thereby result from the scientific basis that a substance poses a lower risk if the exposure is lower. Enhanced supervision on the annual reporting of intermediates and downstream manufacturers' clarification can be initiated by the relevant authority to ensure that the reduced registration requirements are not claimed incorrectly.

Intermediates are distinguished from other substances, and different provisions on reduced requirements for intermediates exist in other major industrial countries and regions including the United States (US), the European Union (EU), Switzerland, Canada and Japan. For example, the provisions below are implemented in the European Regulation on Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH):

<sup>3</sup> In China, for the measurement tons of CO<sub>2</sub> per GDP (tCO<sub>2</sub>/GDP), GDP equates to CNY 10,000.



Type of Intermediates	Registration Requirement	Notes
Non-isolated intermediates	Exempt	
On-site isolated intermediates manufactured or used under strictly-controlled conditions	<p>&lt;1 ton: exempt from registration. 1-1,000 tons: only existing data is required. &gt;1,000 ton: only need to follow the 1-10t/y standard registration requirement.</p>	<p>Reduced data requirements; if the intermediates are sold, the manufacturer or importer needs confirmation from the customer that they observed that the conditions were strictly controlled.</p>
Transported isolated intermediates manufactured or used under strictly-controlled conditions		
Isolated intermediates that are not manufactured or used under strictly-controlled conditions	Standard registration requirement according to 4 tonnage levels.	<p>Data requirements on standards registration is less than those stipulated in the <i>Environmental Management Measures on New Chemical Substances</i> (2010 revision)</p> <p>Order No. 7 of the Ministry of Environmental Protection.</p>

#### Recommendations

- Recognise that intermediates present a lower risk than other regular substances.
- Revise current data requirements on intermediates to treat isolated-intermediates as a special group of substances, and lower their notification requirements.

#### 4. Promote Legislation to Optimise Administration on Hazardous Chemicals (HCs)

##### Concern

The *Catalogue of Hazardous Chemicals* (2015 Version) implemented on 1<sup>st</sup> May, 2015, introduces Globally Harmonised System (GHS) classification and the building block principle in addition to 2,828 listed items, which greatly exceeds the scope and compliance requirements of previous versions.

##### Assessment

Under State Council decree 591 (*Regulations on Safe Management of Hazardous Chemicals*), hazardous chemicals in the *Catalogue of Hazardous Chemicals* must meet the safety management requirements for HC production, storage, use, operation and transportation. This regulation implements a licensing system for producers/operators/users of hazardous

chemicals in the catalogue. The scope of the *Catalogue of Hazardous Chemicals* will directly influence the controlled scope of relevant licensing and registration applications, e.g. the safety production licence, the trading licence, hazardous chemical registration, etc. Though the 2015 version appears smaller in size compared with its 2002 predecessor (total items have been reduced from 2,936 to 2,828),<sup>4</sup> the actual scope has expanded with the introduction of the 'building brick' principle. The application scope of each relevant permit/licence/registration is ambiguous and will impede HC compliance procedures in China.

So far the corresponding guideline of the 2015 catalogue includes GHS classification information, but the United Nations (UN) number has not been released. Meanwhile, the "Inventory exempted from identification" mentioned in Method No. 66 for HCs has been delayed several times, which has led to unnecessary workload for companies who now have to identify the hazardous chemicals within officially-known hazard classifications.

Material safety data sheets (MSDS) play a significant role in HCs' registration. The *Safety Data Sheet for*

<sup>4</sup> The new catalogue of hazardous chemicals will come into effect on May 1, China Quality News, 30<sup>th</sup> March, viewed 30<sup>th</sup> April, 2015, <<http://www.cqn.com.cn/news/zggmsb/diliu/1021450.html>>



*Chemical Products Content and Order of Sections* (GB 16483-2008)<sup>5</sup> was set up to define the structure, content and generic forms of the Safety Data Sheet (SDS). In September 2013, GB 17519-2013<sup>6</sup> was issued and serves as the supporting document to GB 16483-2008, which introduced more stringent rules to cover MSDS format and content. It appears vastly changed compared with the previous version. Even though GB 17519 is a recommended standard, it is still taken as a mandatory requirement in some inspection processes. Since the MSDS maintenance and management of most multinational chemical companies relies on a complex and comprehensive SAP Enterprise Resource Planning (ERP) software system, even a minor change of the MSDS results in high costs in system adjustment.

Multi-level administration of HCs registration for large-scale industry use and for research and development (R&D) use should be applied in a way that is consistent with similar international and domestic regulations (e.g. REACH, the MEP's *Environmental Management Measures on New Chemical Substances* (2010 revision) Order No. 7).

Current requirements for registration procedures for regular chemicals, such as waiving registration for HCs for quantities less than 1t/y, should be revised for R&D use for the purpose of cost savings, workload reduction and to control supply chain shortage risks.

#### Recommendations

- Clarify the administration scope of relevant licence/permit/registration applications—especially for distribution, storage, production and transportation—and publish the corresponding guidelines to ensure regulatory compliance of all industry players.
- Complete supporting documents related to identification of hazardous physical property, and publicise the “Inventory exempted from identification”.
- Adopt international, advanced practices on chemical identification and classification, for example (EC) No 1272/2008 on Classification, Labelling and Packing (CLP).

5 *Safety data sheet for chemical products-Content and order of sections*, 18<sup>th</sup> June, 2008, Ministry of Industry and Information Technology, viewed 30<sup>th</sup> April, 2015, <<http://www.miit.gov.cn/n11293472/n11293877/n14505342/n14506895/n14514379/14514476.html>>

6 *Guidance on the compilation of safety data sheet for chemical products*, Standardisation Administration of the People's Republic of China, 6<sup>th</sup> September, 2015, viewed 30<sup>th</sup> April, 2015, <[http://www.sac.gov.cn/SACSearch/search?channelid=160591&template=gjcxjg\\_detail.jsp&searchword=STANDARD\\_CODE=%27GB/T%2017519-2013%27](http://www.sac.gov.cn/SACSearch/search?channelid=160591&template=gjcxjg_detail.jsp&searchword=STANDARD_CODE=%27GB/T%2017519-2013%27)>

- Accept classification results from companies for pure substances and mixtures based on reliable resources such as GLP laboratories, worldwide authoritative databases and the technical United Nations (UN) calculation principle for the GHS of classification.
- Accept compliant MSDS based on the *Safety Data Sheet for Chemical Products* (GB/T 16483-2008), and continue implementing the transition period for the *2013 Guidance on Compilation of Safety Data Sheet for Chemical Products* (GB 17519-2013).
- Award appropriate exemptions for the import of low volume HCs for laboratory and R&D usage.

## 5. Take Prudent Steps in Consumption Tax Reform

### Concern

The reform of consumption tax and the introduction of environment taxes, as proposed by the Third Plenum in 2013, needs a solid impact assessment in order to incentivise the industry to develop energy-saving and environmental procedures and minimise the impact on consumers.<sup>7</sup>

### Assessment

A consumption tax was firstly imposed in 1994 on consumer goods that have a high energy cost to produce and are highly polluting, in order to guide production and consumption toward being environmentally-friendly and to promote a sustainable economic growth model.<sup>8</sup> Tax adjustment of petroleum products is a global trend and underlines the urgent need to promote a green economy worldwide. Recently, China announced that it will impose consumption tax on some chemical-related products, such as certain types of batteries and paint, which are currently not subject to consumption tax in China, and raise consumption tax rate on some products to encourage environmental protection and sustainable development.<sup>9</sup> While this is a welcome step towards a more sustainable and environmentally-friendly development model, there are concerns about

7 *Notice on the 12<sup>th</sup> Five-year Plan about the State Environmental Protection*, State Council, 2011, viewed 14<sup>th</sup> April, 2015, <[http://www.gov.cn/zwqk/2011-12/20/content\\_2024895.htm](http://www.gov.cn/zwqk/2011-12/20/content_2024895.htm)> (Alternatively: *Expert: Green taxes meet a difficult in the choosing time and the early effect is not too big*, China Environment, 6<sup>th</sup> December, 2010, viewed 14<sup>th</sup> April, 2015 <<http://www.chinaenvironment.com/view/viewnews.aspx?k=20101206171437500>>)

8 *The Interim Regulations on Consumption Tax of the People's Republic of China*, SAT, 1993, implemented 1<sup>st</sup> January, 1994, viewed 14<sup>th</sup> April, 2015, <<http://hd.chinatax.gov.cn/guoshui/action/GetArticleView1.do?id=547&flag=1>>

9 *Notice on New Consumption Tax of Battery Coating*, SAT & MOF, 2015, viewed 14<sup>th</sup> April, 2015, <<http://www.chinatax.gov.cn/n810341/n810755/c1489741/content.html>>



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efficiency and equality in the application of the revised consumption tax.

In November 2014, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) announced that it will impose consumption tax on crude oil products to help cut emissions and boost the green economy.<sup>10</sup> The tax involves other petroleum products including naphtha, lubricating oil and jet fuel, while small-displacement motorcycles, tyres and ethyl alcohol were exempted in order to reduce burdens on the low and middle-income group.

It is counterproductive to impose a blanket consumption tax on chemical enterprises without taking into account the individual company's environmental record in terms of energy use and pollutant emissions. It is in the interests of the industry to promote a tax system that incentivises environmentally-friendly business practices.

In light of the adjustment on petrochemical-related products, boosting consumption tax may not satisfy the goal of more efficient social income redistribution. Most enterprises in the chemical industry are aware of their social responsibilities in terms of environmental impact. Therefore, it is counterintuitive not to align environmental best practices with profit, i.e. lower consumption tax for lower emissions. Otherwise, an increased tax liability for enterprises will ultimately be passed onto customers in the form of higher prices.

### Recommendations

- Publicise the selection criteria and list of potential categories that may be subject to consumption tax for public opinion.
- Involve experts to discuss the standards and measurement of particular matters (e.g. consumption tax rate, tax production stage or retail stage) according to the current development of the chemical industry in China.
- Involve industry experts to analyse the impact of the draft consumption tax reform on related enterprises and end customers.

## Abbreviations

CNY	Chinese Yuan
CLP	Classification, Labelling and Packaging
ERP	Enterprise Resource Planning
ETS	Emissions Trading Scheme
EPL	Environmental Protection Law
EC	European Commission
EU	European Union
FTZs	Free Trade Zones
GHS	Globally Harmonised System
GLP	Good Laboratory Practice
GDP	Gross Domestic Product
HCs	Hazardous Chemicals
MSDS	Material Safety Data Sheets
MOFCOM	Ministry of Commerce
MEP	Ministry of Environmental Protection
MOF	Ministry of Finance
MNC	Multinational Corporation
PCR	Petrochemicals, Chemicals and Refining
PPP	Public-Private Partnerships
REACH	Registration, Evaluation, Authorisation and Restriction of Chemicals
R&D	Research and Development
SDS	Safety Data Sheet
SAP	Standard Assessment Procedure
AQSIQ	State Administration of Quality Supervision, Inspection and Quarantine
SAT	State Administration of Taxation
SFDA	State Food and Drug Administration
UN	United Nations
US	United States

<sup>10</sup> Notice on the Further Increase on Consumption Tax of Oil Products, SAT & MOF, 2015, viewed 14<sup>th</sup> April, 2015, <[http://www.gov.cn/xinwen/2015-01/12/content\\_2803343.htm](http://www.gov.cn/xinwen/2015-01/12/content_2803343.htm)>




# Pharmaceutical Working Group

## Key Recommendations

### 1. Promote Innovation in the Medical Industry through Reasonable Policies

#### 1.1 Intellectual Property Rights (IPR)

- Enhance the protection of IP, and encourage technical innovation.
-  • Establish a patent extension period for pharmaceutical products, utilising the experience of developed countries.
- Revise drug registration laws to ensure exclusive data protection for all new chemical entities (as defined internationally) in order to encourage more investments in innovation.

#### 1.2 Drug Quality

- Enhance compliance with and enforcement of Good Manufacturing Practice (GMP) and Good Clinical Practice (GCP) in China.
- Speed up laws focused on pharmaceutical regulation and adopt international best practices on safety and risk management.
- Establish a uniform, quantitative and standardised drug quality evaluation system.
- Carry out quality evaluations of generic drugs, in addition to the existing in vitro dissolution standard, when comparing generic drugs with originator drugs.

### 2. Further Improve the Market Access System for Drugs

#### 2.1 Drug Registration and Approval

- Optimise the registration process for drugs and accelerate their time to market, and reduce the time required to obtain approval for clinical trials in China to under 90 days, in line with international practices.
- Allow CPP submission at any time before the final import licence is issued, instead of insisting it be provided during the primary application for the listing of new drugs.
- Improve the systematic management of the drug application and assessment process; establish a separate approval system for innovative new drugs; allow internationally-recognised clinical trials to be conducted domestically; and simplify the requirements of the approval procedure.
- Involve a team of experts in the assessment process in order to improve assessment quality and efficiency.
- Designate one authority to handle the entire registration and approval procedure.

#### 2.2 Drug Pricing Reform

- Promote a pricing mechanism that takes into account the quality and function of different drugs, and consider an appropriate drug classification when establishing supporting policies related to bidding, procurement and insurance.
- Establish a monitoring system for drug prices and publish the principles and methods on which the system is based.
- Designate government departments to monitor pricing fluctuations and control policies to ensure the free-market pricing mechanism operates smoothly.
- Establish an appropriate medical insurance reimbursement mechanism for patients based on reliable clinical trial data, and consolidate regional policies into one national policy with clear guidelines.

 Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.



- Restructure the medical industry and continue drug pricing reform to promote greater innovation and access to affordable quality drugs.

### 2.3 Drug Bidding and Centralised Purchasing

- Publish a centralised policy focused on procurement/bidding in order to reduce prices and make drug quality the primary factor, in order to satisfy the needs of the patient.
- Categorise drugs in terms of innovation and quality, in the following categories:
  - patent drugs;
  - off-patent originator products, EU- or US-authorized drugs;
  - first generic (also known as GMP first); and
  - Ordinary generic (also known as ordinary GMP drugs).
- Increase the weight associated with product quality in the procurement process.
- Eliminate hospitals' ability to force second-round negotiations and extort income.
- Accelerate the bidding and procurement process, and the flow of drugs into hospitals.

### 2.4 Drug Reimbursement

- Update the *National Reimbursement Drug List (NRDL)* more frequently and develop more preferential insurance reimbursement policies for innovative drugs.
- Include more drugs for treatment in the NRDL and set limits on the access and use of supportive drugs.
- Develop medical reimbursement policies that encourage reasonable use of drugs and restrict the overuse of alternative drugs.
- Reduce the difference between outpatient and inpatient reimbursements, so as to enhance the fairness of patients' medical treatment.
- Develop a reasonable and scientifically-backed, cost-control system and policies, ensuring that the cost-control system does not prevent the development of normal medical treatment activities.
- Increase overall health care expenditure, especially investment in medical insurance.

### 2.5 Health Technology Assessment (HTA) System

- Use the Health Technology Assessment (HTA) system according to current healthcare developments and the specific needs of China.
- Make the availability of high-quality, innovative drugs to patients the only core criteria in decision making.
- Make use of international experience and expertise in this area.

## 3. Emulate International Best Practice to Promote the Implementation of Good Healthcare Practice in China

### 3.1 Mutual Trust between Doctors and Patients

- Establish a pharmaceutical industry with mutual trust between doctors and patients.
- Establish a sound legal system to handle medical disputes.
- Increase support programmes for professionals and guide the public's understanding of the medical industry.
- Build a smooth communication platform between doctors and patients.

### 3.2 International Think Tanks

- Consult industry associations to gain insight on international experiences on healthcare reform.
- Take part in the activities of international industry associations to accumulate international experience.
- Incorporate insights from international experiences in Chinese policy-making where appropriate.



## Working Group Introduction

The Pharmaceutical Working Group represents over 60 foreign pharmaceutical manufacturing companies operating in China. The working group encourages government policies that support the creation of a sustainable system that fosters innovation and healthy growth of the pharmaceutical industry as a whole, while improving patient access to innovative, high-quality medicines, in line with China's declared strategic objectives for the healthcare sector. Policies related to intellectual property (IP), pricing and reimbursement are the most potentially useful tools for rewarding quality and safety while creating incentives for domestic and multinational companies alike to bring innovative medicines to the Chinese market. The working group supports the establishment of a transparent regulatory environment to solicit comments and participation from the pharmaceutical industry (both local and foreign) before formal policies on issues such as pricing, reimbursement and intellectual property rights (IPR) are announced.

## Recent Developments

The year 2014 marked the fifth year since the issuance of the *Opinions of the CPC Central Committee and the State Council on Deepening the Reform of the Medical and Healthcare System*,<sup>1</sup> and the second year since further reform targets were promulgated in the *Decision*,<sup>2</sup> following the Third Plenum. Many of these reforms targeted medical and health systems, including the development of medical security, medical services, public health, traditional medicines, drug supply and pricing reforms, and the reform of the supervision system. In addition, they have accelerated reforms of public hospitals, challenged hospital profit making as part of the drug bidding process, and begun to allow doctors to practice across different locations.

The *Joint Reformation for Public Health Services, Medical Insurance, and Medical Production-Circulation (JRPMM)*<sup>3</sup> has led to a structural change of the industry. So far, 2015 has seen the end of centralised

drug pricing and a greater role for market forces in the fields of drugs and medical treatment. The joint reformation aims to create a more level playing field for drug manufacturers and allow more capital to enter the market.

In recent years the biological pharmaceutical (biopharma) industry in China has developed rapidly with the help of the Chinese Government, which designated it one of seven key strategic new industries. Biological drugs and technologies have been hailed as breakthrough innovations, with some experts expecting biopharma to be a major source of innovation within the medical industry. The European Chamber supports the Chinese Government's policies that support innovation and the development of the biopharma industry.

The most significant policy to affect the pharmaceutical industry in 2014, was the *Promotion of Price Reform Plan for Drugs* (draft for comments).<sup>4</sup> The reform cancelled the government's right to set the maximum retail price or ex-factory price of drugs. The actual trading price of drugs will now be formed by market competition, by using medical insurance coverage and procurement by bidding. This reform highlights China's commitment to increasing the role of market forces in the pricing mechanism, as outlined in the Third Plenum – all prices that can be determined by the market shall be formed by market competition, as opposed to being manipulated by the government.

In February 2014, the National Health and Family Planning Commission (NHFP) issued the *Notice on Promotion of Critical Illness Insurance for Urban and Rural Residents*.<sup>5</sup> This pilot reform aims to reduce the burden and cost of critically ill patients on average households.

In March 2014, at the executive meeting of the State Council, Premier Li Keqiang proposed a three-pronged reform to the medical industry: public health services reform, medical insurance reform and pharmaceutical production reform.

On 26<sup>th</sup> March, 2014, the *Promotion of Integrated*

1 *Opinions of the CPC Central Committee and the State Council on Deepening the Reform of the Medical and Health Care System*, State Council, 17<sup>th</sup> March, 2009, viewed 17<sup>th</sup> June, 2015, <[http://www.gov.cn/jrzq/2009-04/06/content\\_1278721.htm](http://www.gov.cn/jrzq/2009-04/06/content_1278721.htm)>

2 The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.

3 *Deepening the Reform of the Medical and Healthcare System Video and Telephone Conference*, State Council, 29<sup>th</sup> April, 2015, viewed 16<sup>th</sup> June, 2015, <<http://www.jkb.com.cn/news/healthCareReform/2015/0429/367931.html>>

4 *Promotion of Price Reform Plan of Drugs* (draft for comments), NDRC, 25<sup>th</sup> November, 2014, viewed 17<sup>th</sup> June, 2015, <<http://news.hexun.com/2014-11-27/170844593.html>>

5 *Notice on Promotion of Critical Illness Insurance for Urban and Rural Residents*, NHFP, 8<sup>th</sup> February, 2014, viewed 16<sup>th</sup> June, 2015, <<http://www.moh.gov.cn/tigs/s7846/201402/3e605fe2f3e64c46be3e516fc1fb8f62.shtml>>





*Reform of Public Hospitals at the County Level* (draft for comments)<sup>6</sup> was jointly issued by the NHFPC, the Ministry of Finance (MOF), the State Commission Office (SCO), the National Development and Reform Commission (NDRC) and the Ministry of Human Resources and Social Security (MOHRSS). This piece of legislation aims to comprehensively reform the management systems of public hospitals at the county-level. The pilot reform covered over 50 per cent of counties (cities) in 2014, and is an important first step towards addressing the problems of cost and difficulty of scheduling medical appointments for China's citizens. In April 2014, the NDRC, the NHFPC and the MOHRSS issued policies relaxing price controls on non-public medical institutes. This established a foundation for private capital to enter the medical industry.

On 28<sup>th</sup> May, 2014, the *Supervision Management Method for Operation of Internet Food Drugs*<sup>7</sup> (draft for comments) was published by China's Food and Drug Administration (FDA) for comment. The draft expanded the scope of approved chain retailers allowed to sell food and drugs online, as well as approving the use of logistical and distribution companies for storage and transportation.

In June 2014, the NHFPC issued the *Urgent Notice on Control of Rapid Expansion of Scale of Public Hospitals*.<sup>8</sup> This is the first time the NHFPC has pledged to control the rapid expansion of public hospitals as they look to increase the role of private capital in the healthcare market. In July 2014, the *Management Method of Multi-sited Licence of Physicians in Beijing*<sup>9</sup> was published. In November 2014, the *Medical Rules at Shenzhen Special Economic Zone* (draft for comments)<sup>10</sup> was promulgated in Shenzhen, which looks to revoke limitations on physicians' rights to practice in multiple locations.

6 *Notice About Printing the Comments on Integrated Reform of Public Hospitals at the County Level*, NHFPC, MOF, SCO, NDRC and MOHRSS, 26<sup>th</sup> March, 2014, viewed 17<sup>th</sup> June, 2015, <[http://www.mof.gov.cn/zhengwuxinxi/zhengcefabu/201404/t20140408\\_1064889.htm](http://www.mof.gov.cn/zhengwuxinxi/zhengcefabu/201404/t20140408_1064889.htm)>

7 *Supervision Management Method for Operation of Food Drugs via Internet* (draft for comments), China FDA, 28<sup>th</sup> May, 2014, viewed 17<sup>th</sup> June, 2015, <<http://www.cfda.gov.cn/WS01/CL0783/100534.html>>

8 *Urgent Notice Regarding Control on Rapid Expansion of Scale of Public Hospitals*, National Health and Family Plan Committee, 16<sup>th</sup> June, 2014, viewed 17<sup>th</sup> June, 2015, <<http://www.lijingao.com/cacnew/201406/3620093865.htm>>

9 *Management Method of Multi-sited Licence of Physicians in Beijing*, Beijing Municipal Government, 28<sup>th</sup> May, 2014, viewed 17<sup>th</sup> June, 2015, <<http://zhengwu.beijing.gov.cn/gzdt/gggs/t1363324.htm>>

10 *Medical Rules at Shenzhen Special Economic Zone* (draft for comments), Shenzhen NPC Standing Committee General Office, 17<sup>th</sup> November, 2014, viewed 17<sup>th</sup> June, 2015, <[http://www.sz.gov.cn/cn/xxgk/szgg/tzgg/201411/t20141117\\_2680128.htm](http://www.sz.gov.cn/cn/xxgk/szgg/tzgg/201411/t20141117_2680128.htm)>

On 25<sup>th</sup> July, 2014, the NHFPC and the MOC issued the *Notice Regarding Launching a Pilot Scheme of Establishing Wholly Foreign-Owned Hospitals*,<sup>11</sup> allowing foreign investors to set up or form merger partnership-owned hospitals in Beijing, Tianjin, Shanghai, Jiangsu, Fujian, Guangdong and Hainan.

In October 2014, Song Shuli, the press secretary of the NHFPC, introduced a pilot reform promoting categorised medical treatment at public hospitals, and a gradual timeline to form a national categorised medical diagnosis system. Many provinces such as Jiangsu, Sichuan, Zhejiang and Qinghai, or several individual departments have already published special documents related to categorised medical treatment, outlining relevant rules and concerns from the aspects of resource allocation, system establishment and medical assessment. Beijing, Shanghai, Ningxia and Chongqing have all made their positions clear regarding the formation and management of a categorised medical treatment system through medical associations and previous policies related to medical companies.

On 17<sup>th</sup> November, 2014, the State Council issued the *Some Comments about Speeding up Development of Commercial Health Insurance* (draft for comments).<sup>12</sup> The draft requires private insurers to explicitly list the detailed scope of their insurance offerings to urban and rural residents, whilst further encouraging them to expand their existing service offerings. The concept of separating insurance management from the government was put forward and private competition is now encouraged. Qualified commercial insurance institutes can now provide various different types of medical insurance, which will overturn the old selling rules on medicines where price was controlled by the government. When government social security departments act as the sole policy-makers for social welfare and insurance, they tend to enlarge the reimbursement in order to maximise their own profits. Commercial insurance institutes compete with each other, which reduces inefficiency and ensures the market price of pharmaceuticals is determined by competition.

11 *Notice Regarding Launching a Pilot Scheme of Establishing Wholly Foreign-Owned Hospitals*, NHFPC and MOFCOM, 25<sup>th</sup> July, 2014, viewed 17<sup>th</sup> June, 2015, <<http://www.moh.gov.cn/lyygyj/s3577/201408/73f1ec5b56304347aa3436a08e39ddfa.shtml>>

12 *Some Comments about Speeding Up Development of Commercial Health Insurance*, State Council, 27<sup>th</sup> October, 2014, viewed 17<sup>th</sup> June, 2015, <[http://www.gov.cn/zhengce/content/2014-11/17/content\\_9210.htm](http://www.gov.cn/zhengce/content/2014-11/17/content_9210.htm)>





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
<p>The main responsibility and role of the government is to strengthen and improve public services, safeguard fair competition, strengthen oversight of the market and maintain market order. We will further streamline the administration and delegate more power to lower levels, deepen the reform of the system concerning matters subject to government examination and approval. We will cancel all administrative approval procedures for economic activities under the effective regulation of the market mechanism.</p>	<p>Currently, there are only a few departments streamlining administration effectively, for example, the drug price reform by the central government. From 1<sup>st</sup> June, 2015, the government no longer controls the maximum retail price for drugs, but it should still be cautious about its influence on price in other forms. For example, in some provinces, local governments set a minimum percentage for price reduction, which contradicts the market-forces-orientated approach the central government has pledged to adopt.</p>	
<p>We will improve the public security system. We will improve unified, authoritative food and drug safety oversight organisations. We will integrate major law-enforcement bodies, relatively centralise the law-enforcement power, press ahead with comprehensive law enforcement, and do our best to resolve problems such as overlapping functions and duplicate law enforcement to establish an authoritative and efficient administrative law-enforcement system with the integration of power and responsibility. We will reduce the hierarchy of administrative law enforcement and allocate more law-enforcement resources to the primary level in foodstuffs and medicines.</p>	<p>The new Food Safety Law<sup>13</sup> has been published, but supplementary policies are still being devised. The working group hopes the supplementary policies will give clear guidance on administration and enforcement. The working group hopes the new supplementary policies consider the differences between domestic regulations and foreign regulations, and provide a comprehensive mechanism to implement the new law.</p>	
<p>We will reform the methods of insurance payouts, and extend the medical insurance system to all the people. We will speed up the completion of the medical insurance and medical assistance system against fatal and serious diseases. We will improve a financial input system for and the budgeting system of social security. We will strengthen management of and supervision over investment of social insurance funds, and encourage the funds to be invested into diversified sectors in the market. We will steadily make basic urban public services available to all permanent residents in cities, and incorporate farmers who have registered as urban residents into the urban housing and social security network, and make sure their previous subscription to old-age insurance and medical insurance in the countryside continues in the urban social security system.</p>	<p>There is little progress on the methods of insurance payouts.</p> <p>It is still difficult for patients to receive medical treatment in cities where his/her <i>hukou</i> is not located.</p> <p>There is no timeframe for combining medical insurance for urban workers, medical insurance for urban residents, and the new rural cooperative medical system (NRCMS).</p>	

<sup>13</sup> Food Safety Law, National People's Congress, entered into force 1<sup>st</sup> October, 2015, viewed, 16<sup>th</sup> July, 2015, <[http://www.gov.cn/xinwen/2015-04/25/content\\_2852919.htm](http://www.gov.cn/xinwen/2015-04/25/content_2852919.htm)>



We will improve the mechanism whereby prices are mainly determined by the market. Relax price control in competitive areas. We will abolish the practice of raising medicine prices to make up for the shortfall in hospital funds, rationalise the prices of medical services and medicines, and establish an appropriate compensation mechanism. Promote market-oriented reform in width and in depth, greatly reducing the government's role in the direct allocation of resources, and promote resources allocation according to market rules, market prices and market competition, so as to maximise the benefits and optimise the efficiency.

▶ The control on maximum retail prices for drugs has been abolished. In some areas, however, hospitals are manipulating the bidding system to extract their own revenue from the process. The working group hopes the government enforces its commitment to allow market forces to form prices through competition by devising supplementary policies to support this reform.



## Key Recommendations

### 1. Promote Innovation in the Medical Industry Through Reasonable Policies

#### 1.1 Intellectual Property Rights (IPR)

##### Concern

The overall IPR protection system for pharmaceutical products is inefficient and costly, the patent protection period for pharmaceuticals in China is too short and there is a lack of data protection for some drugs.

##### Assessment

The Third Plenum's *Decision*,<sup>14</sup> put forward a mechanism to encourage innovation, enhance the application and protection of intellectual property (IP), and build reputable IP courts. At present, the penalties and fines for patent infringements generally are so low that they appear to allow infringers to earn an adequate profit, even if caught and fined – most studies suggest that fines represent only a tiny fraction of the estimated sales revenue lost to patent holders.

The protection of IP within the pharmaceutical industry in China will accelerate the research and development (R&D) of new drugs, enhance drug quality and safety, and become an important measure to promote sustainable development of the industry. The establishment of a fair, open and transparent system for protection of IP would therefore act as a catalyst for innovation in the pharmaceutical industry.

A survey carried out by the R&D-based Pharmaceutical

Association Committee (RDPAC) under the China Association of Enterprises with Foreign Investment (CAEFI) showed that, on average, the patent protection period of innovative drugs after the launch is about 11 years in China, compared with 19 years in the United States (US) and 17 years in Japan.

Innovative drugs are generally safer and more effective, thereby reducing hospitalisation days and producing less adverse side effects. This benefits patients, reduces costs throughout the medical service chain and improves the efficiency of public healthcare expenditure.

Due to the lack of data protection laws in China, generic drugs have appeared on the market too early. This has had an adverse effect on investment in R&D for drugs, and is threatening the future development of innovative drugs.

##### Recommendations

- Enhance the protection of IP, and encourage technical innovation.
- ▶ Establish a patent extension period for pharmaceutical products, utilising the experience of developed countries.
- Revise drug registration laws to ensure exclusive data protection for all new chemical entities (as defined internationally) in order to encourage more investments in innovation.

#### 1.2 Drug Quality

##### Concern

Continuous drug price reductions and a centralised procurement procedure which only focuses on price

<sup>14</sup> The Decision of the Chinese Communist Party Central Committee on Major Issues concerning Comprehensively Deepening Reform (Decision), Communist Party of China, 12<sup>th</sup> November, 2013, viewed 17<sup>th</sup> June, 2015, <[http://www.gov.cn/jrzq/2013-11/15/content\\_2528179.htm](http://www.gov.cn/jrzq/2013-11/15/content_2528179.htm) >



have forced some manufacturers to reduce quality to lower their costs in order to maintain competitive prices. Good Manufacturing Practice (GMP) certification should be the standard certification related to the quality of listed drugs, yet it is not widely accepted in China.

#### Assessment

Currently, domestic generic drugs and imported originator drugs differ in their clinical efficacy. This is also the case for generic drugs manufactured by different companies, and even drugs of different batches manufactured by the same company. This results in a wide range of quality standards.

Only a strict quality assurance system can ensure drug quality. In recent years, the concept of 'quality by design' has been widely recognised in academic and industrial circles. Institutional reform will guide manufacturers to emphasise drug quality from the beginning of the R&D process.

Only by improving drug production quality standards and the quality of clinical testing can the industry make meaningful steps towards improving drug quality. The transition to commonly-accepted, international quality standards is a vital measure in order to encourage pharmaceutical companies to adhere to the same general standards related to drug quality.

Traditional assessment on drug quality still relies on the 'sampling pass ratio' concept, which is detrimental towards the formation of a standardised drug quality assessment system. A standardised assessment system would eliminate unnecessary ambiguity by adopting a single result format and removing subjective wordings.

Currently, the quality evaluation of generic drugs is carried out by using the in vitro dissolution standard, which fails to comprehensively evaluate the quality parameters of generic drugs since equivalent tests, such as biological tests, have not been made. The working group advocates for the establishment of a uniform quality evaluation system for generic drugs and an improved integrated evaluation method with indexes.

#### Recommendations

- Enhance compliance with and enforcement of *Good Manufacturing Practice* (GMP) and *Good Clinical Practice* (GCP) in China.

- Speed up laws focused on pharmaceutical regulation and adopt international best practices on safety and risk management.
- Establish a uniform, quantitative and standardised drug quality evaluation system.
- Carry out quality evaluations of generic drugs, in addition to the existing in vitro dissolution standard, when comparing generic drugs with originator drugs.

## 2. Further Improve the Market Access System for Drugs

### 2.1 Drug Registration and Approval

#### Concern

New drugs must obtain clinical trial authorisation (CTA) and apply for a new drug application (NDA), after first providing a Certificate of Production Permission (CPP). This dual registration system is time consuming and complicated by international standards.

#### Assessment

Currently, a strict review and approval system for clinical trials is carried out in China. Applicants must get the approval from the China Food and Drug Administration (CFDA) and start clinical tests only after receiving the Clinical Trial Permission. The whole review and approval process involves a large number of administrative departments, including provincial drug supervision departments, the provincial Institute for Drug Control, the Centre for Drug Evaluation (CDE), and the CFDA. In contrast, many countries (including the US) adopt a much looser review and approval system. For example, applicants may carry out tests on new drugs provided they do not receive an objection notice from the Food and Drug Administration (FDA) within 30 days of their application receipt date.

Chinese authorities do not acknowledge foreign clinical trial data. To check whether a drug's foreign clinical trial reflects its suitability for Chinese people, it would seem reasonable to examine the data to see if people of different races were included as test subjects. Generally speaking, in nations with mixed racial demographics such as the US, the suitability of new drugs for different races is taken into consideration during clinical trials. For drugs that exhibit no variation in clinical efficacy on test subjects during foreign clinical trials, the mandatory clinical tests in China are unnecessary and only delay Chinese patients from accessing innovative drugs.



In China, as in most emerging markets, a CPP must be obtained before a NDA can be approved. A CPP is issued by the relevant body in the drug manufacturer's country of origin, which confirms the drug has been approved to be listed and sold in that country. As China's import procedure for pharmaceutical products requires the CPP to be submitted, together with the import registration application, it therefore requires any foreign drug product to have already been approved in its country of origin before entering China. This also greatly delays the time to market for new drugs in China, and prevents Chinese patients from accessing the most innovative drugs on the global market.

China still uses a dual registration system of marketing authorisation and production licensing. Innovative enterprises focused on R&D may not have a production licence and, as such, are unable to manufacture their own end-product. In this scenario they are forced to transfer technology to independent manufacturers who have the necessary dual approval. If their IP cannot be sufficiently protected or the terms of a transfer cannot be agreed on, Chinese consumers may miss out on innovative new drugs. In addition, the requirement to own a production licence has led to overcapacity in production facilities as Chinese manufacturers have raced to meet the dual requirements.

### Recommendations

- Optimise the registration process for drugs and accelerate their time to market, and reduce the time required to obtain approval for clinical trials in China to under 90 days, in line with international practices.
- Allow CPP submission at any time before the final import licence is issued, instead of insisting it be provided during the primary application for the listing of new drugs.
- Improve the systematic management of the drug application and assessment process; establish a separate approval system for innovative new drugs; allow internationally-recognised clinical trials to be conducted domestically; and simplify the requirements of the approval procedure.
- Involve a team of experts in the assessment process in order to improve assessment quality and efficiency.
- Designate one authority to handle the entire registration and approval procedure.

## 2.2 Drug Pricing Reform

### Concern

China's aim to have the retail price of drugs determined by market competition will be difficult to achieve without the introduction of top-down, supporting policies related to procurement processes and the role of medical insurance.

### Assessment

The government has relaxed controls on the maximum retail prices of drugs in order to allow market forces to determine price, as outlined in the NDRC's *Promotion of Reform Scheme of Drug Pricing (draft for comments)*, released on 5<sup>th</sup> May, 2015, and active since 1<sup>st</sup> June, 2015. The government intends to promote a free-market pricing mechanism backed by competitive bidding procurement and medical insurance reimbursement, as is the case in other developed markets. However, a lack of supporting policies means that it will be difficult for market forces to function adequately.

As a result of the relaxed price controls, quality drugs have lost the ability to suitably differentiate themselves. Before the draft was issued, and in the absence of drug quality assessment, the NDRC was responsible for drug pricing and as such assigned higher prices to higher quality drugs. Now, with the removal of government-controlled pricing, the new pricing system controlled by bidding procurement and insurance reimbursement is motivated by the lowest price and is failing to value drugs according to drug quality.

Public hospitals earn revenue through three channels – pharmaceutical sales, medical treatment and government funding. Post-reform, free-market pricing has created an environment where hospitals are incentivised to push for second-round negotiations even after the bidding price has been agreed. In this scenario, the difference between the first-round and the second-round price becomes the hospital's income, which completely negates the government's attempt to eliminate the manipulation of drug prices. This has also created a bidding system whereby hospital procurement teams are solely motivated by low prices and usage rates. This is to the detriment of the development of the pharmaceutical industry in China, as high quality drugs are inherently disadvantaged in the bidding process due to their high price relative to the low price of inferior drugs. As a result, Chinese patients do not have access



to high quality drugs.

At the core of an effective medical insurance and reimbursement system is drug classification. Following the abandonment of centralised, fixed pricing, an adequate insurance and social welfare system is required to protect the rights of the patient. So far, there has been no central government policy related to drug classification, which is hindering the role of medical insurance and also damaging patients' ability to access quality drugs. The local governments of Sanming, Chongqing, Zhaoxing and Anhui have already devised classification models based around four different types of drugs. A comprehensive guideline for insurance payments and reimbursement based on drug quality classification is an essential foundation for a functioning social welfare and healthcare system in China.

There is a vast difference in the quality of drugs available in China. Most of the generic drugs have not received a biological equivalence evaluation and the prevalence of counterfeit drugs is widespread. The intense nature of competition in the industry is yielding low profits and hampering investment in innovation. These factors are inhibiting the structural upgrade of the industry and preventing access to innovative drugs for patients. The 2015 Central Economic Conference further emphasised the need to shift to an economic model that encourages innovation and improved labour efficiency to cope with demographic shifts. The working group hopes the government will consider devising policies to correct the current bias towards the lowest price during the bidding process and improve investment into innovation-focused activities.

#### Recommendations

- Promote a pricing mechanism that takes into account the quality and function of different drugs, and consider an appropriate drug classification when establishing supporting policies related to bidding, procurement and insurance.
- Establish a monitoring system for drug prices and publish the principles and methods on which the system is based.
- Designate government departments to monitor pricing fluctuations and control policies to ensure the free-market pricing mechanism operates smoothly.
- Establish an appropriate medical insurance reimbursement mechanism for patients based on reliable clinical trial data, and consolidate regional policies into one national policy with clear guidelines.

- Restructure the medical industry and continue drug pricing reform to promote greater innovation and access to affordable quality drugs.

### 2.3 Drug Bidding and Centralised Purchasing

#### Concern

The bidding process is too focused on price and consequently ignores drug quality, and hospitals are negotiating post-bidding, second-round prices that are significantly lower than the initial bidding price

#### Assessment

Emphasising drug price too much in the bidding process can result in poorer quality drugs being administered to patients. The bidding process needs to be improved, by incorporating economic and technical evaluations to reflect the value of drug quality, in order to eliminate the 'lowest price only' mentality.

The bidding process has not been refined to reflect the new changes in pricing legislation. As a result, hospitals are manipulating the process to extract income at the expense of foreign drug manufacturers. This is completely contrary to the government's regulatory effort to limit hospitals' income from drug procurement. There is no transparency during the second round negotiation, which leaves the process open to corruption. This practice is squeezing pharmaceutical companies' margins and artificially elevating drug prices against the will of the market.

Ensuring the continued supply of quality drugs to patients should be the primary objective of the drug procurement system. To distinguish between different levels of quality, an appropriate evaluation and classification of quality standards in accordance with the relevant medicine is necessary. Procurement prices should be based on objective evaluation of drug quality. Therefore, centralised procurement is an important function to ensure that only quality medicines enter the supply chain. As such, the drug procurement process should be categorised according to drug type and rated in terms of innovation and quality.

#### Recommendations

- Publish a centralised policy focused on procurement/bidding in order to reduce prices and make drug quality the primary factor, in order to satisfy the needs of the patient.
- Categorise drugs in terms of innovation and quality,



in the following categories:

- patent drugs;
  - off-patent originator products, EU- or US- authorised drugs;
  - first generic (also known as GMP first); and
  - ordinary generic (also known as ordinary GMP drugs).
- Increase the weight associated with product quality in the procurement process.
  - Eliminate hospitals' ability to force second-round negotiations and extort income.
  - Accelerate the bidding and procurement process, and the flow of drugs into hospitals.

## 2.4 Drug Reimbursement

### Concern

Long drug reimbursement times and ineffective medical insurance policies mean patients are increasingly waiting for prolonged periods to obtain new drugs, which has an adverse effect on innovation and the development of the industry.

### Assessment

The *National Reimbursement Drug List (NRDL)* has not been updated for five years, greatly limiting the availability of innovative drugs and preventing doctors from choosing the best treatment programmes. The reimbursement and approval process in China takes much longer in comparison to international standards. As shown by related research, it takes about six years for a new drug to be priced, launched into market and reimbursed following its registration in China. The same process only takes three to six months in the UK, Japan and France.

The MOHRSS is in charge of reimbursement policies and processes. However, in practice, three levels of authorities (state level, provincial level and city level) are involved. Key Opinion Leaders (KOLs), the MOF and the China Health Insurance Research Association (CHIRA) differ in their understanding, implementation and interpretation of the reimbursement policies, leading to differences between the actual reimbursement percentage covered and the actual drug expenses incurred. In addition, the funding and scope of the national insurance scheme is insufficient.

With regards to medical insurance fund management and reimbursement, there is a lack of policies in place to encourage reasonable use of drugs and to restrict

the overuse of alternative drugs. This leads to a waste of medical insurance funds and a tendency amongst patients to overuse alternative drugs to compensate for a lack of access to the best treatment. Moreover, during the reform of medical insurance expense control and payment models, there has been no sufficient research into expense control indicators and measures, or a proper evaluation of the expense control measures' influence on treatment and medical insurance funds. As a result, the expense control measures are generally simple and unrefined (such as the limits on the expense of a single prescription or drug usage), causing inconvenience to patients or hindering the adoption of better treatment programmes.

### Recommendations

- Update the NRDL more frequently and develop more preferential insurance reimbursement policies for innovative drugs.
- Include more drugs for treatment in the NRDL and set limits on the access and use of supportive drugs.
- Develop medical reimbursement policies that encourage reasonable use of drugs and restrict the overuse of alternative drugs.
- Reduce the difference between outpatient and inpatient reimbursements, so as to enhance the fairness of patients' medical treatment.
- Develop a reasonable and scientifically-backed, cost-control system and policies, ensuring that the cost-control system does not prevent the development of normal medical treatment activities.
- Increase overall health care expenditure, especially investment in medical insurance.

## 2.5 Health Technology Assessment (HTA) System

### Concern

The Health Technology Assessment (HTA) System does not play a full role in healthcare decision making, and patients are not the core factor in the HTA process.

### Assessment

A transparent HTA can improve cooperation among stakeholders and maintain a procedure to make innovative drugs quickly available to patients. A HTA should be kept independent from regulations and supervision procedures.

### Recommendations

- Use the HTA system according to current healthcare developments and the specific needs of China.



- Make the availability of high-quality, innovative drugs to patients the only core criteria in decision making.
- Make use of international experience and expertise in this area.

### 3. Emulate International Best Practice to Promote the Implementation of Good Healthcare Practice in China

#### 3.1 Mutual Trust between Doctors and Patients

##### Concern

Conflicts between doctors and patients have hindered the development of healthcare sector.

##### Assessment

According to related data, about 115,000 medical disputes occurred in 2014.<sup>15</sup> The reasons behind increasing instances of violent medical disputes lie in insufficient healthcare investments. This leads to high costs for medical treatments and the absence of recognition and compensation for doctors. There is also a lack of regulations regarding medical negligence and disputes, and the communication between doctors and patients is not effective.

##### Recommendations

- Establish a pharmaceutical industry with mutual trust between doctors and patients.
- Establish a sound legal system to handle medical disputes.
- Increase support programmes for professionals and guide the public's understanding of the medical industry.
- Build a smooth communication platform between doctors and patients.

#### 3.2 International Think Tanks

##### Concern

There is a lack of close cooperation between foreign-funded medical industry associations and Chinese counterparts.

##### Assessment

Foreign-funded industry associations have access to extensive networks. In addition they can support academic exchanges and offer the latest policy research and advice. The working group hopes the

<sup>15</sup> Year-on-year Growth of Cases of Judicial Channel from Medical Disputes, China Daily, 21<sup>st</sup> April, 2015, viewed 17<sup>th</sup> June, 2015, <[http://www.chinadaily.com.cn/micro-reading/dzh/2015-04-21/content\\_13576980.html](http://www.chinadaily.com.cn/micro-reading/dzh/2015-04-21/content_13576980.html)>

Chinese Government can cooperate more closely with these international associations and draw on international experience and expertise when formulating and implementing policies.

##### Recommendations

- Consult industry associations to gain insight on international experiences on healthcare reform.
- Take part in the activities of international industry associations to accumulate international experience.
- Incorporate insights from international experiences in Chinese policy-making where appropriate.

### Abbreviations

Biopharma	Biological Pharmaceutical
CAEFI	China Association of Enterprises with Foreign Investment
CDE	Centre for Drug Evaluation
CFDA	China Food and Drug Administration
CHIRA	China Health Insurance Research Association
CPC	Communist Party of China
CPP	Certification of Production Permission
CTA	Clinical Trial Authorisation
EU	European Union
FDA	Food and Drug Administration
GCP	Good Clinical Practice
GMP	Good Manufacturing Practice
HTA	Health Technology Assessment
IP	Intellectual Property
IPR	Intellectual Property Rights
JRPMM	Joint Reformation for Public Health Services, Medical Insurance, and Medical Production-Circulation
KOL	Key Opinion Leader
MOC	Ministry of Commerce
MOF	Ministry of Finance
MOHRSS	Ministry of Human Resources and Social Security
NDA	New Drug Application
NDRC	National Development and Reform Commission
NRCMS	New Rural Cooperative Medical System
NRDL	National Reimbursement Drug List
R&D	Research and Development
RDPAC	R&D-Based Pharmaceutical Association Committee
SCO	State Commission Office
US	United States





## Rail Working Group

### Key Recommendations

- 1. Increase Market Access and Strengthen Competition in the Railway Industry**
  - Allow foreign companies to compete as local players in the market by lifting all restrictions and letting market forces drive competition.
  - Revise the National Development and Reform Commission's (NDRC's) localisation policy to foster innovation, improve technology, project execution, quality and safety in the railway industry.
- 2. Improve Transparency in the Standardisation and Specification Process**
  - Allow all companies legally registered in China to participate as members in all relevant technical committees and working groups to get involved in the formulation process of industry standards.
  - Increase transparency in the standardisation formulation process, especially for the formulation of industrial standards.
- 3. Improve the Rail Industry Supply Chain Through Further Protection of Intellectual Property Rights (IPR)**
  - Protect intellectual property rights (IPR) to encourage investment in the railway sector.
  - Improve the railway supply chain by encouraging investment from small and medium-sized enterprises (SMEs).

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.

### Introduction to the Working Group

The Rail Working Group consists of manufacturers in the fields of rolling stock, rail infrastructure and signalling systems along with services for rail. The working group represents the common interests of the European rail industry and is composed of around 20 active members from private sector.

### Recent Developments

#### Industry Development

By the end of 2014, China's rail network, with a route length of 112,000km, ranked as the second largest rail network in the world.<sup>1</sup> The rapid expansion of China's high-speed rail (HSR) network has reached 16,000 km, making it by far the largest in the world.<sup>2</sup>

China also has the world's busiest railway system, both in terms of passenger and freight traffic. In 2014,

railways in China delivered 2.3 billion passenger trips, generating 1,160 billion passenger-kilometres and carried 3.8 billion tons of freight, generating 2.8 billion cargo ton-kilometres. In terms of urban rail transit, 38 cities in China have built urban mass transit systems over the last decade. Presently, 22 Chinese cities have well-established mass transit systems (including metro and tram) with a total length of 2,900 km.

By 2020, it is estimated that more than 50 cities in China will have metro systems, including many second- and third-tier cities. According to the estimated statistics, 142 of China's cities will have a population of over one million people by 2020. Among those cities of high population density, six will have a population of over 10 million and 10 will have a population of between five million and 10 million. The estimates indicate that there is still room for continued growth of the urban rail transit in China.

#### Chinese Government and Rail Industry

The former Ministry of Railways (MOR) was dismantled

<sup>1</sup> *The world's 10 longest railway networks*, Railway-Technology, 20<sup>th</sup> February, 2014, viewed on 3<sup>rd</sup> July, 2015, <<http://www.railway-technology.com/features/featurethe-worlds-longest-railway-networks-4180878/>>

<sup>2</sup> Ibid



in 2013, and two new organisations were set up to replace the MOR's role:

- The China Railway Corporation (CR); and
- The State Railway Administration (SRA).

In the new structure, the CR, as a state-owned enterprise (SOE), is responsible for constructing new lines and operating existing lines, whereas the SRA, as a government unit, is responsible for creating regulations and standards for the industry. The SRA reports to the Ministry of Transportation (MOT), which oversees the general development of the industry and policy landscape in China.

As one of the biggest SOEs in China, the CR has a registered capital of over Chinese Yuan (CNY) 1 trillion and employs almost two million employees. It is supervised by the Ministry of Finance (MOF) on behalf of the State Council. In 2014, the CR invested CNY 809 billion in rail-related infrastructure development and put a record 8,427 km of new railways into operation.<sup>3</sup> In February 2015, the CR announced that it would continue to invest over CNY 800 billion in railway infrastructure in 2015. The plan was to expand China's railway network to 120,000 km by 2015.

In terms of the Chinese railway planning, China identified railway equipment—especially high-speed rail equipment such as Electric Multiple Units (EMUs)—as the direction of future development for the industry. Therefore, the Chinese Government has been giving considerable policy support to state-owned national champions in the field of railway equipment manufacturing and encouraging them to enter the international market.

Given the importance attached to railways by the government, the next five years will continue to be a pivotal period for railway construction in China. As railway construction was an important part of the government's *12<sup>th</sup> Five-Year Plan (2011–2015)* for national economic development, it is a realistic estimate that the *13<sup>th</sup> Five-Year plan (2016–2020)* is going to extend China's 'golden age' for railway building.

### The Merger of CSR and CNR

In early 2015, China's state-owned train manufacturing

companies China North Railway (CNR) Corporation and China South Railway (CSR) Corporation decided to merge to create a world-leading railway supplier. This amalgamation, China Rail Rolling Stock (CRRC) Co Ltd, is believed to help China compete with international rivals on the market, including firms such as Bombardier and Siemens. Given that China's domestic market is largely saturated, the newly-merged company will also help strengthen China's capacity in developing high-speed trains and further expand abroad.

### Rail Industry and the Third Plenum

The Third Plenum in 2013, outlined a path for China's market-oriented reforms and indicated an expanded role for market forces to determine economic outcomes. For the railway industry, the expectations were raised high for further commercialising and partly privatising this poorly-managed and highly inefficient sector. However, until today—almost two years after the Third Plenum—the progress on “allowing the market play a decisive role in allocating resources”<sup>4</sup> in the railway sector is somewhat disappointing. The table on the following page compares what was said in the Third Plenum's *Decision on Some Major Issues Concerning Comprehensively Deepening the Reform (Decision)*<sup>5</sup> with the current reality.

## Key Recommendations

### 1. Increase Market Access and Strengthen Competition in the Railway Industry

#### Concern

Foreign players in China's railway manufacturing sector face regulatory restrictions while participating in the domestic railway market. By law, foreign enterprises are only able to enter certain markets by offering technology transfer to local partners, and this significant market access barrier interrupts normal market forces, invites unfair competition and results in less investment in China's rail sector.

#### Assessment

Limited market access remains a major issue for foreign players participating in the Chinese market. For

<sup>3</sup> Chen, Yang, *National rail investment target fulfilled in 2014*, *Global Times*, 29<sup>th</sup> January, 2015, viewed 3<sup>rd</sup> July, 2015, <<http://www.globaltimes.cn/content/904894.shtml>>

<sup>4</sup> The Full Texts of the Third Plenum *Decision*, CNR.com, 12<sup>th</sup> November 2013, viewed 3<sup>rd</sup> July 2015, [http://news.cnr.cn/native/gd/201311/t20131112\\_514111965.shtml](http://news.cnr.cn/native/gd/201311/t20131112_514111965.shtml) (Chinese language)

<sup>5</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.



Third Plenum Reality Check		
What did the Third Plenum's Decision say?	What is the reality?	Status
Let the market play a decisive role in allocating resources.	Limited market access remains a major issue for foreign players in the Chinese railway industry. No foreign entity is allowed to bid directly for a project in rolling stock or signalling segments.	
The government should encourage healthy competition on the market.	China has identified railway equipment—especially high-speed rail equipment—as a strategic emerging industry, which means that the government will continue to support the development of state-owned national champions in the field of railway equipment manufacturing.	
Create a fair and transparent regulatory environment.	Foreign players in the rail industry are often not given the opportunity to comment on drafts of standards and specifications, which may lead to entry barriers and unfair competition.	

markets related to mainline rail business, no foreign entity is allowed to bid directly for a project in rolling stock or signalling segments. For certain markets that are partially open, such as the market for signalling systems, foreign enterprises are forced to relinquish proprietary information before any contract is signed. In some cases, bidding processes are only open to tenders from either local enterprises or joint ventures (JVs) with a foreign share of less than 50 per cent. For the market of urban rail, the regulatory system also restricts foreign companies from bidding directly for rolling stock and signalling business, some even prevented Sino-foreign JVs from obtaining a licence or qualification to bid.

In addition, the criteria for bidding participation are often rigidly defined and do not allow for any flexibility among different entities of a foreign enterprise.<sup>6</sup> The rigid requirements for bidding largely prevent foreign companies from allocating resources in different entities, such as in a wholly foreign-owned enterprise (WFOE) or a JV. In terms of maintenance, overhaul and after sales service facilities, there is a clear indication through various tendering documents that Chinese companies should hold a majority stake in those companies.

<sup>6</sup> For instance the traction package, Train Control and Monitoring System (TCMS) and bogie capability are to be held by a local rolling stock manufacturer.

Furthermore, the Chinese Government has made several statements regarding the opening up of the railway market to private capital, using either the terms *minjian ziben* or *shehui ziben*, which is usually translated as 'private capital'. This also indicates that the government treats domestic capital preferentially.

#### Recommendations

- Allow foreign companies to compete as local players in the market by lifting all restrictions and letting market forces drive competition.
- Revise the NDRC's localisation policy to foster innovation, improve technology, project execution, quality and safety in the railway industry.

## 2. Improve Transparency in the Standardisation and Specification Process

#### Concern

Foreign players in the rail industry are often not given the opportunity to comment on drafts of standards and specifications, which may lead to entry barriers and unfair competition.

#### Assessment

In order for both foreign and domestic players to provide compatible products and services to Chinese



customers, foreign players should be given more opportunities to get involved in drafting regulations on specification and standardisation.

In April 2012, the State Council Legislative Affairs Office (SCLAO) issued provisional measures which were intended to streamline the consultation process for draft legislation and regulations. According to these measures, public consultation for draft regulations should not be less than 30 days.<sup>7</sup> The Rail Working Group advises that these rules should be applied to the railway industry legislative process so that foreign players can have a voice in the development of relevant policies and regulations.

#### Recommendation

- Allow all companies legally registered in China to participate as members in all relevant technical committees and working groups to get involved in the formulation process of national and industry standards.
- Increase transparency in the standardisation formulation process, especially for the formulation of industrial standards.

### 3. Improve the Rail Industry Supply Chain Through Further Protection of Intellectual Property Rights (IPR)

#### Concern

Poor enforcement of intellectual property rights (IPR) protection discourages technological innovation in the rail industry, especially from specialised small and medium-sized enterprises (SMEs): enhancing IPR protection can incentivise SMEs' participation and innovation.

#### Assessment

China's regulatory environment, which lacks enforcement of IPR, has resulted in companies' hesitance to bring their latest technology to China. These IPR concerns from foreign players can affect project execution and safety and therefore undermine the partnerships between foreign and Chinese companies.

In the rail industry, supply chain-based SMEs, are usually the ones that drive innovation and technological

progress for the whole industry. Given their nature of flexibility and specialised expertise, these SMEs foster innovation quickly and provide necessary products and services for large rail companies. Such companies are normally active in multiple industrial sectors, which enables them to introduce best practices and cutting-edge technologies from other industries. To ensure the healthy development of the rail industry, China needs the participation of SMEs. However, a successful integration of SMEs is not possible without sufficient IPR protection because most SMEs' business is intellectual property-based. Obviously, China's current regulations on forced technology transfer do not encourage SMEs to invest in China.

#### Recommendations

- Protect IPR in order to encourage investment in the railway sector.
- Improve the railway supply chain by encouraging investment from SMEs.

### Abbreviations

CNR	China Northern Railway
CR	China Railway Corporation
CRRC	China Rail Rolling Stock Co. Ltd
CSR	China Southern Railway
HSR	High-Speed Rail
IPR	Intellectual Property Rights
JV	Joint Venture
MOR	Ministry of Railways
MOT	Ministry of Transport
NDRC	National Development and Reform Commission
SCLAO	State Council Legislative Affairs Office
SME	Small and Medium-Sized Enterprise
SRA	State Railway Administration
TCMS	Train Control and Monitoring System
WFOE	Wholly Foreign-Owned Enterprise

<sup>7</sup> *Opinions of the State Council Legislative Affairs Office on Soliciting Comments on Draft Legislation and Regulations*, Legislative Affairs Office of the State Council, 27<sup>th</sup> April, 2012, viewed 20<sup>th</sup> June, 2013, <<http://www.chinalaw.gov.cn/article/cazjgg/201204/20120400367358.shtml>> (Chinese language)

## Renewable Energy Sub-Working Group

### Key Recommendations

- 1. Increase Transparency and Promote a Level Playing Field for Both Domestic and International Companies in the Renewable Energy Sector in China**

  - Increase transparency in the project design and approval process since authority has been given to the provincial and municipal level.
  - Encourage higher transparency in terms of the performance of operating wind farms, operating solar photo voltaic (PV) farms and distributed generation (DG) solar PV systems by enforcing a unified reporting standard on technical availability.
  - Increase the focus on best practices in terms of operation and maintenance (O&M).
  - Promote a transparent bidding system that includes long-term cost criteria, such as life-cycle costs and the cost of energy in the evaluation of bids.
  
- 2. Encourage Policies that Allow for Increased Supply and Demand Flexibility in the Wind Sector**

  - Ensure a coordinated development between grid expansion and wind energy capacity build-out.
  - Implement better forecasting of electricity generation from wind and incentivise wind power plant (WPP) owners and grid companies to utilise such features.
  
- 3. Steer China's Solar PV Market Momentum Towards Healthy and Sustainable Development**

  - Establish an independent, third-party inspection, acceptance, verification and monitoring scheme to ensure the deployment of high-quality components, thus achieving long-lasting, high-performing systems.
  - Establish a fine-tuned, feed-in-tariff- (FIT)-based support scheme for solar PV installations reflecting different technologies, e.g. multi-crystalline, thin film, concentrating solar PV, applications and possibly system sizes.
  - Provide clarification regarding future regulations concerning the 50 per cent value-added tax (VAT) rebate and annual FIT adjustments until 2020.
  - Introduce legislation allowing a faster market penetration in the residential sector, e.g. in the green building sector to have mandatory building requirements ensuring that solar PV systems can be installed.
  - Promote a business environment allowing a faster deployment of electrical energy storage systems in combination with solar PV, particularly in the industrial and commercial sector, e.g. to replace diesel generators used as back-up systems by factories.
  
- 4. Support the Introduction of Biomass Technology Solutions into the Chinese Market**

  - Support the development of modern biomass energy technologies, such as biogas produced from wet and dry anaerobic digestion, pellet heating systems, composting and the production of liquid biofuels and purification of biological compressed natural gas.

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.





- Support the development of a comprehensive centralised monitoring centre to assess the actual biogas production of the individual plants and make monitoring a precondition to receive a public output subsidy.
- Promote biomass technology as a serious alternative solution to the use of coal in the heating sector by particularly developing a rationalised local heat supply programme, including specific plans for the development of efficient Combined Heat and Power (CHP) and Combined Cooling, Heat and Power (CCHP) projects.
- Establish a national power market to create incentives for flexible operation and to set specific targets for the use of biomass-based energy in the transportation and manufacturing sectors.

## Introduction to the Working Group

The Renewable Energy Working Group is a sub-working group of the Energy Working Group. It was formed in 2008 to respond to the rapidly-changing policy and business environment affecting renewable energy companies. The working group is primarily composed of renewable energy equipment manufacturers and developers and is very active in engaging Chinese and European officials on policies and regulations in the field of renewable energy.

Other energy-related issues are dealt with in the *Energy Position Paper* and the *Smart Grid Position Paper*.

## Recent Developments

On 19<sup>th</sup> November, 2014, the State Council released its *National Action Plan for Energy Strategy Development 2014–2020*.<sup>1</sup> It states that by 2020, China will cap its annual primary energy consumption at an amount equivalent to 4.8 billion tonnes of standard coal. This means that energy usage in China must grow by only 3.5 per cent or less each year from now until 2020.<sup>2</sup> The plan also includes a goal to cap total coal use at approximately 4.2 billion tonnes by 2020, which implies that China can increase its coal usage by around 17 per cent from 2013 levels.<sup>3</sup>

In terms of clean energy in its total energy mix, the State Council aims at raising the current percentage of

10 per cent to 15 per cent by 2020, and to 20 per cent by 2030.<sup>4</sup> The plan also seeks to reduce China's overall share of coal from the current level of 66 per cent to 62 per cent by 2020.

China outlined the 13<sup>th</sup> *Five-Year Plan* (FYP) on energy.<sup>5</sup> It says that its total wind power installed capacity will reach 200 gigawatts (GW) by 2020, which is twice as high as the 12<sup>th</sup> FYP period's level.

Moreover, the wind power price will be the same as the on-grid price of thermal power by 2020, and the solar power price will be the same as the grid retail price by then. Finally, the government's subsidies to the renewable energy industry are likely to be abolished in the period 2020–2022.

On 23<sup>rd</sup> March, 2015, the National Energy Administration (NEA) released the *Notice on Promoting Adaptation to the Grid of New Wind Power in 2015*.<sup>6</sup> The notice requires, among other things, that related administrations should attach great importance to the adaptation of the grid to new wind power, promote the development of the grid to incorporate new wind power in central, east and south China, and actively develop markets where wind power could be used efficiently.

On 15<sup>th</sup> March, 2015, the State Council released the *Opinions on Deepening the Reform of the Electricity*

1 *Energy Development Strategy Action Plan (2014-2020)*, State Council, 19<sup>th</sup> November, 2014, viewed 20<sup>th</sup> May, 2015, <[http://www.gov.cn/zhengce/content/2014-11/19/content\\_9222.htm](http://www.gov.cn/zhengce/content/2014-11/19/content_9222.htm)>

2 *In New Plan, China Eyes 2020 Energy Cap*, *The Diplomat*, 20<sup>th</sup> November, 2015, viewed 19<sup>th</sup> June, 2015, <<http://thediplomat.com/2014/11/in-new-plan-china-eyes-2020-energy-cap/>>

3 Ibid

4 Ibid

5 *National Climate Change Plan (2014-2020)*, NDRC, 19<sup>th</sup> September, 2014, viewed 28<sup>th</sup> May, 2015, <[http://www.sdpc.gov.cn/zcfb/zcfbtz/201411/t20141104\\_642612.html](http://www.sdpc.gov.cn/zcfb/zcfbtz/201411/t20141104_642612.html)>

6 *Notice on Promoting Adaptation to the Grid of New Wind Power in 2015*, NEA, 23<sup>rd</sup> March, 2015, viewed 21<sup>st</sup> May, 2015, <[http://zfxgk.nea.gov.cn/auto87/201504/t20150407\\_1900.htm](http://zfxgk.nea.gov.cn/auto87/201504/t20150407_1900.htm)>





*System*.<sup>7</sup> It contains new policy suggestions for deepening reform of the electricity market. The document outlines aims to increase the proportion of electricity generated from renewable energy and distributed energy (DE) in the electricity supply system. It also seeks to support the generators of renewable energy to connect them to the grid.

On 2<sup>nd</sup> September, 2014, the NEA published the *Notice about Further Implementation of Relative Policies on Distributed Solar PV Power Generation*.<sup>8</sup> It is a comprehensive policy designed to allow the accelerated deployment of distributed solar photovoltaic (PV) systems.

On 12<sup>th</sup> February, 2014, the NEA released the *Notification on the Target for Newly Constructed PV Generation Capacity in 2014*.<sup>9</sup> The NEA set an annual solar PV target, demonstrating a greater sense of directing the overall domestic market development.

In addition to an annual target of 14 GW, split into 8 GW of distributed PV and 6 GW of utility-scale PV, each province has received a specific annual quota for both distributed and utility-scale PV.

During the past year, several new laws and regulations have been approved reflecting the government's desire to push for the further development of the biomass sector:

- On 21<sup>st</sup> April, 2015, the NEA issued the *Biomass Thermal Column 2015 Circular Economy Promotion Plan*.<sup>10</sup> The plan foresees the development of 120 large-scale, advanced biomass boiler heating projects to replace coal-fired boiler heating. Moreover, it encourages the implementation of cogeneration transformation of conventional biomass cogeneration units with a capacity of over one million

7 *Opinions on Deepening the Reform of the Electricity System*, State Council, 15<sup>th</sup> March, 2015, viewed 20<sup>th</sup> May, 2015, <[http://www.chinasmartgrid.com.cn/news/20150323/600488.shtml?utm\\_source=Azure+Cleantech+Update&utm\\_campaign=bd583fb020-Azure\\_China\\_Cleantech\\_Update7\\_3\\_2014&utm\\_medium=email&utm\\_term=0\\_6bc3c93c4c-bd583fb020-216350441](http://www.chinasmartgrid.com.cn/news/20150323/600488.shtml?utm_source=Azure+Cleantech+Update&utm_campaign=bd583fb020-Azure_China_Cleantech_Update7_3_2014&utm_medium=email&utm_term=0_6bc3c93c4c-bd583fb020-216350441)>

8 *Notice about Further Implementation of Relative Policies on Distributed Solar PV Power Generation*, NEA, 2<sup>nd</sup> September, 2014, viewed 14<sup>th</sup> May, 2015, <[http://zfxgk.nea.gov.cn/auto87/201409/t20140904\\_1837.htm](http://zfxgk.nea.gov.cn/auto87/201409/t20140904_1837.htm)>

9 *China's 2014 Target for Newly Constructed PV Generation Capacity Sets as 14GW*, State Grid Corporation of China, 20<sup>th</sup> February, 2014, viewed 14<sup>th</sup> May, 2014, <<http://www.sgcc.com.cn/ywlm/mediacenter/industrynews/02/307438.shtml>>

10 *Biomass Thermal Column 2015 Circular Economy Promotion Plan*, NEA, 21<sup>st</sup> April, 2015, viewed on 7<sup>th</sup> May, 2014, <[http://www.nea.gov.cn/2015-04/21/c\\_134169487.htm](http://www.nea.gov.cn/2015-04/21/c_134169487.htm)>

kilowatts (kW) by the end of 2015.

- On 4<sup>th</sup> April, 2015, the NEA issued the *Notice on the Demonstration of the Clean Heating System Using Renewable Energy in Beijing*.<sup>11</sup> With this plan the Beijing Municipal Government seeks to promote the adjustment of the energy and heating structure, and explore ways to implement a demonstration of the clean heating system utilising renewable energy.
- On 31<sup>st</sup> December, 2014, the National Development and Reform Commission (NDRC) issued the *Significant Resources Recycling Project (Technology Promotion and Equipment Industry) Plan*.<sup>12</sup> This plan states the intention to accelerate the development of the resources recycling industry.
- On 28<sup>th</sup> November, 2014, the NEA issued the *Biodiesel Industry Development Policy*.<sup>13</sup> The policy aims to support the development of the biodiesel industry in order to improve air quality and the environment, and to increase the proportion of clean fuels applications.

#### ▶ **Negotiations on the EU-China Comprehensive Agreement on Investment (CAI)**

Regarding the EU-China CAI, the Renewable Energy Working Group would like to emphasise the need to increase transparency and create a level playing field for both domestic and international companies in the renewable energy sector in China.

## Key Recommendations

### ▶ **1. Increase Transparency and Promote a Level Playing Field for Both Domestic and International Companies in the Renewable Energy Sector in China**

#### Concern



Although the Chinese Government has approved a series of regulations reflecting a desire to further promote the development of renewable energy, those measures primarily support the development of Chinese companies and technologies.

11 *Notice on the Demonstration of the Clean Heating System Using Renewable Energy in Beijing*, NEA, 4<sup>th</sup> April, 2015, viewed 27<sup>th</sup> May, 2015, <[http://zfxgk.nea.gov.cn/auto87/201504/t20150428\\_1910.htm](http://zfxgk.nea.gov.cn/auto87/201504/t20150428_1910.htm)>

12 *Significant Resources Recycling Project (Technology Promotion and Equipment Industry) Plan*, NDRC, 31<sup>st</sup> December, 2014, viewed 7<sup>th</sup> May, 2015, <[http://www.sdpc.gov.cn/gzdt/201501/t20150128\\_661433.html](http://www.sdpc.gov.cn/gzdt/201501/t20150128_661433.html)>

13 *Biodiesel Industry Development Policy*, NEA, 28<sup>th</sup> November, 2014, viewed 7<sup>th</sup> May, 2015, <[http://zfxgk.nea.gov.cn/auto83/201501/t20150123\\_1882.htm](http://zfxgk.nea.gov.cn/auto83/201501/t20150123_1882.htm)>



Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> <sup>14</sup> say?	What is the reality?	Status
<p>We must put in place a modern market system in which enterprises enjoy independent management and fair competition ... products and factors of production flow freely and are exchanged on an equal basis, strive to remove market barriers, and raise the efficiency and fairness of resource allocation.</p>	<p>Although the Chinese Government has approved a series of regulations reflecting a desire to further promote the development of renewable energy, those measures primarily support the development of Chinese companies and technologies. Therefore, more transparency, particularly in the bidding system, and a level playing field are needed.</p>	
	<p>There is still a lot of potential in China in terms of biomass development. But to allow European companies to contribute to China's biomass development, a more open and flexible national power market is needed to help European companies overcome barriers in terms of permits, licensing and regulatory issues.</p>	

**Assessment**

European companies in the renewable energy sector could effectively support the Chinese economy thanks to their long experience and high-quality technical solutions. However, they are being faced with multiple difficulties in the development of their daily business. The main problems are a lack of transparency in the bidding system, a tendency to promote cheap Chinese technologies and a lack of clear regulations.

**Project approval process**

European companies are faced with many challenges in navigating China's bidding system, in particular at the local and provincial level. There is a lack of clearly defined regulations in terms of selection criteria and transparency of the project approval process. Moreover, European companies have to deal with a lack of access to information regarding the introduction of new policies. Consequently, foreign-invested enterprises (FIEs) are having difficulties trying to build a sustainable business.

**Performance transparency**

The Chinese Government is pursuing its goal of encouraging local companies to carry out innovation. But in general, technologies that do not meet the highest efficiency standards have been introduced. European companies are committed to the highest

quality standards. High-quality products ensure sustainability and a higher return on investment and lead to more confidence for both investors and financiers thanks to dramatically reduced maintenance, operation and decommissioning costs.

There is currently a lack of performance transparency among operating companies. Transparency is essential because it allows all players to be able to invest in the most efficient technologies, thus contributing to a market-driven consolidation of the renewable energy sector.

**Long-term approach**

The Chinese Government needs to switch from a cost-oriented approach to an efficiency-oriented approach. The current tendency to invest in the lowest initial cost-proposed project affects the long-term sustainability of renewable energy generation in China. However, the projects with the lowest capital expenditure (CAPEX) aren't necessarily the ones with the best price-performance-ratios.

In the Chinese market the local contractor usually ends up choosing products at the lowest price to meet budget targets. Consequently, European companies are not able to compete in such an environment. A focus on the long-term sustainability of projects would be highly beneficial to the sustainable development of the renewable energy sector. This would ensure that the

<sup>14</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.





most efficient and innovative solutions prevail.

### Recommendations

- Increase transparency in the project design and approval process since authority has been given to the provincial and municipal level.
- Encourage higher transparency in terms of the performance of operating wind farms, operating solar PV farms and DG solar PV systems by enforcing a unified reporting standard on technical availability.
- Increase the focus on best practices in terms of O&M.
- Promote a transparent bidding system that includes long-term cost criteria, such as life-cycle costs and the cost of energy in the evaluation of bids.

## 2. Encourage Policies that Allow for Increased Supply and Demand Flexibility in the Wind Sector

### Concern

China has now surpassed the 100 Gigawatt (GW) mark in terms of total installed wind capacity and thus boasts the world's undisputed largest fleet of wind turbines. However, independent analyses have shown that the utilisation rate and electricity generated by the cumulative installed base still lags behind, mainly due to a lack of proper grid integration.

### Assessment

Several factors contribute to the discrepancy between China's installed wind capacity and the actual electricity generated that is fed into the grid for consumption. The three predominant causes are product quality, O&M and grid integration. The latter is the most direct cause of the absorption shortfall of wind in the overall energy mix.

Such sub-optimum utilisation of capital-intensive assets represents an enormous loss for the Chinese Government, as the country is unable to reap the full benefits of wind power. For industry players, this not only leads to investments in inferior assets, but also to purchasing behaviour that does not support long-term, healthy and sustainable development of the wind energy industry in China.

Proper integration of renewable energy into the grid is vital to ensure system stability and long-term development. However, at present, technology

development and market mechanisms do not go hand in hand to ensure solutions are available and proper incentives are in place to implement those solutions. Therefore, addressing the level of flexibility in the power system is the ultimate cure for solving curtailment of wind energy.

### Competition with thermal power

Over the past few years, approval of new wind projects in the three northern regions—Northwest, North Central, and Northeast China—have either been suspended or considerably reduced due to heavy curtailment of electricity generated by the already-existing, installed base. These three regions have been badly hit due to several reasons: they require heating during the winter seasons, they have low and even declining electricity consumption and yet they have very good wind resources.

Moreover, wind power is competing with thermal power generation for access to the grid. The problem is that wind energy is only being absorbed by the grid when the thermal power supply falls short. This reduces the role of wind energy to *gap-filler*.

### Ultra-high voltage transmission capacity

Low or even declining electricity consumption means that the generated electricity from wind needs to be transmitted elsewhere. With ultra-high voltage transmission capacity being expanded, the transmission bottleneck issue, which has plagued the industry for years, is seeing a solution. However, this capacity expansion must keep pace with the growth of the installed wind base. Otherwise the proportionate amount of wind turbines that are not connected to the grid will increase, whereas the absolute amount of such turbines will remain low.

### Predictability

Good wind resources means consistent winds over the course of the year. This also means predictable electricity generation. Although wind energy is intermittent, today's technologies are able to predict power production down to two hours ahead with very little deviation. This gives wind power plant (WPP) owners and grid companies the possibility to plan ahead and adjust other generation sources.

Although a wealth of expertise is available among European companies, countries and institutions,



countless workshops and seminars have been held without a significant sign of progress or effective initiatives over the past year.

#### Recommendations

- Ensure a coordinated development between grid expansion and wind energy capacity build-out.
- Implement better forecasting of electricity generation from wind and incentivise WPP owners and grid companies to utilise such features.

### 3. Steer China's Solar PV Market Momentum Towards Healthy and Sustainable Development

#### Concern

The NEA set ambitious annual deployment targets aiming at an approximately 50 per cent increase of solar energy year-on-year (2013: 10 GW,<sup>15</sup> 2014: 14 GW<sup>16</sup> and 2015: 17.8 GW<sup>17</sup>). Such targets not only risk compromising the quality standards during manufacturing, procurement of components, system design, construction, installation and O&M, but eventually put the overall reputation of solar PV technology at stake if this technology underperforms significantly once deployed in the field.

#### Assessment

Over the course of 2014, the NEA issued a series of official notifications designed to further promote the local deployment of solar PV and to support a more healthy development of the entire solar PV industry.

The most prominent announcement was made early September 2014, when the NEA released a policy update for distributed solar PV.<sup>18</sup> Developers were given the opportunity to choose a feed-in-tariff (FIT) previously set for utility-scale, ground-mount systems.

According to these new regulations, projects of up to 20 megawatts (MW) that comply with certain criteria are considered as distributed, such as greenhouse projects, fishponds, projects in wasteland or tidal areas. The

<sup>15</sup> *National Energy Conference Held and Energy Secretary Made a Report*, State Council, 8<sup>th</sup> January, 2013, viewed 28<sup>th</sup> May, 2015, <[http://www.gov.cn/gzdt/2013-01/08/content\\_2307603.htm](http://www.gov.cn/gzdt/2013-01/08/content_2307603.htm)>

<sup>16</sup> *Notification on PV Construction Plans in 2014*, NEA, 17<sup>th</sup> January, 2014, viewed 28<sup>th</sup> May, 2015, <[http://zfxgk.nea.gov.cn/auto87/201402/t20140212\\_1763.htm](http://zfxgk.nea.gov.cn/auto87/201402/t20140212_1763.htm)>

<sup>17</sup> *Notification on PV Construction Plans in 2015*, NEA, 16<sup>th</sup> March, 2015, viewed 28<sup>th</sup> May, 2015, <[http://zfxgk.nea.gov.cn/auto87/201503/t20150318\\_1891.htm](http://zfxgk.nea.gov.cn/auto87/201503/t20150318_1891.htm)>

<sup>18</sup> *Notification on Further Implementation of Distributed PV*, NEA, 2<sup>nd</sup> September, 2014, viewed 28<sup>th</sup> May, 2015, <[http://zfxgk.nea.gov.cn/auto87/201409/t20140904\\_1837.htm](http://zfxgk.nea.gov.cn/auto87/201409/t20140904_1837.htm)>

new definition helps to stimulate demand in this market segment. Further streamlining of application processes, easier access to the grid, greater enforcement of policy implementation and the fact that disbursement of FIT shall be settled on a monthly basis have also greatly improved the execution of distributed solar PV.

In general, the NEA intends to seek a greater share of deployed solar systems to be installed closer to the point of consumption. This could alleviate the need to rely on long-distance transmission lines and would address the prevailing grid curtailment in various provinces across western China.

On 28<sup>th</sup> January, 2015, the NEA set up a China PV Testing and Accreditation Technical Committee in an attempt to ensure a greater level of quality during the execution of projects.<sup>19</sup> The Renewable Energy Working Group welcomes the introduction of such a committee, as it reflects the NEA's desire to ensure that only systems of a high quality will be installed.

Furthermore, on 30<sup>th</sup> March, 2015, the Ministry of Industry and Information Technology (MIIT) published revised technical benchmarks for the upstream sector in order to stimulate demand for further innovation.<sup>20</sup> This will lead to a greater consolidation of the upstream sector, because higher benchmarks mean that companies that do not perform up to these standards will need to pull out of the sector.

#### Recommendations

- Establish an independent, third-party inspection, acceptance, verification and monitoring scheme to ensure the deployment of high-quality components, thus achieving long-lasting, high-performing systems.
- Establish a fine-tuned FIT-based support scheme for solar PV installations reflecting different technologies, e.g. multi-crystalline, thin film, concentrating solar PV, applications and possibly system sizes.
- Provide clarification regarding future regulations concerning the 50 per cent VAT rebate and annual FIT adjustments until 2020.

<sup>19</sup> *Certification and Accreditation Administration and NEA Set Up a Joint PV Testing and Accreditation Technical Committee*, China Certification and Accreditation Information Network, 5<sup>th</sup> February, 2015, viewed 28<sup>th</sup> May, 2015, <[http://www.cait.cn/news/tpxw/201502/t20150205\\_241077.shtml](http://www.cait.cn/news/tpxw/201502/t20150205_241077.shtml)>

<sup>20</sup> *Announcement of the Ministry of Industry and Information Technology 'PV manufacturing industry standard requirements (2015 version)'*, Ministry of Industry and Information Technology, 30<sup>th</sup> March, 2015, viewed 5<sup>th</sup> June, 2015, <<http://www.miit.gov.cn/n11293472/n11293832/n12845605/n13916898/16524572.html>>



European Chamber  
中国欧盟商会

- Introduce legislation allowing a faster market penetration in the residential sector, e.g. in the green building sector to have mandatory building requirements ensuring that solar PV systems can be installed.
- Promote a business environment allowing a faster deployment of electrical energy storage systems in combination with solar PV, particularly in the industrial and commercial sector, e.g. to replace diesel generators used as back-up systems by factories.

#### 4. Support the Introduction of Biomass Technology Solutions into the Chinese Market

##### Concern

There is still a lot of potential in China in terms of biomass development. However, to allow the involvement of European companies in the sector, a more open and flexible power market on the national level is needed to help European companies overcome barriers in terms of permits, licences and regulatory issues.

##### Assessment

Market access barriers impede European companies' full access to the biomass sector. A more open and flexible market would allow European companies to introduce advanced solutions, thus increasing local feedstock availability and improving the biomass feedstock logistics industry.

It is fundamental to establish a national power market to create incentives for flexibility and to set specific targets for the use of biomass-based energy in the manufacturing, heating and transportation sectors.

##### Biogas sector

China has been developing an ambitious biogas programme focused on introducing small-scale units in farms involved in livestock production. However, the future trend is towards large-scale applications for centralised and industrial production.

The benefits of large-scale applications have been widely accepted throughout the stakeholder landscape and have been further institutionalised by the Chinese Government in the most recent *Agricultural Industry Standards (NYT 667- 2011) of the People's Republic of*

*China, Classification of Scale for Biogas Engineering (>5,000 m<sup>3</sup> of fermented volume).*<sup>21</sup>

A centralised monitoring centre to assess the actual biogas production of the individual plants is still pending by the Chinese Government. The monitoring of the individual plants through the centralised monitoring system should be the fundamental precondition for receiving a public output subsidy.

The promotion of biogas as a cross-cutting technology in the agricultural value chain needs to be further developed in order to support the application of effluent as an organic fertiliser, and market incentives for local farmers need to be developed.

##### Biomass sector

Despite China's considerable biomass potential, local companies continue to focus on installing traditional technology solutions instead of pushing for the introduction of modern biomass technologies. Modern biomass technologies are two to three times more efficient than traditional techniques.

Currently, the sector encounters many restraint factors, such as the inconclusive biomass resources distribution, the obstructed supply chain of raw materials, an immature market mechanism, imperfect laws and regulations as well as an unfriendly market environment.

European players do not manage to find market openings to introduce technology solutions to implement smaller and flexible scale biomass plants that could help to fully exploit biomass energy flexibility and adaptability to local market needs.

##### Heating sector

The share of renewable energy could amount to two-thirds in China's heating sector. Biomass technology could be very useful in the introduction of efficient solutions for heating, the space/water heating process and cooling systems.

Unfortunately, China is still focused on massively exploiting the use of coal. Without a comprehensive and

<sup>21</sup> *Agricultural Industry Standards (NYT 667- 2011) of the People's Republic of China, Classification of Scale for Biogas Engineering*, Ministry of Agriculture, 1<sup>st</sup> September, 2011, viewed 2<sup>nd</sup> June, 2015, <[http://www.biogas.cn/UploadEditor/file/20150415/20150415153951\\_2885.pdf](http://www.biogas.cn/UploadEditor/file/20150415/20150415153951_2885.pdf)>



strategic approach, Combined Heat and Power (CHP), Combined Cooling, Heat and Power (CCHP), heat pump solutions and fry fermentation applications using municipal waste cannot become reliable technology solutions for the development of the Chinese district heating sector.

In the utilisation of municipal solid waste European companies are not able to introduce effective technology solutions that could overcome the low caloric value of Chinese waste, introduce better processing equipment and finally bring in technologies to control air emissions coming from incinerators. This is also due to pricing of waste treatment services and the allocation of energy recovery benefits.

### Transportation and industrial sectors

Even though the 12<sup>th</sup> FYP includes specific guidance for energy efficiency improvement in both the transportation and industrial sectors, there is still room for further improvement.

Despite the fact that the transportation sector represents a major cause of air pollution, advanced bio-fuels in China have not become a reality yet. Moreover, most small biodiesel producers are not fully incentivised to introduce the latest advanced technology solutions due to lower financial support, feedstock collection and unstable price problems.

Today, China has the largest share of cement and steel production in the world, even though those industries require high levels of steam. Instead of coal, biomass technology should be used in industrial CHP plants and heaters to generate process heat, thus limiting the harmful emissions of nitrogen dioxide (NO<sub>2</sub>) and nitrogen oxides (NO<sub>x</sub>).

### Recommendations

- Support the development of modern biomass energy technologies, such as biogas produced from wet and dry anaerobic digestion, pellet heating systems, composting and the production of liquid biofuels and purification of biological compressed natural gas.
- Support the development of a comprehensive centralised monitoring centre to assess the actual biogas production of the individual plants and make monitoring a precondition to receive a public output subsidy.
- Promote biomass technology as a serious alternative

solution to the use of coal in the heating sector by particularly developing a rationalised local heat supply programme, including specific plans for the development of efficient CHP and CCHP projects.

- Establish a national power market to create incentives for flexible operation and to set specific targets for the use of biomass-based energy in the transportation and manufacturing sectors.

## Abbreviations

CAI	Comprehensive Agreement on Investment
CAPEX	Capital Expenditure
CCHP	Combined Cooling, Heat and Power
CHP	Combined Heat and Power
DE	Distributed Energy
DG	Distributed Generation
FIT	Feed-in-Tariff
FYP	Five-Year Plan
GW	Gigawatt
MIIT	Ministry of Industry and Information Technology
MW	Megawatt
NO <sub>2</sub>	Nitrogen Dioxide
NO <sub>x</sub>	Nitrogen Oxides
O&M	Operation and Maintenance
PV	Photovoltaic
RE	Renewable Energy
VAT	Value-Added Tax
WPP	Wind Power Plant

## Smart Grid Sub-Working Group

### Key Recommendations

- ▶ **1. Ensure a Fair Business Environment and Offer Non-Discriminatory Treatment During the Project and Technology Bidding Process**
- Ensure that all standards required for technology bidding are publicly available.
  - Prevent China's grid operators from discriminating against foreign suppliers by restricting them from using required encryption algorithms.
  - Ensure that effective and efficient standardisation processes exist and promote the development of smart grid use cases and standards by involving all stakeholders (incumbents and potential new market actors).
  - Facilitate coordination of domestic and international standardisation work to drive down the costs of smart grid deployment by promoting interoperability of smart grid components with the help of compatible interfaces, technical requirements and communication protocols.
  - Allow European firms to participate in the *Guobiao* (GB) standards development committees so that they can learn about and participate in the standards drafting process.
- ▶ **2. Encourage the Development of Distributed Energy Resources (DER) and Promote Microgrids**
- Increase the scope and depth of participation of European Union (EU) enterprises in the smart grid pilot projects involving all components defined by the National Energy Administration (NEA).
  - Promote the use and development of renewable energy sources and technologies for fully integrated power heating, ventilation and air conditioning in buildings.
  - Establish a regular, systematic Sino-EU Smart Grid communication platform where European enterprises can share their experience in smart grid projects with the State Grid Corporation of China (SGCC) and the China Southern Power Grid (CSG).
- ▶ **3. Create a Level Playing Field to Allow New Market Actors Access to Power System Infrastructure and Information and Encourage the Establishment of the Demand Response (DR) Service Market**
- Actively engage European companies to participate in demand side management (DSM) pilots, particularly with regard to implementing DR, supported by new pricing policies.
  - Open the grid retail market to all capital and private investors in order to leverage the potential of new and innovative market actors offering services and technologies to enable: DR (load management); the aggregated management of DER; the adjustment of end-user's electricity consumption patterns to facilitate energy conservation; efficiency improvements; and, adaption of the time of use to intermittent supply.
  - Allow European companies to play an active role in supporting new business models resulting from transmission and distribution pricing pilots in Shenzhen, West Inner Mongolia, Anhui, Hubei, Ningxia and Hunan.
  - Promote the development of a platform for the non-discriminatory management of power system information, which allows eligible parties to access and use the data provided to develop and offer

▶ Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.



innovative energy services and technologies.

- Refine time-of-use pricing in order to set sufficient incentives for investments in the standard solar model (SSM), DSM, and energy storage (ES) for all categories of consumers (e.g. by means of large differences between peak and off-peak prices).

#### 4. Accelerate the Development of the ES Industry by Testing Subsidy Support Programmes

- Limit the use of '973', '863' and other domestic innovation programmes in funding ES pilots as this restricts foreign participation and severely limits the potential for international partnerships.
- Test subsidies and pricing mechanisms that support viable business models that will enable significant cost reductions through economies of scale.
- Establish stronger ties to international organisations currently developing ES standards in order to improve cross-border trade.
- Facilitate the publishing of results data of China's initial ES demonstrations, in order to enable foreign developers to share their experiences to help overcome issues.

#### 5. Develop Smart Cities Within the National New-type Urbanisation Plan (2014–2020)

- Identify viable EU business models for smart city projects that can be scaled to Chinese cities in an EU-China framework.
- Establish an EU-China smart city platform where European companies can share their knowledge and show their best practices, and communicate on common smart city projects with relevant Chinese stakeholders.
- Establish benchmarks and indicators, provide government support and set policy incentives to facilitate the development of integrated smart city concepts, including strategies on renewable energy, smart grids, ES, energy efficiency in buildings, water management, climate change and sustainable transportation.
- Enable market access for private sector providers and suppliers and engage in multi-level partnerships under the umbrella of a local authority framework in a pilot city.
- Enable joint efforts in smart grid and city innovation through an EU-China smart city lab.

## Introduction to the Working Group

The Smart Grid<sup>1</sup> Working Group is a Sub-Working Group of the Energy Working Group. It was formed in January 2010, to help European companies respond to the market growth and policy changes in China's smart grid sector. The working group is composed of power

equipment manufacturers, information technology solution developers, system integrators as well as other important stakeholders. It has been proactively engaging Chinese and European policy-makers on policies, regulations and standards related to the development of smart grids.

Other energy-related issues are dealt with in the *Energy Position Paper* and the *Renewable Energy Position Paper*.

## Recent Developments

The Smart Grid Working Group anticipated the smart grid market to become one of the biggest commercial

<sup>1</sup> Smart grid technologies have the purpose of integrating new energy, materials and equipment as well as advanced technologies in information, automatic control and energy storage for realising digital management, intelligent decision-making and interactive transaction in power generation, transmission, distribution, consumption and storage. Furthermore, smart grid assets optimise the resource allocation and satisfy the diverse needs of customers as well as ensure the safety, reliability and cost-efficiency of the power supply. Finally, the new technology—in the sense of smart technology—bridges the constraint of environmental protection and the development of the power market. Yu, Y., Yang, J. and Chen, B., *The Smart Grids in China – A Review*, *Energies*, 4<sup>th</sup> May, 2012, MDPI, <http://www.mdpi.com/journal/energies>





opportunities for companies in the years to come, particularly due to the drive towards more renewables announced on 1<sup>st</sup> January, 2013, in the State Council's *Notice on Printing the 12<sup>th</sup> Five-Year Plan (FYP) for Energy Development*.<sup>2</sup> However, due to considerable market access barriers and discriminatory treatment during the project and technology bidding process, European companies have not been able to fully benefit from China's rapid smart grid development.

On 15<sup>th</sup> April, 2015, the National Development and Reform Commission (NDRC) released *Accelerating the Reform of the Transmission and Distribution Electricity Prices*.<sup>3</sup> It aims at expanding the regional scope of the transmission and distribution pricing reform pilots. Following the development of pilots in Shenzhen and the West Inner Mongolia Autonomous Region (IMAR) grid, the four provinces of Anhui, Hubei, Ningxia, and Yunnan will also begin conducting transmission and distribution pricing reform pilots. The rapid expansion of this reform's regional scope is believed to indicate a strong commitment by the central government.

On 7<sup>th</sup> April, 2015, the NDRC and the Ministry of Finance (MOF) released *Improving Electricity Emergency Response Mechanism and Demand Side Management City Pilots in China*.<sup>4</sup> The policy calls for other pilot cities to incorporate best practices from Shanghai's demand response (DR) pilot, which is the first to provide an economic incentive for short term DR services.

On 2<sup>nd</sup> April, 2015, the State Grid Corporation of China (SGCC) released the *White Paper on Encouraging New Energy Development* introducing ways in which the grid operator is working to better integrate wind and solar resources.<sup>5</sup> The SGCC expects to install 27 Gigawatts (GW) of renewable energy per year, connecting 10 GW of solar and 17 GW of wind to China's grid by 2020. The SGCC claims to have built the world's largest and most comprehensive wind power forecasting network

covering 972 wind farms with a precision greater than 85 per cent. To further support renewable energy (RE) integration, the SGCC calls for more flexible generation and greater adoption of demand side management (DSM) measures. Correspondingly, the world's largest grid operator also calls for the government to provide stronger pricing support for load following generation and DSM.

On 15<sup>th</sup> March, 2015, the State Council released the *Document Opinions on Deepening the Reform of the Electricity System*.<sup>6</sup> It contains new policy suggestions for deepening reform of the electricity market. The policy suggestions include several important goals. The government aims to allow multiple parties, including industrial parks, social capital investment companies, water and gas utilities, energy services companies (ESCOs) and generators to compete as electricity retailers. Moreover, it seeks to change the revenue model for China's grid operators by setting transmission and distribution prices based on cost and reasonable profit basis.

On 31<sup>st</sup> December, 2014, the NDRC released a pricing list for transmission and distribution services for the Shenzhen pilot from 2015–2017.<sup>7</sup> This pilot is testing a very important reform. By fixing transmission and distribution pricing, the NDRC is opening up opportunities for direct sales between electricity consumers and generators.

In the 12<sup>th</sup> FYP, the National Energy Administration (NEA) proposed four important targets for smart grids:

- Establish an information database of potential pilot projects.
- Determine 21 pilot projects.
- Study the scope of application and standards of smart grid technology.
- Explore effective economic compensation patterns and investment recovery mechanisms.

### ▶ Negotiations on the EU-China Comprehensive Agreement on Investment (CAI)

In terms of the negotiations for the EU-China CAI, the Smart Grid Working Group would like to emphasise the following issues:

<sup>2</sup> *Notice on Printing the 12th FYP for Energy Development*, State Council, 1<sup>st</sup> January, 2013, viewed 27<sup>th</sup> June, 2014, <[http://www.gov.cn/zwzgj/2013-01/23/content\\_2318554.htm](http://www.gov.cn/zwzgj/2013-01/23/content_2318554.htm)>

<sup>3</sup> *Accelerating the Reform of the Transmission and Distribution Electricity Prices*, NDRC, 15<sup>th</sup> April, 2015, viewed 25<sup>th</sup> June, 2015, <[http://www.ndrc.gov.cn/xwzx/xwfb/201504/t20150415\\_688161.htm](http://www.ndrc.gov.cn/xwzx/xwfb/201504/t20150415_688161.htm)>

<sup>4</sup> *Improving Electricity Emergency Response Mechanism and Demand Side Management city pilots in China*, NDRC and MOF, 7<sup>th</sup> April, 2015, viewed 25<sup>th</sup> June, 2015, <[http://www.ndrc.gov.cn/fzggzj/jjyx/zhd/201504/t20150409\\_677037.html](http://www.ndrc.gov.cn/fzggzj/jjyx/zhd/201504/t20150409_677037.html)>

<sup>5</sup> *White Paper on Encouraging New Energy Development*, SGCC, 2<sup>nd</sup> April, 2015, viewed 25<sup>th</sup> June, 2015, <<http://www.sgcc.com.cn/xwzx/gsyw/2015/04/323661.shtml>>

<sup>6</sup> *Opinions on Deepening the Reform of the Electricity System*, State Council, 15<sup>th</sup> March, 2015, viewed 25<sup>th</sup> June, 2015, <<http://www.chinasmartgrid.com.cn/news/20150323/600488.shtml>>

<sup>7</sup> The NDRC's Approval of the Transmission and Distribution Electricity Prices of Shenzhen Electricity Corporation, NDRC, 31<sup>st</sup> December, 2014, viewed 20<sup>th</sup> May, 2015, <[http://www.sdpc.gov.cn/gzdt/201501/t20150115\\_660251.html](http://www.sdpc.gov.cn/gzdt/201501/t20150115_660251.html)>





Third Plenum Reality Check		
What did the Third Plenum's Decision <sup>8</sup> say?	What is the reality?	Status
We must put in place a modern market system in which enterprises enjoy independent management and fair competition, ... products and factors of production flow freely and are exchanged on an equal basis, strive to remove market barriers, and raise the efficiency and fairness of resource allocation.	There is a strict control of foreign participation in the standardisation process and the SGCC has a huge influence on the standard-setting process. This discriminates against European firms in China. Fair access to the development of the DR service market, microgrids and integrative DER is needed.	
	New market actors can only succeed if the regulatory framework ensures non-discriminatory access to power system infrastructure and information, but this is currently lacking. Therefore, the government should promote the development of a platform for the non-discriminatory management of power system information.	

- Discriminatory barriers should be eliminated in the project and technology bidding process, in the development of microgrids and integrative DER, and in the access to China's power system infrastructure and information.
- Fair access to the development of the DR service market is needed.

## Key Recommendations

### 1. Ensure a Fair Business Environment and Offer Non-Discriminatory Treatment During the Project and Technology Bidding Process

#### Concern

Strict control of foreign participation in the standardisation process, and the huge influence by the SGCC on the standards-setting process have supported discriminatory practices against European firms in China. These discriminatory practices as well as the incompatibility of Chinese and international standards restrict cross-border trade and collaboration.

#### Assessment

European companies that offer smart meters and monitoring and information collection systems have been negatively impacted by discriminatory practices. In order to sell systems that operate within the Chinese grid, these vendors must use encryption algorithms

<sup>8</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.

supplied by the SGCC and the China Southern Power Grid Company (CSG) to ensure data security. The SGCC and the CSG control who is eligible to use these encryption algorithms and can therefore decide which firms are able to participate in the market.

European firms have worked diligently to provide all necessary documentation to use these algorithms, but they have been refused for the last two years without any official explanation. Meanwhile, Chinese suppliers do have access to encryption algorithms needed to participate in the European market.

It is not clear whether the SGCC or the CSG are directly restricting foreign company participation or if local regulations regarding data security are causing this issue. Since smart grid technology lies at the intersection of information technology and power grid technology, data security is a major issue. Encryption systems help protect the grid from outside attacks and ensure the authenticity of internal communications. Therefore, European firms request direct action is taken to limit this discriminatory treatment.

Limited transparency and accessibility in the standardisation process remains an ongoing issue. Specifically, tender documents provided by the SGCC list technical requirements and standards that are not accessible to foreign companies. Without access to these enterprise standards, foreign firms struggle to meet bid requirements and are effectively excluded.





Another key challenge of smart grids is to integrate its different components and ensure that they can communicate with the help of information and communication technology (ICT). This is accomplished by developing a comprehensive set of supporting standards. The definition of common standards for interfaces and communication protocols is therefore of utmost importance in order to ensure interoperability and a smooth exchange of information between the different elements of a smart grid. The costs of connecting smart grid technologies through ICT (integration costs) significantly affects the overall costs of deploying smart grid technologies and is thus one of the key success factors for smart grids.

Coordinating the Chinese smart grid standardisation efforts with international standardisation work will increase the efficiency of the overall process, contribute to the maturing of smart grid technologies, innovation and business models and further drive down the costs for deployment. While allowing European companies to contribute to Chinese standardisation work and vice versa, a coordinated approach to standardisation may also help to avoid the misallocation of societal resources through inefficient investments in obsolete or inadequate technologies.

The work of the EU Smart Grid Coordination Group (SG-CG) based on the European Mandate M/490<sup>9</sup> with the intention of promoting the development of a unified and commonly-accepted view on smart grids may serve as a reference point. According to the provisions and requirements of the National Standards Commission, foreign-funded enterprises can join the Chinese standards committees or its working groups, and participate in the standards drafting and voting. However, in practice, under the leadership of the SGCC and the CSG, its technical committee has not allowed any EU companies to participate in the drafting of standards and technical regulations, and has only authorised them to participate as simple observers with no voting rights.

These restrictions have caused China's smart grid standards to be largely unrecognised by the international community, and have prevented the opening up of China's smart grid market as well as the

creation of a fair competition. Restrictions provide a disincentive to the efficient allocation of investments, hinder the deployment of state-of-the-art smart grid technologies and increase the costs for smart grid development and integration of its components and standardised interfaces and protocols. In addition, the lack of exposure to international competition may impede the ability of the domestic smart grid industry to catch up with the latest global developments in smart grid technologies and services.

The Smart Grid Working Group hopes that China will adopt existing smart grid international standards, and define new standards in new domains in cooperation with EU companies. This approach would be the best to build China's smart grid standards while promoting innovation, which both Chinese and EU companies would benefit from.

#### Recommendations

- Ensure that all standards required for technology bidding are publicly available.
- Prevent China's grid operators from discriminating against foreign suppliers by restricting them from using required encryption algorithms.
- Ensure that effective and efficient standardisation processes exist and promote the development of smart grid use cases and standards by involving all stakeholders (incumbents and potential new market actors).
- Facilitate the coordination between domestic and international standardisation work to drive down the costs of smart grid deployment by promoting interoperability of smart grid components with the help of compatible interfaces, technical requirements and communication protocols.
- Allow European firms to participate in the *Guobiao*<sup>10</sup> (GB) standards development committees so that they can learn about and participate in the standards drafting process.

## 2. Encourage the Development of DER and Promote Microgrids

#### Concern

European companies have been mainly excluded from the development of microgrids and integrative DER in

<sup>9</sup> Mandate M/490 for Smart Grid, European Commission, 2011, viewed 27<sup>th</sup> June, 2014, <[http://ec.europa.eu/energy/gas\\_electricity/smartgrids/doc/2011\\_03\\_01\\_mandate\\_m490\\_en.pdf](http://ec.europa.eu/energy/gas_electricity/smartgrids/doc/2011_03_01_mandate_m490_en.pdf)>

<sup>10</sup> *Guobiao* standards are the Chinese national standards issued by the Standardisation Administration of China (SAC), the Chinese National Committee of the International Organisation for Standardisation (ISO) and the International Electrotechnical Commission (IEC).



China, even though they have proven experience in the development of smart grids and microgrids. Moreover, current microgrid operation contradicts the existing Chinese Electric Power Law.<sup>11</sup>

#### Assessment

On 28<sup>th</sup> April, 2014, the NEA released *Matters on Simplifying Licence Application of Power Generation-Related Business in the Electricity Industry*.<sup>12</sup> This enabled renewable energy power projects less than six Megawatts (MW) to be able to connect to the grid without obtaining a power generator licence.

Although the Chinese regulators released a number of enabling policies for distributed generation in 2014, supporting laws and regulations for microgrid and distributed Combined Heat and Power (CHP) applications are incomplete and sometimes contradictory. Local policies call for electricity trade between multiple sources of generation and load. However, grid operators that control electricity distribution resources do not provide access and supportive pricing regimes.

Following the design of the Shenzhen electricity market reform pilot as well as recently released suggestions for deepening electricity market reforms,<sup>13</sup> the Smart Grid Working Group would like to see more pilots with set distribution prices to enable microgrid-type applications that demonstrate the value of these systems. European companies have considerable experience in this field and would like to play an active role in these pilots, ideally through a Sino-European Smart Grid cooperation platform.

#### Recommendations

- Increase the scope and depth of participation of European Union (EU) enterprises in the smart grid pilot projects involving all components defined by the NEA.

11 *Electric Power Law of the PRC, The Central People's Government of the People's Republic of China*, 1<sup>st</sup> April, 1996, viewed 27<sup>th</sup> June, 2014, <[http://www.gov.cn/ztlz/2005-12/30/content\\_142165.htm](http://www.gov.cn/ztlz/2005-12/30/content_142165.htm)>

12 *Matters on Simplifying Licence Application of Power Generation-Related Business in Electricity Industry*, NEA, 2014, viewed 27<sup>th</sup> June, 2014, <[http://www.gov.cn/xinwen/2014-04/28/content\\_2667808.htm](http://www.gov.cn/xinwen/2014-04/28/content_2667808.htm)>

13 *Next Steps Deepening Electricity Market Reform*, State Council, 9<sup>th</sup> April, 2015, viewed on 25<sup>th</sup> May, 2015, <[http://www.sdpc.gov.cn/fzgggz/tzgg/ggkx/201504/t20150409\\_676931.html](http://www.sdpc.gov.cn/fzgggz/tzgg/ggkx/201504/t20150409_676931.html)>. These policy suggestions, which are not yet official, contain a number of important goals. They aim to change the revenue model for China's grid operators by setting transmission and distribution prices based on cost and reasonable profit basis. This type of reform is already underway in Shenzhen and West Inner Mongolia. The government is seeking to allow multiple parties—including industrial parks, social capital investment companies, water and gas utilities, ESCOs and generators—to compete as electricity retailers. This should unlock trading between generators and large electricity consumers as well as open the door for microgrid and distributed energy business models.

- Promote the use and development of renewable energy sources and technologies for fully integrated power heating, ventilation and air conditioning in buildings.
- Establish a regular, systematic Sino-EU Smart Grid communication platform where European enterprises can share their experience in smart grid projects with the SGCC and the CSG.

### ▶ 3. Create a Level Playing Field to Allow New Market Actors Access to Power System Infrastructure and Information and Encourage the Establishment of the DR Service Market

#### Concern

Demand response is one of the best ways to control energy infrastructure costs and increase the electric grid's ability to integrate more renewable energy. However, the market needs to allow greater access to private and foreign players, supported by new pricing policies.

#### Assessment

In 2013, the MOF and the NDRC carried forward experimental DSM projects in different cities—Beijing, Suzhou, Tangshan and Foshan—to a critical stage. In 2014, the development of DR services in China took a major step forward with the introduction of a payment mechanism for DR within the Shanghai DSM pilot project. In April 2015, the NDRC called for this payment mechanism to be expanded to other regional DSM pilot programmes. Despite having experience in this market, European companies have not been invited to participate in these early pilot projects.

New market actors can only succeed if the regulatory framework ensures non-discriminatory access to power system infrastructure and information. Power system information and data are becoming increasingly important and are a prerequisite for third parties (new market actors) to offer new and innovative products and services. This does not mean that each established or new market actor has access to all information, or that information is even open to the public. Instead, it means that each eligible market actor has equal and fair access to the power system information relevant for their business model. It is the role of the government to promote the development of a platform for the non-discriminatory management of power system information.



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European companies started working on DR many years ago, and through the improvement of DR mechanisms were able to master services to tackle the growth of electricity demand, peak load balancing and transmission and distribution issues. The DR pilot in Shanghai, which is testing a new DR pricing mechanism, is an excellent platform for incorporating the experience of European market players, but no European companies were actively invited to participate in this project despite their considerable background in this field.

### Recommendations

- Actively engage European companies to participate in DSM pilots, particularly with regard to implementing DR, supported by new pricing policies.
- Open the grid retail market to all capital and private investors in order to leverage the potential of new and innovative market actors offering services and technologies to enable: DR (load management); the aggregated management of DER; the adjustment of end-user's electricity consumption patterns to facilitate energy conservation; efficiency improvements; and adaption of the time of use to intermittent supply.
- Allow European companies to play an active role in supporting new business models resulting from transmission and distribution pricing pilots in Shenzhen, West Inner Mongolia, Anhui, Hubei, Ningxia and Hunan.
- Promote the development of a platform for the non-discriminatory management of power system information, which allows eligible parties to access and use the data provided to develop and offer innovative energy services and technologies.
- Refine time-of-use pricing in order to set sufficient incentives for investments in SSM, DSM, and ES for all categories of consumers (e.g. by means of large differences between peak and off-peak prices).

## 4. Accelerate the Development of the ES Industry by Testing Subsidy Support Programmes

### Concern

While there is a great potential for ES to facilitate renewable energy integration and to avoid investment in heavy polluting conventional power plants, ES developers and system integrators currently face a market with few development pathways: without government support, most ES technologies under

development will not be able to bridge the gap between the demonstration phase and the commercial phase. In addition, foreign cooperation is significantly restricted by domestic innovation funding programmes, '973' and '863'.<sup>14</sup>

### Assessment

China wants to raise its share of renewable energies, and by linking large-scale ES projects to renewable installations, not only is a higher share of renewable energies guaranteed, but grid stability issues can be addressed and high costs for grid expansion avoided too.

The next stage of ES industry growth will require repeatable business opportunities enabled by subsidies and uniquely-defined business models, like those currently being offered by European governments.

Significant research—produced in coordination with Chinese and international organisations—should be conducted to understand the impact of subsidies on market growth and forecast when commercial markets, not reliant on subsidies, will emerge. In this way, policy-makers will understand how a fixed, short-term investment can provide significant, long-term benefits. European companies have experience with ES subsidies, and their participation will help create a subsidy that is more economically efficient and easier to implement. Moreover, the equal treatment of European companies is important – Chinese companies receive the same in European markets.

Currently, foreign cooperation is significantly restricted by domestic innovation funding programmes, '973' and '863'. There are a number of European ES firms with innovative technology that fit well within the Chinese market and have the potential to benefit from manufacturing and project development cooperation with Chinese companies. The first step towards establishing partnerships typically requires a reference project in the Chinese market. However, European firms, even those collaborating with Chinese firms, are

<sup>14</sup> The '973' and '863' are domestic innovation programmes designed to support the development of domestic core intellectual property (IP). They were started in March 1997 and March 1986, respectively. The '973' programme focuses on early stage scientific research, while the '863' supports technology demonstrations, enabling companies to bridge the research and development (R&D) and commercial market phase. Given their focus on domestic IP development, they necessarily exclude foreign participation. Serving as the main funding source for energy technology development, they strongly restrict foreign participation in developing technology markets, such as energy storage.



excluded due to the foreign origin of their technology. This supports discriminatory practices and prevents cross-border innovation.

Beyond subsidy support, China's ES market needs to be more transparent. Results from the first phase of the Zhangbei National Wind, Solar, and ES Demonstration Project have not been released. Without this feedback, ES developers cannot adapt their technology to better meet State Grid's and customer expectations.

#### Recommendations

- Limit the use of '973', '863' and other domestic innovation programmes in funding ES pilots as this restricts foreign participation and severely limits the potential for international partnerships.
- Test subsidies and pricing mechanisms that support viable business models that will enable significant cost reductions through economies of scale.
- Establish stronger ties to international organisations currently developing ES standards in order to improve cross-border trade.
- Facilitate the publishing of results data of China's initial ES demonstrations, in order to enable foreign developers to share their experiences to help overcome issues.

### 5. Develop Smart Cities Within the National New-type Urbanisation Plan (2014–2020)

#### Concern

China has already started several smart grid initiatives in response to its urbanisation development and it also calls for the development of smart cities. However, China's current smart city plans lack an integrative and holistic smart city concept that is scalable, environmentally-friendly, resource-efficient, liveable and socially harmonious, and there are likely limits to the financial and human resources which city authorities can use to promote the smart development of their cities.

#### Assessment

According to the *National New-type Urbanisation Plan (2014–2020)*,<sup>15</sup> issued by the State Council on 16<sup>th</sup> March, 2014, China aims to have about 60 per cent of its population living in cities by 2020. Chapter 18

of the plan calls for the promotion of new types of city construction, including green cities and smart cities. The latter stresses the importance of new information technologies, such as the internet of things (IoT), cloud computing and big data. It also includes six areas where such information technologies can make a difference: the expansion of broadband connectivity, the computerisation of planning management, intelligent infrastructure, making public services more convenient, modernisation of industrial development and carrying out social governance more meticulously.

On 27<sup>th</sup> August, 2014, the Chinese Government issued *Guidance Regarding Promoting the Healthy Development of Smart Cities*,<sup>16</sup> which clarifies its understanding of the concept of smart cities. It states that under the guidance of the (local) government, the market should play a decisive role in developing smart cities. The *Guidance* document lists the following five main goals:

1. Make public services more convenient.
2. Make urban management more meticulous.
3. Make the living environment more liveable.
4. Build intelligent or smart infrastructure.
5. Ensure safeguards and network security.

Cities consume around 70 per cent of the world's energy resources and account for nearly 80 per cent of global greenhouse gas (GHG) emissions. In China, energy consumption in buildings and infrastructure accounts for approximately 30 per cent of the total energy consumption.

The Smart Grid Working Group believes that the creation of integrative smart cities models, energy-efficient buildings, highly efficient-energy systems and sustainable transport should form the pillars of a green and low-carbon urbanisation.

China should run the smart cities of the future by using an energy subsidy principle and allow for better institutions and incentives of smart city standards.

In the context of China's rapid urbanisation, the pilot construction of smart cities is considered as a vital force to promote a new type of urbanisation in China. In addition to the smart city pilots established by the

<sup>15</sup> *National New-type Urbanisation Plan (2014–2020)*, State Council, published 16<sup>th</sup> March, 2014, viewed 27<sup>th</sup> June, 2014, <[http://www.gov.cn/gongbao/content/2014/content\\_2644805.htm](http://www.gov.cn/gongbao/content/2014/content_2644805.htm)>

<sup>16</sup> *Guidance Regarding Promoting the Healthy Development of Smart Cities*, NDRC, 27<sup>th</sup> August, 2014, viewed 14<sup>th</sup> May 2015, <[http://www.sdpc.gov.cn/gzdt/201408/t20140829\\_624003.html](http://www.sdpc.gov.cn/gzdt/201408/t20140829_624003.html)>



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Ministry of Housing and Urban-Rural Development (MOHURD), China launched 62 new-type urbanisation pilot cities in 2014. Such pilot cities should handle pollution by ensuring decentralised solutions, close alignment of demand and supply, smart grids and metering, and a high percentage of renewable energy and ES into the overall energy supply.

European companies have demonstrated integrated smart city platforms, including intelligent traffic solutions, green buildings, water management and smart grid infrastructure. This could play a valuable role in the development of China's smart cities and fits well within China's *National New-type Urbanisation Plan (2014–2020)*. The working group would like to facilitate the sharing of best practices through an EU-China cooperation framework and create market access for European solution providers. However, EU companies have experienced that the Chinese Government is cautious about working with foreign companies for financial and information security reasons.

### Recommendations

- Identify viable EU business models for smart city projects that can be scaled to Chinese cities in an EU-China framework.
- Establish an EU-China smart city platform where European companies can share their knowledge and show their best practices, and communicate on common smart city projects with relevant Chinese stakeholders.
- Establish benchmarks and indicators, provide government support and set policy incentives to facilitate the development of integrated smart city concepts, including strategies on renewable energy, smart grids, ES, energy efficiency in buildings, water management, climate change and sustainable transportation.
- Enable market access for private sector providers and suppliers and engage in multi-level partnerships under the umbrella of a local authority framework in a pilot city.
- Enable joint efforts in smart grid and city innovation through an EU-China smart city lab.

## Abbreviations

CAI	Comprehensive Agreement on Investment
CHP	Combined Heat and Power
CSG	China Southern Power Grid Company
DER	Distributed Energy Resources
DSM	Demand Side Management
DR	Demand Response
EU	European Union
ES	Energy Storage
FYP	Five-Year Plan
GB	<i>Guobiao</i>
GDP	Gross Domestic Product
GHG	Greenhouse Gas
ICT	Information and Communication Technology
IEC	International Electrotechnical Commission
IP	Intellectual Property
IoT	Internet of Things
ISO	International Organisation for Standardisation
MOF	Ministry of Finance
MOHURD	Ministry of Housing and Urban-Rural Development
MW	Megawatt
NEA	National Energy Administration
NDRC	National Development and Reform Commission
R&D	Research and Development
SAC	Standardisation Administration of China
SGCC	State Grid Corporation of China
SG-CG	Smart Grid Coordination Group
SSM	Standard Solar Model



## European Wood Working Group

### Key Recommendations

- ▶ **1. Promote Wood Construction as a Sustainable Building System**
  - Include wood as a sustainable structural material and modern wood construction as a sustainable building solution in the *Action Plan of Green Buildings*, jointly issued by the National Development and Reform Commission (NDRC) and the Ministry of Housing and Urban-Rural Development (MOHURD) in March 2013, and provide greater policy support to developers and end-users to adopt wood construction.
  - Develop policies to promote wood materials and wood constructions at the local government level and in industry.
  - Organise education and training programmes on wood construction at the governmental level.
  - Emphasise the importance of wood construction to help achieve China's carbon dioxide (CO<sub>2</sub>) reduction targets and energy saving targets, and to protect the environment.
  - Create a platform for wood and wood construction that is as equal to the one that exists for concrete and steel structures.
  
- 2. Improve Fire Regulations to Enlarge the Application Scope of Wood Materials and Wood Construction both in Residential and Public Buildings**
  - Improve the revised fire code GB50016 to overcome the main barriers for the development of wood construction.
  - Increase the height of wood constructions for buildings to more than three storeys.
  - Release height limitations for partition walls as exteriors for six-storey buildings, and no restrictions for interiors.
  - Enlarge the application scope for glulam structures by regulating no limitation for floor space and no height limitation of three storeys.
  - Add cross-laminated timber (CLT) to the current fire code in order to give industry more opportunities for application.
  - Carry out more research on performance-based regulations for fire prevention in wood construction instead of focusing on prescriptive building codes.
  - Improve coordination work between professional committees and research institutes and between the Ministry of Public Security (MPS) and the MOHURD.
  
- ▶ **3. Promote the Use of Wood from Sustainably-managed Forests Worldwide both for Interiors and Building Construction**
  - Enhance certification management for forests.
  - Make good use of domestic, fast-growing wood species.
  - Establish stricter policies for illegal trading of wood.
  - Disseminate understanding of the benefits of using sustainable wood for interior applications.
  - Make comprehensive use of wood materials in the industry.
  - Change attitudes towards imported timber and trade on a global level.

▶ Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.



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## Introduction to the Working Group

The European Wood Working Group was established in order to promote the use of wood and wood structures in China. It works closely with European Wood, a cooperative partnership between the national wood promotion organisations in Sweden, Norway, France and Austria. Its main goal is to establish and improve the system of codes and standards in China. The head office of European Wood is in Stockholm, the European Chamber hosts its representative office in Beijing for China operations, and a Sino-European Wood Centre for technical support was established in Shanghai in 2012.

The European Wood Working Group promotes comfortable and efficient building systems based on the benefits of using wood and wood products from sustainably-managed forests. Activities in China involve transferring many years of experience, technology and knowledge in modern wood construction to the relevant Chinese central ministries and expert bodies, such as official, national, professional standardisation committees. The objective is to remove, or at least lower, technical barriers and to develop building codes and standards so that wood can be widely used in construction in China.

The European Wood Working Group is specifically focused on providing efficient building solutions with wood, such as building envelopes (partition walls plus wooden roofs), hybrid construction (concrete and timber structures), glulam structures, cross-laminated timber (CLT), and components using engineered wood. The working group also supports the use of wood and transfers experiences with design for interior decoration, furniture and wood panels.

## Recent Developments

Currently, China is faced with an imbalance between wood supply and demand. For example, China possesses 198 million hectares of natural forests, but since the launch of the Natural Forest Protection Programme in 1998, 127 million hectares have been put under protection. The State Forest Administration (SFA) also said that all commercial logging of natural forests will be phased out by 2017.<sup>1</sup> Moreover, China's

population growth and rapid urbanisation—by 2020 its urbanisation rate is expected to reach 60 per cent<sup>2</sup>—exacerbate the wood supply and demand imbalance.

Statistics show that current wood consumption in China amounts to approximately 500 million cubic metres, 50 per cent of which depends on the import of wood and wood materials. By 2020, China's wood consumption is estimated to reach 800 million cubic metres due to its rapid economic development.<sup>3</sup>

In 2014, China's forest coverage amounted to 22 per cent, which is far below the global average of 31 per cent, and only about 25 per cent of the per capita global average. China aims at reaching the goal of 23 per cent of forest coverage by 2020.<sup>4</sup>

The following key recent developments took place:

- On 30<sup>th</sup> June, 2015, China submitted its Intended Nationally Determined Contributions (INDCs) to the United Nations Framework Convention on Climate Change (UNFCCC) secretariat. China pledged to increase its forest stock volume by around 4.5 billion cubic metres by 2030 against 2005 levels.<sup>5</sup>
- On 16<sup>th</sup> March, 2015, the State Council published the *National New-type Urbanisation Plan 2014–2020*, regulating that 50 per cent of new constructions should meet the criteria of green buildings by 2020.<sup>6</sup>
- In the Chinese Government's work report of 5<sup>th</sup> March, 2015, Prime Minister Li Keqiang stated that "all forests, grass, rivers and wetlands are the green wealth provided by nature to human beings, and we must value and respect this". He added that to enlarge the protection range of natural forests, commercial cutting of natural forests should be phased out and that action must be taken to protect

<sup>1</sup> *China to phase out commercial logging of natural forests by 2017*, *China Daily*, 10<sup>th</sup> June, 2015, viewed 29<sup>th</sup> July, 2015, <[http://www.chinadaily.com.cn/china/2015-06/10/content\\_20962885.htm](http://www.chinadaily.com.cn/china/2015-06/10/content_20962885.htm)>

<sup>2</sup> *National New-type Urbanisation Plan (2014–2020)*, State Council, 16<sup>th</sup> March, 2014, viewed 1<sup>st</sup> June, 2014, <[http://www.gov.cn/gongbao/content/2014/content\\_2644805.htm](http://www.gov.cn/gongbao/content/2014/content_2644805.htm)>

<sup>3</sup> The State Council Information Office of People's Republic of China, 25<sup>th</sup> February, 2014, viewed 1<sup>st</sup> June, 2015, <<http://www.scio.gov.cn/xwfbh/xwfbh/wqfbh/2014/20140225/index.htm>>

<sup>4</sup> *Chinese Forestry Promotes the Historical Transformation, People*, 12<sup>th</sup> March, 2015, viewed 1<sup>st</sup> June, 2015, <<http://politics.people.com.cn/n/2015/0312/c70731-26678661.html>>

<sup>5</sup> *Enhanced Actions on Climate Change: China's Intended Nationally Determined Contributions*, National Development and Reform Commission, Department of Climate Change, 30<sup>th</sup> June, 2015, viewed 6<sup>th</sup> July, 2015, <<http://www4.unfccc.int/submissions/INDC/Published%20Documents/China/1/China%27s%20INDC%20-%20on%2030%20June%202015.pdf>>

<sup>6</sup> *National New-type Urbanisation Plan (2014–2020)*, State Council, 16<sup>th</sup> March, 2014, viewed 1<sup>st</sup> June, 2014, <[http://www.gov.cn/gongbao/content/2014/content\\_2644805.htm](http://www.gov.cn/gongbao/content/2014/content_2644805.htm)>



the environment.<sup>7</sup>

- The SFA is in charge of the *Construction Plan for National Storage and Production Bases of Wood 2013–2020*, which aims at setting up 140 thousand square kilometres of wood bases in six regions of China's 25 provinces by 2020. Through such wood bases, China will increase its annual wood supply by 95 million cubic metres.<sup>8</sup>
- On 15<sup>th</sup> April, 2014, the Ministry of Housing and Urban-Rural Development (MOHURD) issued the *Evaluation Code for Green Building GB/T50378-2014*, which entered into force on 1<sup>st</sup> January, 2015.<sup>9</sup> The new evaluation code widens the application scope for green buildings to all types of civil buildings, whereas previously only residential and public buildings were covered. It also promotes new building materials and systems with properties benefiting environmental protection, energy efficiency, resource-efficiency, water saving and land saving.

### Negotiations on the EU-China Comprehensive Agreement on Investment (CAI)

As the CAI is believed to contain a chapter on sustainability, the European Wood Working Group would like to emphasise the need to push for the promotion of wood construction as a sustainable building system. So far, the Chinese Government has been reluctant to officially promote the use of wood and wood structures and it does not enjoy the same preferential treatment as other building materials, such as high-strength concrete and steel. However, wood is proven to have a lower carbon footprint than other building materials and it helps mitigate climate change.

Second, the working group would like to call for the promotion of wood from sustainably-managed forests both for interior and building constructions. China has been demanding increasing quantities of imported wood from other countries due to its rapid economic development. However, reports show that more than 20 per cent of China's imported wood materials come

from countries and regions that do not have sustainable forest management practices. This encourages illegal felling and deteriorates the environment. Some low-quality wood products used for interior applications are also harmful to people's health.

## Key Recommendations

### 1. Promote Wood Construction as a Sustainable Building System

#### Concern

The Chinese Government remains reluctant to officially promote the use of wood and wood structures and, as a result, wood does not enjoy the same preferential treatment as other building materials, such as high-strength concrete and steel. However, wood is proven to have a lower carbon footprint than other building materials and it helps mitigate climate change.

#### Assessment

In 2014, China's urbanisation rate reached 55 per cent. But China's current urbanisation rate is still significantly behind the average level of developed countries, which stands at 80 per cent.<sup>10</sup>

But China's urbanisation rate will gradually increase. For example, as part of the *National New-Type Urbanisation Plan* the Chinese Government aims to increase its urbanisation rate to 60 per cent by 2020,<sup>11</sup> and to 79 per cent by 2050.<sup>12</sup>

The urbanisation trend will result in a significant increase in domestic demand for goods, including wood. A large percentage of state investment and domestic consumption will be allocated to buildings and construction, which will provide a strong incentive for the building industry. But at the same time, this trend will add to China's climate and environmental challenges.

However, as stated in the *Action Plan of Green Building*<sup>13</sup> and the new *Evaluation Code for Green*

7 Li Keqiang Puts Much Emphasis on Energy Saving, Exhaust Reduction and Environmental Protection in the Government Report at the 12<sup>th</sup> NPC, Ministry of Environmental Protection, 5<sup>th</sup> March, 2015, viewed on 4<sup>th</sup> June, 2015, <[http://www.mep.gov.cn/zxxx/hjyw/201503/t20150306\\_296864.htm](http://www.mep.gov.cn/zxxx/hjyw/201503/t20150306_296864.htm)>

8 *The Basic Condition of Construction of National Storage and Production Bases of Wood, People*, 20<sup>th</sup> May, 2015, viewed 1<sup>st</sup> June, 2015, <<http://env.people.com.cn/n/2014/0520/c1010-25041082.html>>

9 *The Evaluation Standard of the Green Building (GB/T50378-2014) will be implemented in 2015, chinanhu*, 19<sup>th</sup> June, 2014, viewed 4<sup>th</sup> June, 2015, <<http://www.chinanhu.com/index.php/default/content/115319.html>>

10 Anderlini, Jamil, *China reveals blueprint to expand urbanisation*, *Financial Times*, 2014, viewed 24<sup>th</sup> June, 2014, <<http://www.ft.com/intl/cms/s/0/ea62ecc2-ad89-11e3-af3e-00144feab7de.html#axzz35XE240Ve>>

11 *National New-type Urbanisation Plan (2014–2020)*, State Council, 16<sup>th</sup> March, 2014, viewed 1<sup>st</sup> June, 2014, <[http://www.gov.cn/gongbao/content/2014/content\\_2644805.htm](http://www.gov.cn/gongbao/content/2014/content_2644805.htm)>

12 *World Urbanisation Prospects*, United Nations, 2014, viewed 8<sup>th</sup> May, 2015, <<http://esa.un.org/unpd/wup/Highlights/WUP2014-Highlights.pdf>>

13 *Action Plan of Green Building*, State Council, 6<sup>th</sup> January, 2013, viewed 8<sup>th</sup> July, 2015, <[http://www.gov.cn/zwgc/2013-01/06/content\\_2305793.htm](http://www.gov.cn/zwgc/2013-01/06/content_2305793.htm)>





*Buildings*<sup>14</sup> issued by the National Development and Reform Commission (NDRC) and the MOHURD, concrete and steel enjoy preferential treatment. At the same time, wood and wood construction are not considered as an important sustainable material and building system and do not enjoy the same treatment, despite the fact that wood is proven to have a lower carbon footprint and is an effective solution for tackling climate change.

### Helping to tackle climate change

Wood plays a key role in the fight against climate change. Forests are an important part of the Earth's ecosystem. Sustainably-managed forests are carbon sinks: trees grow through photosynthesis and absorb carbon dioxide (CO<sub>2</sub>) from the atmosphere at the rate of roughly one tonne for every cubic metre's growth, while at the same time they produce approximately 0.7 tonnes of Oxygen (O<sub>2</sub>).<sup>15</sup> According to the Edinburgh Centre for Carbon Management (now Verco), every cubic metre of wood used instead of other building materials saves between 0.7 and 1.1 tonnes of CO<sub>2</sub>.

As trees reach maturity, the rate at which they absorb CO<sub>2</sub> and produce O<sub>2</sub> slows down. But when wood is used as a building material, the harvested tree retains much of the CO<sub>2</sub> it has absorbed for the life of the building, and beyond through recycling.

### Reducing energy consumption

Energy consumption refers to two elements: the amount of energy used in the materials, transport and construction phase of the building (the embodied energy) and the amount used by the occupiers during its life time. An Australian study shows that a typical timber house has less than half the embodied energy of a concrete block or steel frame house.<sup>16</sup> This is not surprising when you consider that a steel beam requires ten times more energy to produce than the equivalent timber beam, or eight times as much as a glulam beam.

Timber is also more energy efficient when it comes to

the in-use phase. Because it is such a good thermal insulator (approximately 400 times better at resisting thermal conductivity than steel, and 10 times better than concrete or bricks<sup>17</sup>), it is easier to achieve very well insulated timber buildings, as extra insulation or thicker walls are required for steel, concrete or masonry structures to achieve the same level of thermal resistance.

Based on statistics from the MOHURD, the energy consumption of buildings accounts for more than 30 per cent of China's total energy consumption and is expected to increase in the coming years.<sup>18</sup> It is likely that most urban buildings will have been retrofitted by 2020, in order to improve energy efficiency. In this respect, wood offers a sustainable solution, as wood construction consumes minimal energy, is lightweight, requires minimal foundations and is easy to work with on site.

### Reducing waste

Wood helps reduce waste in a number of ways: all parts of the tree are used, whether for timber, or as by-product for providing the energy for kiln-drying. Timber is suitable for off-site construction, which reduces the amount of wastage of materials on site. Timber can also be recycled into panel products or animal bedding. Finally, it can be used as a bio-fuel, substituting fossil fuels.

According to reports by the MOHURD, many of China's existing buildings have a 25- to 30-year service life, which is much shorter than the life span of 50 to 70 years as designed for in building codes. On the other hand, a lot of wood constructions in Europe have already been in place for more than 100 years, whereas 70 years is the average level. Since Chinese buildings are mainly constructed from concrete and bricks, it is not possible to reuse and recycle the building materials once the buildings have been taken down. But in the case of wood constructions, all the materials can be reused and recycled again.

### Recommendations

- Include wood as a sustainable structural material and

14 *Evaluation Code for Green Buildings*, MOHURD, 29<sup>th</sup> January, 2015, viewed 8<sup>th</sup> July, 2015, <<http://www.njlsjzw.com/news/show.php?itemid=6190>>

15 Burnett, Jill, *Forestry Commission Scotland - Greenhouse Gas Emissions Comparison Carbon benefits of Using Timber in Construction*, Edinburgh Centre for Carbon Management Ltd, 2006, viewed 8<sup>th</sup> July, 2015, <<http://www.doc88.com/p-199104889701.html>>

16 *The Environmental Properties of Timber – Summary Report*, The Forest and Wood Products Research and Development Corporation, Australian Government, 2004, Project No. PN009.59, viewed 15<sup>th</sup> December, 2013, <[http://www.wpv.org.au/6star/docs/PN005\\_95\\_Environmental\\_Properties\\_of\\_Timber.pdf](http://www.wpv.org.au/6star/docs/PN005_95_Environmental_Properties_of_Timber.pdf)>

17 *Thermal Conductivity*, Georgia State University, 2014, viewed 11<sup>th</sup> April, 2014, <[hyperphysics.phy-astr.gsu.edu/hbase/tables/thrcn.html](http://hyperphysics.phy-astr.gsu.edu/hbase/tables/thrcn.html)>

18 Li Bingren: *The Energy Consumption of Buildings Accounts for 30% of the Countries Total Energy Consumption*, China Construction and Decoration Net, 21<sup>st</sup> September, 2010, viewed 8<sup>th</sup> July, 2015, <<http://news.ccd.com.cn/Htmls/2010/9/21/20109219545498126-1.html>>



modern wood construction as a sustainable building solution in the *Action Plan of Green Buildings*, jointly issued by the NDRC and the MOHURD in March 2013, and provide greater policy support to developers and end-users to adopt wood construction.

- Develop policies to promote wood materials and wood constructions at the local government level and in industry.
- Organise education and training programmes on wood construction at the governmental level.
- Emphasise the importance of wood construction to help achieve China's CO<sub>2</sub> reduction targets and energy saving targets, and to protect the environment.
- Create a platform for wood and wood construction that is as equal to the one that exists for concrete and steel structures.

## 2. Improve Fire Regulations to Enlarge the Application Scope of Wood Materials and Wood Construction both in Residential and Public Buildings

### Concern

There are a lot of restrictions for wood materials and wood components in buildings, with the current Chinese fire code for buildings in particular presenting a major bottle-neck. Although it has been recently revised, the fire code is still out-of-date and prescriptive instead of performance-based, which blocks the promotion and development of wood construction in China.

### Assessment

China has a long history of using wood for construction, but it has been focused on traditional building methods and is therefore arguably underdeveloped in its understanding of modern wood construction. Old-fashioned codes and standards, a lack of knowledge and experience, and policy orientation have all affected the use of wood in construction.

So far, there exist approximately 10 codes and standards as well as a handbook for wood construction. This provides a platform to promote and construct wooden buildings in China. However, among these codes and standards, there is one code that blocks the rapid development of modern timber structures in the Chinese market: the *GB50016 Code of Fire Prevention for Buildings*.

The GB50016 fire code has been revised recently. It

was officially approved by the Ministry of Public Security (MPS) and the MOHURD and was published on 1<sup>st</sup> May, 2015.<sup>19</sup> The revised code includes a new chapter on *Fire Prevention for Timber Structures*. However, the fire code concept remains out-of-date and prescriptive instead of performance-based.

Moreover, the fire code still contains many restrictions and limitations for wood components and systems to be applied in buildings. In particular, the fact that the height of wood constructions is restricted to three storeys presents a major bottle-neck.

In many European countries wood constructions are not restricted to three storeys. For example, in Sweden, Germany, Austria and the United Kingdom, an increasing number of residential buildings are being built with more than eight storeys of timber structure, as well as many public buildings with large-span glulam structures. A new type of system with CLT has become more and more popular. Many eight- and nine-storey residential and public buildings are constructed using this system. The tallest building height with CLT in Europe stands at 14 storeys.

### Excellent fire safety properties

Compared to other building materials, wood has excellent fire safety properties. Timber behaves predictably in fire by forming a charred surface that provides protection for the inner structure. This allows timber elements to remain intact and fully load-bearing during a fire. This predictability implies that escape or rescue times can be planned for and the safety of inhabitants can be guaranteed. By contrast, steel can distort and collapse within a short period of time under certain temperatures.

Moreover, when combined with other materials, wood can easily meet fire requirements. This is the case when wood components and constructions are combined with materials, such as fire-rated gypsum boards, fire retardants and fire-rated paint.

### Recommendations

- Improve the revised fire code GB50016 to overcome the main barriers for the development of wood

<sup>19</sup> Notification on the Regulations for Fireproofing Architecture Design (National Standard GB50016-2014), The Code Division of Fire Department, Ministry of Public Security, 27<sup>th</sup> August, 2014, viewed 4<sup>th</sup> June, 2015, <[http://www.cnwb.net/html/XW\\_News\\_2\\_15531.html](http://www.cnwb.net/html/XW_News_2_15531.html)>



construction.

- Increase the height of wood constructions for buildings to more than three storeys.
- Release height limitations for partition walls as exteriors for six-storey buildings, and no restrictions for interiors.
- Enlarge the application scope for glulam structures by regulating no limitation for floor space and no height limitation of three storeys.
- Add CLT to the current fire code in order to give industry more opportunities of application.
- Carry out more research on performance-based regulations for fire prevention in wood construction instead of focusing on prescriptive building codes.
- Improve coordination work between professional committees and research institutes and between the Ministry of Public Security (MPS) and the MOHURD.

### 3. Promote the Use of Wood from Sustainably-managed Forests Worldwide both for Interiors and Building Construction

#### Concern

China has been demanding increasing quantities of imported wood from other countries due to its rapid economic development, however, a lot of these imports are a result of illegal felling and trading of wood materials that come from unsustainably-managed forests.

#### Assessment

Statistics show that current wood consumption in China amounts to approximately 500 million cubic metres, 50 per cent of which depends on the import of wood and wood materials. And by 2020, China's wood consumption is estimated to reach 800 million cubic metres.<sup>20</sup> This indicates that imported timber will continue to play an important role in the coming 20 to 30 years, despite the fact that China is the world leader in wood plantations.

According to instructions from the central government, a two-fold approach should be applied to deal with the growing demand for timber. First, domestic fast-growing wood species will be promoted. Second, international cooperation will be reinforced, mainly with Russia.

<sup>20</sup> The State Council Information Office of People's Republic of China, 25<sup>th</sup> February, 2014, viewed 1<sup>st</sup> June, 2015, <<http://www.scio.gov.cn/xwfbh/xwfbfh/wqfbh/2014/20140225/index.htm>>

There are many benefits of sustainably-managed forests, such as mitigation of climate change, preservation of plants and animal species and land stabilisation. However, reports from the World Wide Fund for Nature (WWF) and the British Inspection Agency for the Environment show that more than 20 per cent of China's imported wood materials come from countries and regions that do not have sustainable forest management practices, such as Russia, Indonesia, Myanmar and some African and tropical regions.<sup>21</sup> This encourages illegal felling and deteriorates the environment. Some low-quality wood products used for interior applications are also harmful to people's health.

Since the import of wood materials into China will increase in the long run, it is vital to disseminate understanding of the benefits of sustainably-managed forests to government bodies, professionals, industry and individuals. Furthermore, wood construction provides the economic incentive to expand sustainably-managed forests.

Fortunately, there are many softwood producing countries and regions in the world, such as Europe and North America, to supply the growing Chinese market with high-quality wood materials and wood products from forest reserves certified as sustainably managed.

Credible, independent, third-party forest certification is becoming an important tool for the Chinese Government, the forestry and wood industries, and traders. Certification provides assurance that wood and wood products are legally sourced, environmentally-friendly and come from sustainably-managed forests. The two most widely-accepted certification systems are the Forest Stewardship Council (FSC) and the Programme for the Endorsement of Forest Certification (PEFC).

In general, the Chinese Government should apply stricter policies and regulations and should establish a serious punishment system to fight against illegal trading of wood from unsustainably-managed forests. In addition, more rights and responsibilities should be given to Chinese customs.

#### Recommendations

- Enhance certification management for forests.

<sup>21</sup> *Illegal Wood Trade Conversely Facilitates the Legislation*, yicai, 25<sup>th</sup> August, 2014, viewed 4<sup>th</sup> June, 2015, <<http://www.crcc.cn/g528/s1110/t45275.aspx>>



- Make good use of domestic, fast-growing wood species.
- Establish stricter policies for illegal trading of wood.
- Disseminate understanding of the benefits of using sustainable wood for interior application.
- Make comprehensive use of wood materials in the industry.
- Change attitudes towards imported timber and trade on a global level.

## Abbreviations

CAI	Comprehensive Agreement on Investment
CLT	Cross-Laminated Timber
CO <sub>2</sub>	Carbon Dioxide
FSC	Forest Stewardship Council
INDC	Intended Nationally Determined Contribution
MOHURD	Ministry of Housing and Urban-Rural Development
MPS	Ministry of Public Security
NDRC	National Development and Reform Commission
O <sub>2</sub>	Oxygen
PEFC	Programme for the Endorsement of Forest Certification
SFA	State Forestry Administration
UNFCCC	United Nations Framework Convention on Climate Change
WWF	World Wide Fund for Nature



**European Chamber**  
中国欧盟商会

# **Section Four:**

## **Trade in Services**



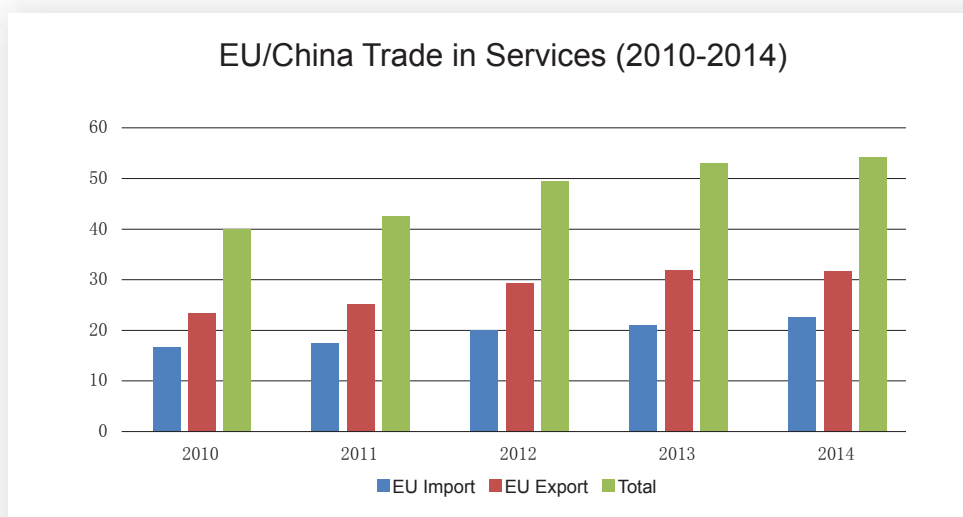
## Trade in Services

The Trade in Services section of the *European Business in China Position Paper 2015/2016* includes position papers from seven European Chamber working groups:

- Aviation and Aerospace
- Construction
- Information and Communication Technology
- Information Security
- Logistics
- Maritime Transport
- Quality and Safety Services

The European Union's (EU's) and China's economies are complementary in many ways. If China further opens its services industry, the EU can contribute greatly to China's economy as it looks to transition from a model based on high-quantity, labour intensive manufacturing, to one based on high-technology manufacturing, services and consumption – all areas of expertise in the EU. Under China's recent ambitious plan for developing markets in third countries—such as its 'one-belt-one-road' initiative—services offered by European players can be instrumental to Chinese partners with investment and production capacities.

In 2014, the growth of China's services industry contributed to 48.2 per cent of its gross domestic product (GDP) increase, continued to lead the industrial sector and thus became the leading industry sector for the national economy. In terms of foreign investment, the services sector accounted for 55.4 per cent of the total foreign direct investment (FDI) into China in 2014.<sup>1</sup>



Source: DG Trade, EU Commission

<sup>1</sup> *China's Services Industry with added value of 30,700 RMB in 2014, an increase of 8.1%*, China News, 2014, Beijing, viewed 21<sup>st</sup> June, 2014, <<http://finance.chinanews.com/cj/2015/02-12/7060271.shtml>>



According to Euro Statistics, the total import and export of services between the EU and China reached euro (EUR) 54 billion, making China the third largest export destination and the third largest origin of import for services.<sup>2</sup>

In comparison to China's manufacturing industries, the level of market access afforded to foreign enterprises in China's services sector is lagging substantially. This despite the promulgation of *The Decision on Major Issues Concerning Comprehensively Deepening Reforms (Decision)* following the Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee, in November 2013. The *Decision* urged the opening up of China's finance, education, cultural, healthcare and other services sectors and an orderly removal of market restrictions for foreign players in the nursery and senior care industries, and for those involved in architectural design, accounting, auditing, logistics and e-commerce, among others.

So far, in certain sectors only general guidance documents have been released without any specific implantation rules. In other sectors, markets open to foreign players are those that are already dominated by Chinese players and are highly competitive, meaning there is a high entrance threshold for additional players. Meanwhile, for areas such as legal services and quality and safety services, no reform plan has been released.

While in general European business was encouraged by the improvements witnessed in China's pilot free trade zones (FTZs),<sup>3</sup> there has been some deterioration in the commercial environment. For example, in the maritime industry, foreign-flagged vessels have been permitted to conduct international relay in any of China's FTZs, but only if the vessel is ultimately Chinese owned. This puts foreign shipping carriers at a significant disadvantage, and they are in fact worse off in this respect than before the FTZs were established.

The following major challenges are reported by EU investors when investing in China's services industry:

#### **Market Access**

Though there has been much promising news regarding opening of the services industry, European Chamber members find that reforms take a long time to trickle down to daily operations. In order to bring about a swift implementation of reforms and trade facilitation measures in telecoms, quality and safety services, and construction design, individual working groups have made specific recommendations in their respective position papers.

#### **Equal Treatment**

In certain areas that are open to foreign investment, foreign investors sometimes find themselves competing on unequal ground. For example, in the information and communication technology (ICT) industry, foreign-invested enterprises find the management of membership of Standards Development Organisations (SDOs) unclear – equal membership access, including voting rights, are not applied in all standardisation technical committees.

2 *EU-28 Trade in Services by leading Trading Partners*, 2014, viewed 12<sup>th</sup> July, 2015, <[http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_122532.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_122532.pdf)>

3 Zhu Min: *23 Opening Measures by Shanghai Free Trade Zone in Services Industry Implemented*, *tuxi.com*, viewed 22<sup>nd</sup> July, 2015, <<http://news.tuxi.com.cn/stocknews/satnamsa/pddetpndp.html>>

### **Alignment with International Rules**

Globalisation requires the alignment of rules by all different parties involved in international trade under one single framework. To improve Chinese enterprises' international competitiveness, alignment of Chinese domestic standards and procedures with international ones are needed. However, in the field of aviation for example, scheduling at major Chinese gateways is not in accordance with global practices such as those laid down in the Worldwide Scheduling Guidelines (WSG).

In the following section, the European Chamber's Aviation and Aerospace, Construction, Information and Communication Technology, Information Security, Logistics, Maritime Transport, and Quality and Safety Services working groups elaborate on their specific challenges investing in the services sector in China and make recommendations aimed at improving the operating environment and levelling the playing field for both foreign and Chinese enterprises.



## Aviation and Aerospace Working Group

### Key Recommendations

- ▶ **1. Continue to Strengthen Exchanges and Cooperation Between the European Union (EU) and China in Aviation Matters**

  - Pursue a dialogue which covers all aspects of the aviation industry.
  - Launch a new EU-China cooperation programme in aviation.
  - Establish a regular EU-China aviation summit/forum.
- 2. Harmonise Airworthiness Certification Processes with International Common Practices (Safety)**

  - Harmonise airworthiness certification processes with international common practices that are conducive to a bilateral aviation safety agreement.
  - Establish a regular exchange mechanism to ensure that relevant certifications are granted in the absence of a bilateral aviation safety agreement.
- 3. Continue to Increase the Efficiency of China's Airspace (Air Traffic Management (ATM))**

  - Continue expanding the airspace for civil aviation, adding international entry-exit points and increasing its efficiency by re-designing some domestic routes.
  - Establish a more efficient and transparent slot allocation system.
  - Strengthen the communication between Europe and China to enable better operational predictability for operators and to lay the grounds for future ATM cooperation.
- 4. Build a Common Vision for Environmental Standards and Technologies (Environment)**

  - Improve cooperation on aviation-related environmental policies and build common positions within the framework set by the International Civil Aviation Organisation (ICAO).
  - Support the industry's four-pillar strategy with incentives and improvements to operational procedures.
- 5. Enhance Cooperation and Exchanges to Advance the Opening of China's Low Altitude Airspace (General Aviation (GA))**

  - Continue the pilot programme of opening airspace for general aviation (GA) in selected cities and regions and expand the programme to new areas.
  - Implement policy incentives which encourage the emergence of para-public services.
  - Align operating guidelines for GA aircrafts with international standards.
- ▶ **6. Develop a More Market-orientated Aviation and Aerospace Market (Economic Regulations)**

  - Relax regulations for foreign companies to establish operations in China.
  - Reduce airport and terminal charges.

▶ Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.

## Introduction to the Working Group

Both the Aviation and the Aerospace working groups were an integral part of the European Chamber since its foundation in 2000. In 2015, the two working groups were merged into a combined Aviation and Aerospace Working Group to create an aligned and cohesive voice for increased political-level exchanges.

The Aviation and Aerospace Working Group includes passenger and freight air carriers and companies that manufacture a broad range of aerospace products including civil aircrafts, aero engines, helicopters, space systems and equipment. It also comprises maintenance and service companies that carry out repairs, training and other activities supporting the aviation industry in general.

## Recent Developments

Recent developments have brought positive momentum to EU-China cooperation on aviation matters. In particular, the signing of the Letter of Intent (LoI) in 2013, between the Directorate-General for Mobility and Transport (DG MOVE) and the Civil Aviation Administration of China (CAAC), has served as a catalyst to accelerate the strategic partnership between the EU and China. In the context of shared interests, the LoI provided a structured framework for discussions between the EU and China. During 2014, a number of discussions were held to explore further cooperation around two major areas: first, technical cooperation regarding aviation safety, notably airworthiness; and second, a potential EU-China comprehensive aviation agreement.

The Aviation and Aerospace Working Group is very encouraged to see increased exchanges between the EU and China on aviation-related topics and strongly believes that these are conducive to more cooperation possibilities in areas detailed in the LoI, such as general aviation (GA), customs, industrial policy and aviation-based investments.

All these developments come at an important time for China. The *Decision on Some Major Issues Concerning Comprehensively Deepening the Reform (Decision)*<sup>1</sup> reinforced China's commitment towards becoming a more market-based economy, and the working

<sup>1</sup> *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform*, Xinhua, 15<sup>th</sup> November, 2013, viewed 3<sup>rd</sup> July, 2015, <[http://news.xinhuanet.com/2013-11/15/c\\_118164235.htm](http://news.xinhuanet.com/2013-11/15/c_118164235.htm)>

group believes that constructive cooperation between Europe and China in the field of aviation will contribute meaningfully to this goal.

## Key Recommendations

### ▶ 1. Continue to Strengthen Exchanges and Cooperation Between the European Union (EU) and China in Aviation Matters

#### Concern

It has been proven in the past that misunderstanding of policies issued by either the EU or China have the potential to hinder the development of their respective aviation industries, therefore keeping regular exchanges at government-to-government level is necessary for both parties to better understand each other's priorities and avoid communication gaps.

#### Assessment

Europe and China have both had a long-standing interest in the aviation industry. Policies have been introduced by lawmakers on both sides to support the foundation of the industry. In an industry as international as the aviation industry is, these policies often have an effect on the development of both domestic and international players in China and in Europe. Therefore the coordination in their enactment becomes ever more important, especially for issues like aviation safety, security, air traffic management (ATM) and the environment. Other areas which deserve equal attention are GA, customs, aerospace industrial policy and those related to investments in the industry.

Recently, both sides have announced their willingness to enhance the existing technical cooperation in civil aviation-related fields. With the former EU-China Civil Aviation Project (EUCCAP) having ended in October 2013, there has been a growing need for a new initiative that can build on the success of previous projects and further support industry participation in these renewed exchanges between Europe and China.

In addition to the need for a cooperation programme, there has been a request from the industry for a regular forum in the form of an EU-China aviation summit, where European and Chinese stakeholders, together with industry involvement, can exchange views on industry and international issues. Such a forum would enable both government and industry to understand





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
In natural monopoly industries in which state-owned capital continues to be the controlling shareholder ... carry out reform focusing on separation of government administration from enterprise management ...	It is widely acknowledged among industry players that China's over-regulation in the aviation sector has become a bottleneck to the market and risks hampering industry growth.	
Supporting the healthy development of the non-public sector.	There has been a very positive development in the emergence of new private airlines. On the manufacturing side, however, private sector development lags behind. This is detrimental to the development of new technologies and the competitiveness of this sector in China.	
... develop a mechanism within which the market plays a key part in determining innovation programmes and allocation of funds, and assessing results.	The support for innovation from private industry is limited and the allocation of funds is not efficient.	
All enterprise investment projects ... should be decided by the enterprises independently in accordance with the law, and no longer require government approval.	Burdensome administrative approval processes are still common in certain areas, for instance aircraft purchase and registration.	
... improve the government organisational structure, function composition and work procedures.	Multiple government agencies regulate the industry, resulting in different understanding, inefficient work and unnecessary costs.	
Further opening up inland and border areas. ... will support inland cities to start more international passenger and freight air routes.	China has been very active in developing western (southwest/northwest) areas with special incentive policies for direct international air links.	

each other's priorities and initiate discussions for policy applications and evaluations.

#### Recommendations

- Pursue a dialogue which covers all aspects of the aviation industry.
- Launch a new EU-China cooperation programme in aviation.
- Establish a regular EU-China aviation summit/forum.

## 2. Harmonise Airworthiness Certification Processes with International Common Practices (Safety)

#### Concern

While China has established solid aviation certification regulations, the implementation of these regulations

often deviates from internationally-accepted practice, in particular the process of validation is very time-consuming with unclear instructions for foreign manufacturers to follow.

#### Assessment

Airworthiness is by far the most important issue for any national aviation authority. In recent years, the working group has witnessed a much closer dialogue between the EU and China on airworthiness-related issues. While the willingness from both sides to discuss a potential bilateral aviation safety agreement is clear, discussions are likely to be carried on for several years.

The problem is that in the near future, both domestic operators and foreign companies are looking to introduce new services and products to China, which will require faster approvals from aviation authorities

than is currently afforded. In this regard, the Aviation and Aerospace Working Group believes that the government's constant procrastination of administrative reviews and approvals would be perceived as a lack of capacity to keep up with international practices.

#### Recommendations

- Harmonise airworthiness certification processes with international common practices that are conducive to a bilateral aviation safety agreement.
- Establish a regular exchange mechanism to ensure that relevant certifications are granted in the absence of a bilateral aviation safety agreement.

### 3. Continue to Increase the Efficiency of China's Airspace (Air Traffic Management (ATM))

#### Concern

With the growth in the number of civil flights, congested airspace has become a major challenge for China's aviation industry during its process of modernisation.

#### Assessment

China's civil aviation authorities have been under great pressure to handle the exponential growth in air travel. The utilisation of airspace for civil aviation remains critically insufficient. Currently, ATM in China is still fragmented by areas in terms of application and approval processes. Civil carriers are not receiving equal treatment in using slots and airspaces.

Possible solutions to the current situation include introducing transparent and fair slot allocation management, granting equal treatment between passenger and cargo carriers and increasing slot usage for civil flights. These measures could significantly improve ATM efficiency. For instance, providing day-time slots, a common practice in other countries, can help the Chinese aviation industry to benefit from global supply chain connectivity. Additionally, developing 'fly-through' joint airspace for civil aviation can also help to optimise aerospace efficiency when it is not occupied by the military.

Authorities need to communicate with the aviation industry and the general public on planned improvements and future challenges. Regular and expanded communication will help to ease public concern and allow industry to contribute to and secure

more support for the CAAC to improve ATM efficiency.

Looking forward, the working group would like to see both the EU and China engage in a long-term cooperation conducive to building commonalities between their respective airspace management modernisation plans. This should also enhance cooperation between industries and encourage openness to common standards and sharing of best practices.

#### Recommendations

- Continue expanding the airspace for civil aviation, adding international entry-exit points and increasing its efficiency by re-designing some domestic routes.
- Establish a more efficient and transparent slot allocation system.
- Strengthen the communication between Europe and China to enable better operational predictability for operators and to lay the grounds for future ATM cooperation.

### 4. Build a Common Vision for Environmental Standards and Technologies (Environment)

#### Concern

The EU and China need to work more closely on aviation-related environmental policies.

#### Assessment

The aviation industry has committed to reducing its environmental impact. This commitment has been reflected in the International Civil Aviation Organisation-(ICAO)-endorsed four-pillar strategy: technological innovation, operational improvements, infrastructure investments and economic incentives.

Technological innovation has been considered one of the most effective measures for curbing emissions. In China, some policy incentives are already being put in place to encourage the use of this kind of technology. For instance, the CAAC, via its Civil Aviation Development Fund, incentivises airlines to adopt new technologies to reduce their carbon footprint in China. Initiatives like this are good complements to comprehensive policies and are also in line with the industry's four-pillar strategy.

Another area that helps to address environmental protection issues is the optimisation of operational procedures. For example, the overuse of aircraft



holding and taxiing often results in unnecessary fuel consumption, therefore if this was controlled more effectively emissions could be reduced. However, such procedural improvements would require advanced coordination between ground support and air traffic control-related functional support. Regular exchanges between China and the EU would provide an opportunity for China to learn from its EU counterparts how to coordinate these procedures more effectively.

#### Recommendations

- Improve cooperation on aviation-related environmental policies and build common positions within the framework set by the ICAO.
- Support the industry's four-pillar strategy with incentives and improvements to operational procedures.

### 5. Enhance Cooperation and Exchanges to Advance the Opening of China's Low Altitude Airspace (GA)

#### Concern

Compared with its commercial aviation sector, China's GA sector is very unevenly developed: coupled with tight regulations and limited technological progress, the slow development of GA indirectly hinders the development of the aviation services industry in areas such as emergency medical services, power line surveillance, tourism and others.

#### Assessment

It is a positive signal for manufacturers that China identified several pilot regions where GA flights are permitted. However, though those pilot projects proved successful, China seemed very hesitant to scale-up operations to other areas which obviously possess the potential to open up aerospace for GA.

Formulating the right regulations for low altitude airspace often requires a thorough evaluation by aviation authorities. The working group is glad to see that the CAAC has been working in this direction. With support from international institutions, numerous exchanges have been held between the CAAC and their counterparts from around the world on the sharing of best practices regarding the opening up of lower airspace.

#### Recommendations

- Continue the pilot programme of opening airspace for GA in selected cities and regions and expand the programme to new areas.
- Implement policy incentives which encourage the emergence of para-public services.
- Align operating guidelines for GA aircrafts with international standards.

### 6. Develop a More Market-orientated Aviation and Aerospace Market (Economic Regulations)

#### Concerns

It is widely acknowledged among industry players that China's over-regulation of the aviation sector has become a bottleneck in the market and even hampers industry growth.

#### Assessment

China's over-regulation of the aviation industry risks hampering its growth. Rules governing the mandatory set-up of joint ventures (JVs), the approval of aircraft purchases/registration, the operation of GA services and the complex airport slot-allocation process are but a few examples of regulations that could be improved to the benefit of the whole industry. While all national and international players have every intention of adhering to existing regulations, sometimes they perceive certain regulations to be going against the economic and strategic interests of companies and consumers.

The aviation and aerospace industry in China has experienced rapid growth and modernisation. However, due to limitations on investment most foreign players currently operating in China are in the form of JVs. In view of China's desire to move towards a market-orientated economy, rules such as mandatory partnerships/JVs, intellectual property (IP) disclosure and ownership rules are strong deterrents to new investments and often complicate existing operations of current projects, jeopardising their successful completion.

The regulations on operations of foreign airlines also deserve closer attention. Currently, many operational charges in China are higher than those in other similar markets in the world, and in certain cases some charges for foreign carriers are higher than those for domestic ones. Furthermore, foreign airlines are still mandated to





use the state-owned employment service company for recruiting new staff. This regulation considerably limits the employment pool that airline operators could enjoy in an otherwise more competitive environment.

#### Recommendations

- Relax regulations for foreign companies to establish operations in China.
- Reduce airport and terminal charges.

### Abbreviations

ATC	Air Traffic Control
ATM	Air Traffic Management
CAAC	Civil Aviation Administration of China
EASA	European Aviation Safety Agency
EUCCAP	EU-China Civil Aviation Project
GA	General Aviation
ICAO	International Civil Aviation Organisation
IP	Intellectual Property
JV	Joint Venture
LoI	Letter of Intent
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission



# Construction Working Group

## Key Recommendations

### 1. Promote Sustainable Urban Development

- Promote human-centred urbanisation, shifting to an approach that emphasises citizens' quality of life.
- Set up a joint research centre with the aim of providing integrated urban planning solutions with Chinese characteristics.
- Encourage cooperation among European and Chinese public and private entities for the creation of eco, smart and cultural cities, as well as advancing the development of major city clusters.
- Deepen reform of the land management system to use land more effectively and economically, employing new standards.
- Strengthen and advance the level of infrastructure and building construction quality and durability as well as management systems.
- Improve energy efficiency at the city- and single-building-scale to reduce energy consumption and carbon dioxide (CO<sub>2</sub>) emissions.
- Maintain foreign direct investment (FDI) policy stability and transparency, and encourage mutual investment in the field of sustainable urban development planning and execution, to make it even more attractive and achievable.

### 2. Enhance Market Access for European Construction (Including Engineering and Architectural) Service Providers (CSPs)

- Apply further liberalisation measures beyond those implemented in the China (Shanghai) Pilot Free Trade Zone (CSPFTZ) to enable European Construction Service Providers (CSPs), and engineering and design entities to undertake construction and engineering projects in a broader range of sectors, and apply for all levels of qualification certificates, including Grade A.
- Recognise international expertise and professional qualifications to facilitate knowledge-sharing and exchange of know-how across regions.
- Improve the efficiency and competency of Chinese CSPs.
- Remove the rigid requirements associated with using standard contracts issued by the Ministry of Construction (MOC) and the State Administration of Industry and Commerce (SAIC) to file construction projects.
- Promote online filing for basic projects and contractor information only.
- Improve the legislation for mergers and acquisitions (M&A) of local companies via FDI.

### 3. Revise Building Codes, Standards and Performance Evaluations to Allow for Flexibility and Evolution in the Implementation of Advanced Construction Materials and Technologies

- Continue the application of harmonised measurement methods, testing procedures and performance assessments of green buildings and sustainable construction materials.
- Allow European and Chinese enterprises to participate in developing local and national Chinese standards on an equal basis.
- Enforce online publication of building construction performance and safety and compliance checks by an independent authority during project execution and commissioning.





- Apply consistent calculation methods for energy performance verification, from the building design to operation stage, and an online monitoring system to understand building energy performance in different climate zones.
- Introduce more professional training programmes for construction professionals to raise the quality of projects.
- Involve all related industry stakeholders in the building code conduction process in a more transparent way, consider employing advanced international experience and technologies—or at least using them as a benchmark—to ensure that different opinions are solicited.
- Consider applying a total-life-cycle, cradle-to-grave approach for calculating building energy efficiency performance evaluations; promote an online energy consumption monitoring system with live monitoring for building performance; and recommend the establishment of a national database for 'big data analysis'.

#### 4. Establish a Fair, Healthy and Advanced Real Estate (RE) Market with Equal Capital, Debt and Procedural Requirements for Foreign and Chinese Companies in RE Investment and Development

- Abolish Circular 171 and related regulations and remove the unfair requirement of higher registered capital for foreign companies.
- Abolish Circular 130 and related regulations which prohibit any foreign loan for RE investment.
- Simplify application procedures, requirements and bureaucratic procedures for development projects.
- Allow the establishment of foreign-invested, limited-liability partnerships with a focus on RE investments.
- Encourage foreign financial institutions and funds to provide more mature financial models, in an initial, immediate roll-out of the policy in all of China's free trade zones (FTZs).

## Introduction to the Working Group

The Construction Working Group was first established in 2003, to represent European construction service providers (CSPs) operating in China. The main objective is to maintain frequent dialogue with key stakeholders, including the Ministry of Housing and Urban-Rural Development (MOHURD), the National Development and Reform Commission (NDRC), European Union (EU) institutions and construction-related organisations and associations. This cooperation aims to provide feedback on and support for Chinese construction policies, with a current focus on sustainable urban development, and promote investment in high-quality, energy-efficient buildings.

## Recent Developments

As the 12<sup>th</sup> Five-Year Plan (FYP) enters its final year in 2015, there is increasing pressure on the Chinese

leadership to achieve building energy-efficiency targets. While more stringent building energy consumption standards, including new energy conservation standards for residential buildings and energy saving standards for building renovations, are currently under revision, there are a few notable regulatory developments.

The MOHURD and other government agencies have issued the following relevant measures:

- *National Additive Manufacturing Industry Development Promoting Plan (2015–2016)*, published by The Ministry of Industry and Information Technology (MIIT), the NDRC and the Ministry of Finance (MOF), in February 2015.1
- The 2015 Pilot Sponge City Construction was embarked on by the MOF, the MOHURD on the 2<sup>nd</sup>

<sup>1</sup> *National Additive Manufacturing Industry Development Promoting Plan (2015–2016)*, MIIT, NDRC, MOF, 11<sup>th</sup> February, 2015, viewed 30<sup>th</sup> June, 2015, <<http://www.miit.gov.cn/n11293472/n11293832/n11293907/n11368223/16474315.html>>







### Third Plenum Reality Check

What did the Third Plenum's <i>Decision</i> <sup>2</sup> say?	What is the reality?	Status
“We will stick to the path of a new-type of urbanisation with Chinese characteristics, push forward people-oriented urbanisation, promote the coordinated development of megacities, mid-sized cities, small cities and small towns, promote the integrated development of industries and cities, and advance urbanisation and the building of new rural areas in a coordinated manner.”	Although sustainable urban development is still high on the agenda, little progress has been seen the last year. In the current challenging property market, sustainability in particular has had less attention paid to it. The sustainable development of a complete living environment—not only limited to green buildings—needs more attention in providing better living conditions.	
“Deepening reform of the management system for science and technology.”	Minor improvements have been seen in terms of implementation of international best practises and standards, transparency, performance tracking and codes.	
“We will promote innovation in urban construction management.”	Little changes have been made. Smart Cities with relevant technology and material innovations should be promoted more and access for foreign global players should be granted.	

February, 2015.<sup>3</sup>

- 103 cities included in the *National List of Pilot Smart Cities*: the cities included on the list, published in August 2013, will develop urban infrastructure and management plans to construct smart cities.<sup>4</sup>
- *Trial Construction Project Environmental Impact Assessment (EIA)*: released in November 2013, the directory aims to increase EIA information transparency and promote public participation in the EIA.<sup>5</sup>
- *Building Construction and Municipal Infrastructure Project Completion and Acceptance Provisions*: the notice, published in December 2013, intends to implement the *Construction Quality Management Regulations* to ensure a higher level of construction project quality.<sup>6</sup>

- *Circular on Implementation of Green Building Actions for Affordable Housing*: the December 2013 document actively promotes building green houses in affordable housing areas.<sup>7</sup>
- *Opinions on Strengthening Supervision of Construction Project Standards Implementation*: published in March 2014, this guidance aims to accelerate comprehensive and effective implementation of project standards.<sup>8</sup>

The *National New-Type Urbanisation Plan*, which was published in March 2014, lays the foundation for China's urbanisation with specified targets and measures up until 2020, promising a human-centred and environmentally-friendly approach. It will serve as an engine for sustainable, healthy economic growth and support China in achieving its ecological and energy targets.

As part of the plan, the Chinese Government aims to lift the urbanisation rate from the current 54 per cent to 60 per cent by 2020. It plans to ensure that every city

<sup>2</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.

<sup>3</sup> *2015 Pilot Sponge City Construction*, Ministry of Water Resources, 2<sup>nd</sup> February, 2015, viewed 30<sup>th</sup> June, 2015 <[http://www.mwr.gov.cn/zwzc/tzgg/tzgs/201502/t20150202\\_619471.html](http://www.mwr.gov.cn/zwzc/tzgg/tzgs/201502/t20150202_619471.html)>

<sup>4</sup> *103 Cities in National List of Pilot Smart Cities*, MOHURD, 8<sup>th</sup> August, 2013, viewed 30<sup>th</sup> June, 2015, <[www.mohurd.gov.cn/zxydt/201308/t20130808\\_214670.html](http://www.mohurd.gov.cn/zxydt/201308/t20130808_214670.html)>

<sup>5</sup> *Notice on Trial Construction Project Environmental Impact Assessment (EIA) Government Information Public Directory*, Ministry of Environmental Protection (MEP), 14<sup>th</sup> November, 2013, viewed 30<sup>th</sup> June, 2015, <[www.mep.gov.cn/gkml/hbb/bgt/201311/t20131118\\_263486.htm](http://www.mep.gov.cn/gkml/hbb/bgt/201311/t20131118_263486.htm)>

<sup>6</sup> *Notice on the Building Construction and Municipal Infrastructure Project Completion and Acceptance Provisions*, MOHURD, 2<sup>nd</sup> December, 2013, viewed 30<sup>th</sup> June, 2015, <[www.mohurd.gov.cn/zc/fjjsbwj\\_0jsbwjgczi/201312/t20131205\\_216438.html](http://www.mohurd.gov.cn/zc/fjjsbwj_0jsbwjgczi/201312/t20131205_216438.html)>

<sup>7</sup> *Construction Project Contracting and Contract Pricing Management Approach*, MOHURD, 11<sup>th</sup> December, 2013, viewed 30<sup>th</sup> June, 2015, <[www.mohurd.gov.cn/zc/fjjsbgzi/201312/t20131223\\_216635.html](http://www.mohurd.gov.cn/zc/fjjsbgzi/201312/t20131223_216635.html)>

<sup>8</sup> *Opinions on Accelerating Implementation and Supervision of Construction Projects Standards*, MOHURD, 17<sup>th</sup> March, 2014, viewed 30<sup>th</sup> June, 2015, <[www.mohurd.gov.cn/zxydt/201403/t20140314\\_217364.html](http://www.mohurd.gov.cn/zxydt/201403/t20140314_217364.html)>





across China with more than 200,000 residents will be connected by rail and express roads by 2020, while new airports will be built to create a civil aviation network that caters to 90 per cent of the country's population. The Construction Working Group hopes that European companies will be able to fully contribute to this process with their leading expertise and technologies.

The Ministry of Land and Resources (MLR) also set up the Real Estate Registration Bureau in May 2014, the first firm step towards a national, unified property registration system.

Although China's urbanisation offers a multitude of opportunities, European CSPs continue to face legal barriers to enter and participate in the Chinese construction market. There have not been many regulatory changes to put European CSPs on an equal footing with their Chinese counterparts; however, the China (Shanghai) Pilot Free Trade Zone (CSPFTZ) reforms are a step in the right direction, with two of particular note:

- The international track record can be used to apply for engineering and design qualifications.
- Restrictions on Sino-foreign construction projects in Shanghai have been lifted.

While the Construction Working Group welcomes these reforms, it nevertheless expects further liberalisation to expand to other construction sectors and also nationwide.

## Key Recommendations

### 1. Promote Sustainable Urban Development

#### Concern

Although European businesses have decades of proven experience in urban planning, urban management, and energy-efficient construction practices, present market entry barriers in China's construction and engineering industry prevent them from fully contributing to China's sustainable urbanisation process.

#### Assessment

In March 2014, the State Council unveiled China's *National New-Type Urbanisation Plan (Urbanisation Plan)* for 2014–2020. The *Urbanisation Plan* is considered the government's blueprint for the continuation of China's state-led urbanisation drive, with specific targets and measures for a human-centred and 'environmentally-

friendly' urbanisation process.

The *Urbanisation Plan* lays out a comprehensive reform agenda to make China's continuing urbanisation process more efficient, inclusive and sustainable by systematically changing the way it allocates land, people and capital across the country. While the *Urbanisation Plan* laid out several issues that national-level reform can resolve—land ownership, *hukou*, the fiscal system and local government reform—it will be its implementation at the local level that will determine the plan's success or failure.<sup>9</sup>

The new model is intended to help China maintain its economic growth at a sustainable level by increasing consumption – a natural consequence of the increase in urban population. While this new urbanisation drive will place increasing strain on infrastructure, it will also free up surplus agricultural labour and open possibilities for the development of industrial (intensive, more efficient) farming, in order to safeguard China's food security.<sup>10</sup>

The *Urbanisation Plan* was developed to establish a diversified and sustainable funding guarantee scheme. The urbanisation market will also be open to private capital to allow for multiple financing arrangements such as Public-Private Partnership (PPP) models. The Construction Working Group expects that European businesses will be given the opportunity to participate on a level playing field with Chinese businesses, so that they can deploy funding and financial skills, as well as global urbanisation expertise, to support China's sustainable urbanisation process.

The current urban planning model and system is outdated and doesn't match the needs of new-style urbanisation. It has therefore become necessary to promote research and studies into the creation of new rules and codes for urban and rural development. It is important for all stakeholders to be integrated in the process.

In order to develop joint research and innovation projects, the Construction Working Group suggests setting up a research centre focused on integrated urbanisation planning with Chinese characteristics, for urban-rural development, by a coordinated approach

9 Bai, Xuemei, *Realizing China's Urban Dream*, Nature Volume 509, Nature Publishing Group, 2014, p.158–160

10 Ibid





between all stakeholders.

Its purpose would be to encourage the relevant organisations from both sides to: cooperate in studying and creating technological and international standards for a New Integrated Planning System for Urban and Rural Area Development; create innovative solutions through collaboration between the academia and industry; and to develop robust data and knowledge, which will provide guidance for the sustainable planning of urban, energy, mobility, water, waste management.

Research should focus on the planning model, applicable to specific Chinese characteristics, in cities developed via this integrated approach. One study topic could be an operational model in order to improve the process for public procurement, construction standards and technologies to be implemented. Pilot projects aimed at validating the technical and economic viability of research and study carried out by the research centre could be another study topic.

Key research targets would include:

- Promoting human-centred urbanisation, shifting to an urbanisation approach that emphasises citizens' quality of life;
- Deepening reform of the land management system, to use land more effectively and economically;
- Improving standards for construction land use, and implementing standards in a more stringent way by improving ecological protection;
- Strengthening and improving the level of infrastructure, building construction quality and durability, as well as management systems;
- Improving efficiency of energy planning for cities;
- Reducing building energy consumption and carbon dioxide (CO<sub>2</sub>) emissions, both in new construction and existing buildings;
- Creating a financial protection mechanism for urbanisation;
- Enhancing the level of basic public services (e.g. healthcare, education, mobility) in urban and rural areas;
- Proposing new standardisation processes to ensure that the best technologies reach market; and
- Overcoming societal and cultural differences, as well as specific issues which the EU and China have on intellectual property (IP) issues.

Taking inspiration from the targets set out in the

*Urbanisation Plan*, the Construction Working Group proposes to select pilot project sites where European and Chinese companies can cooperate on a level playing field, in order to implement suitable projects for Smart Cities, Cultural Cities, Green Cities, and Safe Cities.

Pilot projects should be selected among different level cities of varying sizes, incorporating small to medium-sized cities, with their specifications compared to those of larger tier-1 and tier-2 cities.

In order to guarantee quick completion, pilot projects should have specific targets and operate on a reasonable scale to ensure implementation in a relatively short timeframe.

China's unprecedented rate of urbanisation has seen problems with regard to safety and quality of urban construction. Great emphasis is being placed on improving the safety and quality of energy efficiency in construction, which was underlined by the Chinese leadership in the *China Green Building Action Plan*, published in January 2013. Its main objectives included enforcing mandatory, energy-saving standards for new buildings in urban areas and constructing 1 billion square metres of green buildings within the lifetime of the 12<sup>th</sup> FYP.

European companies possess extensive cutting edge technology and know-how in eco, smart and cultural city planning and green buildings, and continue to assist China in making Chinese cities more intelligent and ecological. However, the lack of a clear regulatory regime has delayed and discouraged the investment in and development of green buildings and smart city projects across China. The Construction Working Group urges relevant Chinese regulators to speed up the process of passing laws and regulations in this area and ensuring enforcement of these laws and regulations at all levels of government – national, provincial and local.

The involvement of European companies in China's sustainable urbanisation is important in the context of the EU-China negotiations for a Comprehensive Agreement on Investment (CAI). The protection of technology, knowledge and patents are important issues for European companies as is the protection of European investments in future cooperation with Chinese entities.



### Recommendations

- Promote human-centred urbanisation, shifting to an approach that emphasises citizens' quality of life.
- Set up a joint research centre with the aim of providing integrated urban planning solutions with Chinese characteristics.
- Encourage cooperation among European and Chinese public and private entities for the creation of eco, smart and cultural cities, as well as advancing the development of major city clusters.
- Deepen reform of the land management system to use land more effectively and economically, employing new standards.
- Strengthen and advance the level of infrastructure and building construction quality and durability as well as management systems.
- Improve energy efficiency at the city-and single-building-scale to reduce energy consumption and CO<sub>2</sub> emissions.
- Maintain FDI policy stability and transparency, and encourage mutual investment in the field of sustainable urban development planning and execution, to make it even more attractive and achievable.

## 2. Enhance Market Access for European Construction (Including Engineering and Architectural) Service Providers (CSPs)

### Concern

European CSPs, including architects, quantity surveyors, project managers and contractors, face legal barriers to enter into the Chinese market, preventing them from sharing world-class expertise and cutting-edge technology with Chinese CSPs.

### Assessment

China's construction market is a highly regulated industry sector. A local presence is required for European CSPs, with various industry qualification requirements as a prerequisite, if they are to provide services in the fields of planning, design and engineering, construction, surveying and construction supervision. Statutory preconditions for the qualifications include registered capital, personnel, place of business, facilities and track record, without consideration for the different market conditions for foreign-invested and domestic CSPs.

This has created problems for the majority of European CSPs that are new to the Chinese market. Even though they hold top qualifications in Europe and have completed numerous prominent projects internationally, most of them may only start with the lowest grade qualification in China, restricting their scope of work. This affects European CSPs' capability to engage in high-end projects, normally requiring a Grade A qualification in China. This restriction has resulted in inadequate technology transfers to Chinese CSPs.

Reciprocal recognition of international experience and qualifications will pave the way for European and Chinese CSPs to enter each other's construction market based on the same regulatory requirements. It will improve market access conditions for European CSPs in China and, in turn, encourage domestic Chinese CSPs to improve their international competitiveness by possessing international qualifications and construction best practices.

The Construction Working Group has raised these concerns for the past several years. It is, however, encouraged by recent reforms in the CSPFTZ that the international track record can be used to apply for architectural design qualifications in the CSPFTZ. Furthermore, liberalisation is expected to soon be rolled out to other construction sectors and nationwide.

Under Decree 113, *Regulations on the Administration of Foreign-Invested Construction Enterprises*, wholly foreign-owned construction enterprises (WFOCEs) are limited to undertaking:

- projects financed by international institutions;
- sino-foreign projects, where foreign investment is greater than 50 per cent; and
- domestic projects, which are so technically demanding that Chinese CSPs are unable to undertake them.

The above restrictions create a major market entry barrier for WFOCEs, many of which possess advanced construction technology, and substantial experience and expertise in project management. The Construction Working Group, nevertheless, welcomes the lifting of restrictions on Sino-foreign projects in Shanghai Municipality, but urges greater liberalisation and nationwide roll-out of the reform.

Under existing regulations, contracts for design, survey, construction and construction supervision are



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required to be filed with local construction authorities, a precondition for the issuance of construction permits.

Dating back to 1999, the MOC and the SAIC issued a set of standard contracts for design, construction and construction supervision for reference and recommendation. In China, it is not legally mandatory to adopt such standard contracts, but, in reality, many construction authorities only accept standard contracts for filing.

Foreign-invested project owners and CSPs tend to use other types of contracts, such as fixed-price contracts, Institution of Civil Engineers, or Fédération Internationale Des Ingénieurs-Conseils<sup>11</sup> terms, rather than standard contracts.

This triggers the problem of black and white construction contracts, leading to legal and compliance issues, which is not desirable for ensuring the proper supervision and administration of China's construction market. It should be sufficient for construction authorities to have basic information of construction projects in its file system, and allow such filings to be completed online.

#### Recommendations

- Apply further liberalisation measures beyond those implemented in the CSPFTZ to enable European CSPs, and engineering and design entities to undertake construction and engineering projects in a broader range of sectors, and apply for all levels of qualification certificates, including Grade A.
- Recognise international expertise and professional qualifications to facilitate knowledge-sharing and exchange of know-how across regions.
- Improve the efficiency and competency of Chinese CSPs.
- Remove the rigid requirements associated with using standard contracts issued by the MOC and the SAIC to file construction projects.
- Promote online filing for basic projects and contractor information only.
- Improve the legislation for M&A of local companies via FDI.

### 3. Revise Building Codes, Standards and Performance Evaluations to Allow for Flexibility and Evolution in the Implementation of Advanced Construction Materials and Technologies

#### Concern

The current lack of transparency in the process of developing or modifying building codes and standards in China undermines the credibility of the process.

#### Assessment

Building codes ensure the health and safety of building occupants and the general public. However, many current building codes in China pay little attention to design verification, project execution and building operational performance, in compliance with approved designs and codes. Incorrect application of procedural rules will hinder national reform efforts related to energy efficiency, indoor air quality or advanced building construction materials.

In 2013, the revision of several building application standards was postponed due to the long-delayed revision of the *National Building Fire Design Code*. Although the revised code is yet to be released, local authorities have already developed regional-specific interpretations and local requirements.

The Construction Working Group welcomes the revision of fire codes and standards to raise the fire safety level because it considers the fact that when fires occur in high-rise buildings rescue facilities are often quite limited, resulting in damage and loss of property and human lives. The construction of high-rise buildings is inevitable in order to accommodate China's large population, given scarce land resources, therefore, safety in high rise buildings remains a critical consideration.

In March 2015, the MOHURD and the MIIT started to revise the *Green Building Material Evaluation Guideline Draft*. In this guideline, it states in item (4.0.2):

“Provisions shall not use flame retardants containing halogen. Flame retardants for environmental issues shall clearly identify what kind of flame retardant for persistent organic pollutants (POPs) are used.”

<sup>11</sup> FIDIC- International Federation of Consulting Engineers.



Members of the Construction Working Group would like the following points to be taken into consideration:

- The halogen flame retardant family includes hundreds of different chemicals which each have unique characteristics. In fact many other types of chemicals and chemical compositions can be used as flame retardants, and these substances are often used in combination. The term "flame retardants containing halogen" only describes a material function, but is not limited to the chemical nature of the material properties.
- The *Green Building Material Evaluation Guideline* (draft) was too focused on the energy consumed during the manufacturing process; most of inorganic materials' assessments were 1, 2 or 3 star, and the guideline didn't reflect the organic materials' significant contribution to energy reduction during the building operation stage.

#### Recommendations

- Continue the application of harmonised measurement methods, testing procedures and performance assessments of green buildings and sustainable construction materials.
- Allow European and Chinese enterprises to participate in developing local and national Chinese standards on an equal basis.
- Enforce online publication of building construction performance and safety and compliance checks by an independent authority during project execution and commissioning.
- Apply consistent calculation methods for energy performance verification, from the building design to operation stage, and an online monitoring system to understand building energy performance in different climate zones.
- Introduce more professional training programmes for construction professionals to raise the quality of projects.
- Involve all related industry stakeholders in the building code conduction process in a more transparent way, consider employing advanced international experience and technologies—or at least using them as a benchmark—to ensure that different opinions are solicited.
- Consider applying a total-life-cycle, cradle-to-grave approach for calculating building energy efficiency performance evaluations; promote an online energy consumption monitoring system with live monitoring for building performance; and recommend the

establishment of a national database for 'big data analysis'.

#### 4. Establish a Fair, Healthy and Advanced Real Estate (RE) Market with Equal Capital, Debt and Procedural Requirements for Foreign and Chinese Companies in RE Investment and Development

##### Concern

In the previous years, real investment accounted for more than 20 per cent of fixed asset investment in China. In 2014, this ratio dropped to 18.9 per cent. Given long-term, strict government control, it remains difficult for European financial experts and developers to fully participate in the Chinese market.

##### Assessment

The release of *Shangzihan 340* on 20<sup>th</sup> June, 2014, jointly published by the Ministry of Commerce (MOFCOM) and State Administration of Foreign Exchange (SAFE) was a positive development. Since its implementation on 1<sup>st</sup> August, 2015, the overall administration of foreign investment in the RE market has proven to be more efficient and simplified. The filing of foreign investment in the RE sector has been delegated to the provincial level, which has saved a lot of time for foreign companies.

There was more positive news after the *Foreign Investment Industry Guidance Catalogue* (2015 amended) (*Catalogue*) was issued on 10<sup>th</sup> March, 2015, and implemented in April, which indicated that certain restrictions in construction industry had been removed. The liberalisation of foreign development of land, high-end hotels, high-end office buildings and international exhibition centres will definitely help China to steadily continue its urbanisation development and upgrade its market structure. Other detailed changes on procedures and regulations are expected to be updated accordingly in the near future.

However, the most stringent regulations, dating back to 2006, are still in place and not suitable for development and upgrading of the market. As such, European investment in the Chinese real estate market is hindered and foreign investors entering China's real estate market face huge operational hurdles.

Circular 171, *Opinions Governing Market Access and*



*the Administration of Foreign Investment in China's Real Estate Market*, addresses a variety of measures to control the flow of foreign capital, including not only the purchase of RE, minimum capital requirements and restrictions on debt financing, but also a range of other measures that discourage foreign investment. It creates unfair competition between local and foreign companies, particularly in relation to the different requirements for registration capital. Foreign-invested enterprises are required to have a minimum registration capital of 50 per cent of the total investment, while the minimum requirement for local companies is roughly 30 per cent. Real estate projects involve a large amount of investment, so it makes a huge difference with regard to capital investment between foreign and Chinese companies.

Moreover, Circular 50, *Notice Governing Further Strengthening and Regulating the Approval and Supervision of Direct Foreign Investment in the Real Estate Sector*, introduced rigid controls on foreign investment in high-end RE projects, particularly in the acquisition of and investment in domestic RE enterprises. Furthermore, foreign-invested RE enterprises are not allowed to hold any foreign debt, according to Circular 130, therefore foreign investment can only be made directly in the form of registered capital. In addition, real property ownership also underwent restrictions under Circular 186, which only allows foreign enterprises to purchase non-residential real properties for their own office use. However, even if an investment is encouraged or permitted under the *Catalogue*, foreign investors still need to be aware of the required approvals and potential regulatory restrictions for their particular investment. They restrict the injection of foreign investment and the know-how that could help to build up a healthier market environment.

Therefore, the above regulations should be reformed and replaced with stricter standards for the housing industry. Property funds are a very commonly used corporate form of RE investment. There have been an increasing number of domestic property funds since 2011, and they form a healthy financing channel for China's RE market.

Following the issuance of foreign-invested, limited-liability partnership rules and related foreign exchange rules, foreign investors should be allowed to set up limited-liability partnerships focusing on real property

investment. However, whether or not such an application can be accepted is still largely subject to the discretion of local government authorities on a case-by-case basis. Therefore, similar to the rules on foreign-invested, limited-liability partnerships for venture capital and equity investment, it is essential to issue rules for foreign-invested, limited-liability partnerships with a RE investment focus. According to the Third Plenum, wider opening of financial industries is key to China's future development plans. There are lots of positive reforms in China's four free trade zones (FTZs) (Guangdong, Tianjin, Fujian and Shanghai), but none of them relate to the opening in the RE sector. A healthier RE sector in China will encourage international development and simultaneously strengthen the financial sector.

#### Recommendations

- Abolish Circular 171 and related regulations and remove the unfair requirement of higher registered capital for foreign companies.
- Abolish Circular 130 and related regulations which prohibit any foreign loan for RE investment.
- Simplify application procedures, requirements and bureaucratic procedures for development projects.
- Allow the establishment of foreign-invested, limited-liability partnerships with a focus on RE investments.
- Encourage foreign financial institutions and funds to provide more mature financial models in an initial, immediate roll-out of the policy in all of China's FTZs.

#### Abbreviations

CSP	Construction Service Provider
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
EIA	Environmental Impact Assessment
EU	European Union
MIIT	Ministry of Industry and Information Technology
MLR	Ministry of Land and Resources
MOC	Ministry of Construction
MOHURD	Ministry of Housing and Urban-Rural Development
NDRC	National Development and Reform Commission
PPP	Public-private Partnership
SAIC	State Administration of Industry and Commerce
SAFE	State Administration of Foreign Exchange
WFOCE	Wholly Foreign-Owned Construction Enterprises





# Information and Communication Technology Working Group

## Key Recommendations

### 1. Develop Information and Communication Technology (ICT) Standards that Benefit the End-user and the Industry as a Whole

- Speed up reforms of the State Council's *Deepening Reform Plan for Standardisation Work*, and make the standardisation process more open and transparent.
- Encourage the practical implementation of the *Deepening Reform Plan for Standardisation Work* in the processes of Standards Development Organisations (SDOs) with fairness, openness and transparency.
- Guarantee full and equal membership of SDOs for foreign-invested enterprises (FIEs) and wholly foreign-owned enterprises (WFOEs), including voting rights within all technical committees (TCs) and working groups (WGs) in China.
- Increase participation and cooperation with the international community on international standardisation initiatives in ICT and harmonise Chinese ICT standards with international standards to increase interoperability.
- Encourage the creation of a healthy eco-system for Time Division Long-Term Evolution (TD-LTE) and fifth generation (5G) by allowing European organisations a fair share of the Chinese market.
- Encourage technology neutrality, ensuring that specific technologies are not unfairly mandated through local standards or other technical requirements.
- Improve the streamlined certification process included in the State Council's *China Standardisation Reform Plan* in such a way that it:
  - clarifies how interested parties can implement it;
  - clarifies to what extent the complex and duplicative ICT equipment certification process will become a simple, transparent and unified certification scheme; and
  - allows foreign-invested licensing and certification agencies to perform desired ICT equipment certification services in China.
- Provide clarification of licensing and certification requirements well in advance of the implementation date, and provide notification under the World Trade Organisation Technical Barriers to Trade (WTO/TBT) Agreement for any standard that is applicable to mandatory certification and market access.
- Avoid testing and certification requirements compelling disclosure of sensitive commercial information and information unrelated to core product features, such as source code and additional software or hardware information.

### 2. Enhance the Efficiency and Effectiveness of China's ICT Services Sector to Provide More Choices at Lower Costs to the Consumer

- Relax the requirements of the *Foreign Investment Industrial Guidance Catalogue (Foreign Investment Catalogue)* with regards to the telecommunication sector, by allowing more foreign participation and easier licensing.
- Further open up the mobile virtual network operator (MVNO) sector and broadband access market to encourage European players to bring more know-how and international practices to the market.
- Update the scope of coverage in the *Value-added Service (VAS) Catalogue* and allow VAS







providers to suggest new services to add to the list as new technologies are developed and allow more foreign capital share in VAS joint ventures (JVs).

- Encourage cross-border, e-commerce business by decreasing cross-border tax and increasing customs declaration efficiency.
- Encourage foreign companies to provide cloud computing services in China.
- Streamline the complex and duplicative VAS licence application process into a simple, transparent and unified scheme for foreign companies.
- Speed up free trade zone (FTZ) policy-making and further relax the requirements of the telecoms catalogue in FTZs.
- Facilitate global joint procurement between Chinese and foreign operators to achieve international expansion for both Chinese and European vendors.

### **3. Encourage Enhanced Innovation and Research that Drives the ICT Industry Forward Through a Global and Cooperative Approach**

- Encourage greater reciprocity in the field of ICT research and engage in further collaboration with European Union (EU) organisations with a view to developing mutually beneficial international standards.
- Streamline the application process for foreign companies applying for Chinese ICT research and development (R&D) programmes by removing unnecessary and overly burdensome document requirements.
- Focus the build-up of indigenous innovation capabilities on enhancing technological innovation that drives the ICT industry forward and benefits end-users in the long term, rather than delivering short-term benefits for domestic enterprises.
- Encourage the build-up of indigenous innovation capabilities through a global and collaborative innovation approach, where global stakeholders—including academia, government, industry and other experts—communicate and cooperate on international research and standardisation in order to maximise end-user benefits.

### **4. Improve the Business Environment with Regards to Information Security, Data Protection and User Privacy**

- Relax the rigid requirement of storing and processing data within the territory of China and allow more flexibility for cross-border data flows.
- Create a more business-friendly IT environment by either removing the requirement that Internet service providers and telecom operators must submit the source codes and encryption keys for filing with regulators, or by outsourcing this task to trusted, independent, third-party testing labs for verification.
- Improve transparency in relation to making and implementing rules and policies for information security and data privacy and encourage greater stakeholder participation.
- Provide clear guidance on what constitutes “secure and controllable technology” for IT procurement by banks and financial institutions, and remove the tendency of favouring local suppliers of ICT products and services.
- Enhance the reciprocity and cooperation between Chinese and foreign ICT suppliers on information and cyber security and data privacy and simplify the homologation procedures.

### **5. Speed Up Internet Access in Support of Corporate Business Development**

- Improve communication services support to corporate business intranets, especially for foreign enterprises in China.

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.





- Upgrade network infrastructure premises to meet the growing corporate need for high-speed global Internet access in support of sustainable business development in China.
- Maintain stable access to global legitimate Internet resources critical for corporate business development.

## Introduction to the Working Group

Formed in 2001, the Information and Communication Technology (ICT) Working Group consists of major European telecommunications vendors, service providers, digital content providers and consulting firms that meet on a regular basis to assess China's reforms and the business environment in the ICT industry. The working group also serves as a platform for information exchange on ICT industry developments, including but not limited to the topics of technology standards, certification, services, spectrum, innovation, research, information security, interoperability and global harmonisation.

European ICT companies are among the largest investors in China today and contribute to China's development by transferring technology, creating jobs, contributing know-how and intellectual property (IP), and training a new generation of Chinese engineers in the ICT field. In addition, a large percentage of these European companies have significant research and development (R&D) units with well-established links to Chinese universities and research institutes that contribute significantly to the development of the ICT sector in China. As such, echoing various recent market reform goals addressed by the Third Plenum's *Decision*,<sup>1</sup> coming from the highest levels of the Chinese Government, foreign companies should receive equal treatment in the Chinese marketplace, which they are currently not afforded. The working group's activities are intended to contribute to consultation and dialogue with all government agencies responsible for the ICT sector. Increased dialogue between Chinese decision-makers and the European ICT industry will improve mutual understanding and benefits.

1 The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*. The *Decision*, a 60-point reform blueprint, detailed the Party's reform plan for the next six years.

## Recent Developments

### Market Size of Mainland China

- In 2014, basic telecommunications services revenue reached Chinese Yuan (CNY) 1.2 trillion, a drop of 5.1 per cent.<sup>2</sup>
- By the end of 2014, mobile Internet users had reached 875 million, a 67.8 per cent penetration rate.<sup>3</sup>
- By the end of 2014, the number of mobile phone users rose to 1.3 billion. Subscribers to 4G and 3G reached 97 million and 485 million respectively, with a respective penetration rate of 7.6 per cent and 37.7 per cent. Users of TD-SCDMA/TD-LTE accounted for 57.4 per cent of the total mobile phone users.<sup>4</sup>
- By the end of 2014, average monthly data consumption per subscriber reached 205 megabytes (MB) with a growth rate of 47.1 per cent compared with 2013. Mobile Internet annual traffic consumption grew by 95 per cent and reached 1.8 billion gigabytes (GB).<sup>5</sup>

In 2014, with the massive roll-out of 4G, 989,000 new base stations were deployed, double the number in 2013.<sup>6</sup> The total number of mobile base stations reached 3.4 million. There were 309,000 public wireless access points (Wi-Fi Aps) added, bringing the total number to six million. Total wireless local area network (WLAN) users numbered 16.4 million.<sup>7</sup>

### 'Internet+'

Premier Li Keqiang first outlined the so-called 'Internet+' strategic action plan in his government work report

2 *2014 Operation Bulletin of the Telecommunications Industry*, Ministry of Industry and Information Technology (MIIT), 26<sup>th</sup> January, 2015, viewed 20<sup>th</sup> July, 2015, <<http://www.miit.gov.cn/n11293472/n11293832/n11294132/n12858447/16414615.html>>

3 *Statistical Report on Internet Development in China*, China Internet Network Information Centre (CNNIC), January, 2015, viewed 10<sup>th</sup> June, 2015, <<http://www1.cnnic.cn/IDR/ReportDownloads/201404/U020140417607531610855.pdf>>

4 *2014 Operation Bulletin of the Telecommunications Industry*, MIIT, 26<sup>th</sup> January, 2015, viewed 20<sup>th</sup> July, 2015, <<http://www.miit.gov.cn/n11293472/n11293832/n11294132/n12858447/16414615.html>>

5 Ibid

6 Ibid

7 Ibid





during the 12<sup>th</sup> National People's Congress meeting in March 2015. The plan outlines greater promotion of innovation between the ICT industry and traditional manufacturing industries, through the greater integration of mobile Internet, cloud computing, big data, and Internet of things (IoT) within modern manufacturing sectors. The aim is to foster an integrated ecosystem of e-commerce, industrial Internet and mobile Internet and incubate leading Chinese businesses to prepare them for exploring global markets. It is designed as a new paradigm for innovation-driven development in China. It was also pointed out in Premier Li's report that China has set up an investment fund worth CNY 40 billion to promote new industry innovation and entrepreneurship under the umbrella of 'Internet+'.

The working group fully supports the government's 'Internet +' plan and many of the recommendations in this paper are meant to feed into the plan's development.

#### 4G

The Ministry of Industry and Information Technology (MIIT) issued the fourth generation Time Division Long-Term Evolution (4G TD-LTE or 4G) licences to China Mobile, China Telecom and China Unicom on 4<sup>th</sup> December, 2013, with an overall frequency resource allocation of 210 megahertz (MHz). On 27<sup>th</sup> February, 2015, the Ministry of Industry and Information Technology (MIIT) issued one LTE FDD licence each to China Unicom and China Telecom, after eight months of field trials dating back to June 2014. China is now in full-scale 4G commercialisation. Domestic vendors have acquired the majority of LTE market share in China during the huge 4G network deployment, with all three operators—China Mobile, China Unicom and China Telecom—taking a share.

#### 5G and Government Funding Projects

Increasing attention has been given to 5G research and standardisation activities in China during 2014. The International Mobile Technology- (IMT)-2020 Promotion Group, led by the MIIT and consisting of domestic ICT experts, is leading China's 5G technology definition activities. In 2014, the IMT-2020 Promotion Group issued China 5G white papers, including 5G requirements and a technology overview. China is also actively engaging in global 5G standardisation discussions in the International Telecommunication Union (ITU) and third generation partnership projects

(3GPP). However, the IMT-2020 promotion group still isn't open to wholly foreign-owned enterprises (WFOEs) and foreign-invested enterprises (FIEs).

From 2015 onwards, 5G will become one of the major investment areas and China's national key projects will receive extensive government funding to support R&D of 5G technologies in China. The planned 5G projects aim to put China in a leadership position in the future of global 5G standardisation and commercialisation. The working group has seen some positive developments with regards to foreign participation in China's recent national key projects, which was warmly welcomed by the European ICT industry. Nevertheless the working group would like to further encourage China to fully open the key national projects on a transparent and equal-access basis to European ICT companies, who have had long-term investments and business in China. It could be a win-win for both sides.

#### Standardisation

Standardisation remains a key issue for European players in China's ICT industry. The Chinese State Council published the *Deepening Reform Plan for Standardisation Work* on 26<sup>th</sup> March, 2015,<sup>8</sup> clarifying the necessity and urgency of deepening the current reform effort, specifically with regards to:

- the issue of obsolete standards, and deficient standards that fail to meet the level of quality and efficiency required for economic upgrading;
- the problem of conflicting and overlapping standards, which is not conducive to the establishment of a unified market system;
- the current unreasonable standards system that fails to meet the developmental needs of a socialist market economy; and
- the lack of both coordination and a viable promotion mechanism, which has restricted the improvement of standardisation management performance.

The *Deepening Reform Plan for Standardisation Work's* general requirements state the aim of:

- establishing a new standards system where government-led standards and market-led standards are coordinated and developed cohesively;
- completely unifying coordination and optimising operations to create a standardised management

<sup>8</sup> *Deepening Reform Plan for Standardisation Work*, State Council, 26<sup>th</sup> March, 2015, viewed 31<sup>st</sup> May, 2015, <[http://www.gov.cn/zhengce/content/2015-03/26/content\\_9557.htm](http://www.gov.cn/zhengce/content/2015-03/26/content_9557.htm)>



system that will be co-governed by the government and the market;

- forming a standardisation work structure with government guidance that is market driven; and
- effectively supporting the establishment of a unified market system where standards can be used as 'hard constraints' for quality issues.

The State Council also announced further reform measures to:

- establish a coordination and promotion mechanism for standardisation at the State Council level;
- streamline mandatory standards;
- optimise recommended standards;
- cultivate and develop organisational standards;
- activate and liberate enterprise standards; and
- increase the international level of Chinese standards.

### China's Free Trade Zones (FTZs)

In 2014, China further opened up its value-added telecommunications sector allowing foreign-invested companies to be established in the China (Shanghai) Pilot Free Trade Zone (CSPFTZ). The MIIT and the Shanghai Government jointly introduced new regulations for the CSPFTZ entitled, *Opinions Regarding Further Opening up Value-added Telecom Service Sector Towards Foreign Investments in the China (Shanghai) Pilot Free Trade Zone (Opinions)*.<sup>9</sup> Under the *Opinions*, Internet data centres (IDCs) remain off-limits to foreign companies but the other seven categories—online data processing and e-commerce processing; store-and-forward switching services; voice and video conference call services; information content provider services; home Internet access services; virtual private network services; and app stores—are all open for foreign investment within the CSPFTZ.

In April 2015, three more FTZs were established in Tianjin, Guangzhou and Fujian. It is expected that the 'negative-list' approach, first piloted in the CSPFTZ, will be implemented in these FTZs, in much the same way that it was implemented in the CSPFTZ.

Based on experiences in the CSPFTZ, approval processes have been streamlined making it more convenient and faster to establish a foreign-invested telecommunications enterprise, however, implementing

rules have yet to be issued. Moreover, certain limits on foreign ownership have yet to be abolished for FTZ-established businesses. For example, foreign enterprises are still limited to a 50 per cent ownership cap in the case of domestic Internet virtual private network (VPN) businesses,<sup>10</sup> and cloud computing is still a grey area for foreign enterprises. The working group appreciates the government's intention to implement relaxed regulations within the FTZs (Shanghai, Tianjin, Fujian and Guangdong), and encourages the FTZ administrations to implement bolder trials to further open up the telecoms sector, by speeding up policy-making and further relaxing the telecoms catalogue in FTZs.

Cloud services can be an ideal sub-sector to embrace more international practices, since it is encouraged by the State Council. However, the Internet Data Centre sub-catalogue, as the basis for providing cloud computing services, is still restricted within the CSPFTZ. The working group believes that cloud computing should be treated as an independent sector and international companies engaged in cloud business should not be asked for any licences. On behalf of European ICT businesses, the Information and Communication Technology Working Group would like to see a reform policy issued in this regard, which would allow international businesses to bring their advanced cloud computing technology, enhance technology innovation and bring new cloud business models into the market.

### Foreign Investment Catalogue

The National Development and Reform Commission (NDRC) released a newly revised *Foreign Investment Industrial Guidance Catalogue (Foreign Investment Catalogue)* in March 2015. It is intended to implement some of the experiences gained in the CSPFTZ and open sectors like paper, auto electronics, liquor, e-commerce, finance companies, chain stores, and import/export China Inspection and Quarantine-(CIQ)-related services. This revised draft is another incremental and positive development for foreign business in some, but not all sectors. In the telecoms industry, foreign companies still face significant market entry barriers, especially in terms of licensing. For basic

<sup>9</sup> *Opinions on Further Opening in Telecommunication Industry in Shanghai Free Trade Zone*, MIIT, January, 2014, viewed 30<sup>th</sup> May, 2015, <<http://www.miit.gov.cn/n11293472/n11293832/n12845605/n13916928/16407135.html>>

<sup>10</sup> *Opinions on Further Opening Up Value Added Telecommunications Services to Foreign Investor in China (Shanghai) Pilot Free Trade Zone*, MIIT, 6<sup>th</sup> January 2014, viewed 10<sup>th</sup> July, 2015, <<http://www.miit.gov.cn/n11293472/n11293832/n12843926/n13917072/15821232.html>>



### Third Plenum Reality Check

What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
The <i>China Standardisation Reform Plan</i> was proposed, making reference to improving the standardisation process, membership openness as well as certification processes.	Some positive implementation of the <i>Decision</i> in the workings of the China Communications Standards Association's Technical Committee 8 (CCSA/TC8) which has been opened to foreign JVs. However, a fair and equal opening of all important standards development organisations to WFOEs is yet to be seen.  No details of the implementation of the standardisation reform plan yet.	
National Key Science & Technology R&D infrastructure should be open to the whole industry without exception, if policy allows. Build up new innovation reporting and censoring mechanism and construct open and transparent national research funding management and project evaluation system.	Small positive steps have been taken in ICT-related China National Key Projects to allow limited participation of FIEs by invitation only. The whole system is still opaque and closed to FIEs, therefore full openness and transparency needs to be implemented.	

telecom services, only companies that are less than 49 per cent foreign owned can apply for a basic telecom service licence. For value-added services, companies that are less than 50 per cent foreign invested (with the exception of e-commerce) can apply for VAS licences. However, the WFOE structure only applies for foreign e-commerce companies operating within the CSPFTZ.

On 7<sup>th</sup> May, 2015, the State Council released the *Opinions on Vigorous Development of E-Commerce to Speed up Cultivation of New Economic Drivers*,<sup>11</sup> a guidance to promote the development of the e-commerce industry in China.<sup>12</sup> On 19<sup>th</sup> June, the MIIT released the *Notice on the Opening up of Foreign Investment in the Online Data Processing and Business Processing in E-Commerce*<sup>13</sup> (*Notice*). According to the *Notice*, the e-commerce industry is 100 per cent open for foreign investment in China. The Information and Communication Technology Working Group welcomes the decision and encourages the Chinese authorities to apply the WFOE structure to other business sectors

such as cloud computing.

#### Security-related Regulations

In 2014, the Chinese Government issued a number of regulations and policies to promote the adoption of “secure and controllable” products in China. These include a document jointly released in September, 2014, by the China Banking Regulatory Commission (CBRC), the NDRC, the MIIT and the Ministry of Science and Technology (MOST) to call for the adoption of “secure and controllable” products to reach an average of 75 per cent in the banking sector by 2019. The following implementing rules,<sup>14</sup> jointly released by the CBRC and the MIIT, were subsequently put on hold.

These regulations require all locally-incorporated banks, including European ones, to change their procurement of IT, specifically information security products, towards “secure and controllable” solutions. The criteria by which a product is deemed to be “secure and controllable”, however, discriminate against foreign suppliers of IT products as most products will have to

11 *Opinions on Vigorous Development of E-Commerce to Speed Up Cultivation of New Economic Drivers*, State Council, 7<sup>th</sup> May, 2015, viewed 30<sup>th</sup> May, 2015, <[http://www.gov.cn/xinwen/2015-05/07/content\\_2858541.htm](http://www.gov.cn/xinwen/2015-05/07/content_2858541.htm)>

12 *Ibid*

13 *Notice on the Opening Up of Foreign Investment in the Online Data Processing and Business Processing in E-Commerce*, MIIT, 19<sup>th</sup> June, 2015, viewed 20<sup>th</sup> June, 2015, <<http://www.miit.gov.cn/n11293472/n11293832/n11293907/n11368223/16645347.html>>

14 *The Guidelines on Banks Using Secure and Controllable Information Technology 2014-2015 (CBRC Guidelines)* were promulgated to CBRC branches and local banks—though apparently not to the banks’ IT suppliers — and became effective on 26<sup>th</sup> December, 2014, (Yin Jian Ban Fa [2014] No. 317). The *CBRC Guidelines* are based on the *Guidelines for Applying Secure and Controllable Information Technology to Enhance Banking Industry Cybersecurity and Informatisation Development* (CBRC No. [2014]39) issued on 3<sup>rd</sup> September, 2014.



undergo intrusive testing and certification conducted by state regulators, hold the requisite encryptions licences and establish local R&D and service centres. Suppliers of IT products to banks would furthermore be required to file their products' source code with the CBRC's Department of IT Supervision.

Similar requirements have also been identified in the respective drafts of China's Counter-Terrorism Law, Cyber Security Law (CSL)<sup>15</sup> as well as the already promulgated National Security Law (NSL).<sup>16</sup> They were also referenced—albeit as a lesser concern—in the *Opinions on the Vigorous Development of E-Commerce to Speed up the Cultivation of New Economic Drivers*.

These recent developments make European ICT companies in China concerned about the current ICT ecosystem, including standards, product and market access barriers. The working group encourages the Chinese Government to address the above mentioned issues and to engage in greater dialogue with European industry, to improve EU-China bilateral trade and collaboration.

#### Premier Li Keqiang's call to "Enhance China Internet speed"

China Premier Li Keqiang called upon the whole industry to "enhance China Internet speed" during an economic seminar hosted by the State Council in April 2015. Premier Li Keqiang shared his views openly that current Internet speeds in China are rather slow, and referred to the ITU ranking statistics which place China only 80<sup>th</sup> worldwide. He also pointed out that data usage packages are expensive in China. Premier Li emphasised that ICT infrastructure is an important public service and therefore investment should be reinforced, and he urged the related government departments to investigate how to increase Internet speed and lower data usage charges.

## Key Recommendations

### 1. Develop ICT Standards that Benefit the End-User and the Industry as a Whole

<sup>15</sup> *People's Republic of China (draft) Cyber Security Law*, National People's Congress, 6<sup>th</sup> July, 2015, viewed 24<sup>th</sup> July, 2015, <[http://www.npc.gov.cn/npc/xinwen/lfgz/flca/2015-07/06/content\\_1940614.htm](http://www.npc.gov.cn/npc/xinwen/lfgz/flca/2015-07/06/content_1940614.htm)>

<sup>16</sup> *People's Republic of China National Security Law*, National People's Congress, 1<sup>st</sup> July, 2015, viewed 24<sup>th</sup> July, 2015, <[http://www.npc.gov.cn/npc/xinwen/2015-07/07/content\\_1941161.htm](http://www.npc.gov.cn/npc/xinwen/2015-07/07/content_1941161.htm)>

#### Concern

There are several distinct concerns in the area of standards and certification, specifically with regard to fairness, openness and transparency of the standardisation system and processes – more improvements are needed.

#### Assessment

##### a. Membership and access to ICT standardisation technical committees (TCs) and working groups (WGs)

The working group welcomed the *Deepening Reform Plan for Standardisation Work* issued by the State Council on 26<sup>th</sup> March, 2015, and hopes that the reform plan will make the standardisation system and respective standardisation processes fairer, more transparent and open. Yet as of now there are still concerns in several areas, notably:

- lack of access to and equal membership of certain Chinese standardisation bodies in the ICT sector. For example, IMT-2020 PG for 5G still doesn't allow European companies as members;
- China's mandating of indigenous technology through local standards without global harmonisation, which limits consumer choice without guaranteeing a better quality of experience;
- China's deviation from international standards in the ICT sector, which fragments the global market, adding costs and product time to market for Chinese consumers and industry; and
- inclusion of voluntary standards within mandatory certification schemes, which creates a difficult and opaque regulatory environment and risks circumvention of the World Trade Organisation's Technical Barriers to Trade (WTO/TBT) notification requirements.

The working groups sees the *Deepening Reform Plan for Standardisation Work* as a very positive signal following on from various statements from China's leadership assuring foreign companies that they will be treated as domestic companies in China, as stated in a speech by Chinese Premier Li Keqiang in early 2015, and hopes that the above-mentioned points will be addressed by the competent authorities.

The working group anticipates that the exact implementation details of the *Deepening Reform Plan for Standardisation Work* will soon be released and hopes that the Standardisation Administration of China (SAC) will start accepting WFOEs and FIEs as full



members in all the TCs in China. These clarifications should be published on the SAC website and be disseminated to all standardisation organisations to guide their practices and to ensure that the State Council's reform plan and SAC's policy are respected and executed comprehensively and with fairness.

In 2009, the SAC issued the *National Standardisation Technical Committee Regulations*<sup>17</sup> allowing representatives of entities legally registered in China to participate as voting 'P' members (i.e. full members) in Chinese national standardisation TCs at the discretion of the respective TC Chair.<sup>18</sup> After many years of advocacy efforts the Information and Communications Technology Working Group is pleased to know that TC 8 of the China Communications Standards Association (CCSA) opened full membership to FIEs and awarded WFOEs observer status in spring 2014. This SAC policy has not been fully implemented in most of the standards-setting TCs and WGs in the ICT sector.

All the TCs of the CCSA and the TC 28/E-Book Working Groups claim that a WFOE legally registered in China cannot be a full member, but only an observer, and in the worst case scenario they are not accepted as any type of member. The TC 28 is part of the China National Information Technology Standardisation Committee and reports to the SAC on national standards management. In most cases, WFOEs are admitted only as observers that have no voting rights, with some TCs even requiring WFOEs to pay double or triple the normal full membership fees for observer status only. Furthermore, network and information security-related standardisation work in China remains closed to any type of foreign participation in China. For example, TC 260, the National Information Security Standardisation Technical Committee, which reports to the SAC, is active in information security-related national standards development, such as trust computing and trust environment. Currently TC 260 still prohibits any FIEs or WFOEs from becoming a full member of most of its major WGs.

The Information and Communications Technology Working Group believes that the main reason for such divergence in the practices of certain TCs is the lack of clarity in some of the articles of the *National Standardisation Technical Committee Regulations*. In particular, Article 4.A.2(4), which states that members should also follow "other conditions prescribed by the *Articles of Association of Technical Committees*", leaves room for individual TCs to establish additional conditions to exclude FIEs and WFOEs from full membership.

As the SAC instructs newly-established TCs to follow the *National Standardisation Technical Committee Regulations* in their approval announcement for established TCs,<sup>19</sup> the working group suggests that the SAC considers providing further written clarifications in their policy articles to ensure that all companies legally-registered in China, including FIEs and WFOEs, are permitted to be full members of TCs, without exception, including:

- for Article 4.A (1), regarding the principles for membership of TCs: add written clarification that TCs must provide fair and non-discriminatory treatment to FIEs and WFOEs; and
- for Article 4.A.2 (4), regarding conditions for members of TCs to be composed of entities legally registered within China: add written clarification that this must include FIEs and WFOEs.

#### **b. Harmonisation with international standards**

Global cooperation in standardisation is the key to achieving economies of scale and brings benefits to the end user in the form of affordable, high-quality products that take advantage of technology breakthroughs around the world. A good example has been the development of the 4G LTE standards, for which the working group welcomes China's collaboration and valuable contribution to the development of TD-LTE. However, at present, China's IMT-2020 Promotion Group for 5G is still not open to foreign industry.

The TD-LTE technology is now becoming a reality, not only in China but also globally, demonstrating the positive momentum that a globally-harmonised standard can generate. This momentum needs to be maintained for the smooth evolution of the TD-LTE technology for the next standardisation releases

17 *National Standardisation Technical Committee Regulations*, SAC, 2<sup>nd</sup> February, 2009, viewed 31<sup>st</sup> May, 2015, <[http://www.sac.gov.cn/bzhgl/gnbzh/zyjswyh/gzzd\\_634/201012/120101220\\_64623.htm](http://www.sac.gov.cn/bzhgl/gnbzh/zyjswyh/gzzd_634/201012/120101220_64623.htm)>

18 *The Management Rules of the National Technical Committee*, SAC, 30<sup>th</sup> May, 2009, viewed 20<sup>th</sup> July, 2015, <<http://www.sac.gov.cn/upload/090202/0902020954577410.doc>> and <<http://www.china-cas.org/ydcwyhgl/153.jhtml>>

19 *Reply on the Establishment of the National Standardisation Technical Committee on Road Transport*, 26<sup>th</sup> September, 2011, viewed 10<sup>th</sup> June, 2015, <[http://www.sac.gov.cn/bzhgl/gnbzh/zyjswyh/cl\\_632/201110/120111012\\_98242.htm](http://www.sac.gov.cn/bzhgl/gnbzh/zyjswyh/cl_632/201110/120111012_98242.htm)>



and into a continuation of this global collaboration as global markets move towards fifth generation (5G) technology. It is very important that the market grows in a healthy way in China and globally, as any unbalance at this critical stage of TD-LTE growth may harm the development of global standards. The working group therefore argues for the collaboration of all players in the global market in order to create a healthy ecosystem.

This example should be followed in other areas of ICT standardisation to avoid issues stemming from the fragmentation of the market through the development of local standards. China's participation and collaboration in international standardisation organisations at the earliest possible stage would benefit all stakeholders involved in traditional areas of ICT such as mobile broadband, Wi-Fi and transport networking, but also new areas such as machine-to-machine (M2M) / Internet of Things (IoT), public safety, cloud computing, software-defined networking and network function virtualisation.

To ensure the best user experience, the mandating of specific technologies that only serve the interests of certain companies should be avoided. Technology neutrality is a well-tested and proven concept that guarantees not only the best quality of experience for the end user but also avoids unnecessary economic burdens. It is proven that the market can indicate which technologies are competent enough to give consumers the best solutions. The working group encourages China to avoid such technology mandates to create a stronger market that will ultimately benefit the end user.

### c. Creation of a healthy mobile telecommunications ecosystem

The working group regards the creation of a healthy ecosystem as crucial for the Chinese ICT market. The global harmonisation of TD-LTE standards showed that this can be possible. It is now of the utmost importance that this trend of global collaboration, especially with European organisations, continues with the development of the Chinese 4G telephony market. Creating standards at the global level will not only promote TD-LTE technology on a global scale, but will also feed back into the Chinese market and help in building a healthy ecosystem with equal opportunities and participation for European vendors. If the Chinese market remains restricted to European companies,

there is a great concern that the global momentum to develop TD technology will falter and not cross over into a normal standard-product-market cycle. This may well curtail opportunities in developing future 5G standards and related activities, to which a global collaborative effort can be seen as essential.

### d. Transparency of certification requirements

The working group welcomes the streamlining of certification processes in the China standardisation reform plan. China's mandatory certification requirements for many types of ICT equipment substantially deviate from international norms and remain a key concern for the industry. Current certification procedures are overly complex as there are three independent mandatory certification requirements that measure compatibility and compliance with selected portfolios of standards developed by standards development organisations (SDOs). These certifications are the Radio Type Approval (RTA), Network Access License (NAL) and China Compulsory Certification (CCC). In this respect, the Information and Communication Technology Working Group recommends that China implements a simple, transparent and unified certification scheme that focuses on only testing the core features of products.

Additional information unrelated to testing core product features, such as disclosure of source code and additional software or hardware information, should not be part of certification requirements as these mainly relate to the exact implementation of the standard and specific techniques. Understanding how each company implements the standard does not add to the reliability of the test itself and adds further complications for companies as they are faced with having to disclose sensitive commercial information.

In addition, the selection of standards for inclusion in testing is often not transparent as finished certification requirements for the above three certificates are not provided with sufficient detail in writing. Of utmost concern to industry are the practices of:

- including voluntary, non-WTO/TBT-notified standards in mandatory certification requirements;
- checking for blacklisted technologies and configurations in a non-transparent process; and
- failing to file WTO/TBT notifications for changes in the certification criteria.

Providing clear, written requirements well in advance





of the implementation date and notifying the WTO/TBT committee on the changes of the certification criteria would ensure that the industry has enough time to comply with the new specifications and regulations so as to ensure that no technical barriers to trade would be established. Please also see the Key Recommendation 1 of *Standards and Conformity Assessment Working Group Position Paper*, where this issue is discussed.

#### e. Operating spectrum for greater service efficiency

The working group urges the opening of the ultra-high frequency (UHF) 700MHz band for IMT service in China to enhance 4G ecosystem development. China has launched the nationwide deployment of the 4G network. Opening part of the UHF 700MHz spectrum will facilitate a faster and more economic deployment of LTE networks. In doing this, it is recognised that coverage for new services that LTE can provide is enhanced due to the low frequency propagation features.

It is an increasing global trend for countries to allocate part of their UHF 700MHz spectrum for LTE operation. A harmonised spectrum is the key for the development of public mobile broadband access as well as for the development of the Chinese 4G industry to be able to successfully carry out national strategic goals by providing standardised products globally. Opening the UHF 700MHz band for IMT service in China will promote healthy and sustainable market growth in the LTE industry.

#### Recommendations

- Speed up reforms of the State Council's *Deepening Reform Plan for Standardisation Work*, and make the standardisation process more open and transparent.
- Encourage the practical implementation of the *Deepening Reform Plan for Standardisation Work* in the processes of SDOs with fairness, openness and transparency.
- Guarantee full and equal membership of SDOs for FIEs and WFOEs, including voting rights within all TCs and WGs in China.
- Increase participation and cooperation with the international community on international standardisation initiatives in ICT and harmonise Chinese ICT standards with international standards to increase interoperability.
- Encourage the creation of a healthy eco-system for TD-LTE and 5G by allowing European organisations a fair share of the Chinese market.

- Encourage technology neutrality, ensuring that specific technologies are not unfairly mandated through local standards or other technical requirements.
- Improve the streamlined certification process included in the State Council's *China Standardisation Reform Plan* in such a way that it:
  - clarifies how interested parties can implement it;
  - clarifies to what extent the complex and duplicative ICT equipment certification process will become a simple, transparent and unified certification scheme; and
  - allows foreign-invested licensing and certification agencies to perform desired ICT equipment certification services in China.
- Provide clarification of licensing and certification requirements well in advance of the implementation date, and provide notification under the WTO/TBT Agreement for any standard that is applicable to mandatory certification and market access.
- Avoid testing and certification requirements compelling disclosure of sensitive commercial information and information unrelated to core product features, such as source code and additional software or hardware information.

## 2. Enhance the Efficiency and Effectiveness of China's ICT Services Sector to Provide More Choices at Lower Costs to the Consumer

#### Concern

European access to China's ICT services market lags dramatically behind the access to China's ICT infrastructure, devices and market.

#### Assessment

The Chinese Government's policy of 'informatisation' has transformed communications in China, benefiting Chinese consumers and ICT suppliers alike. While European companies have played an important role in supplying ICT infrastructure, devices and services to China, creating a significant source of employment in China, they have been, by and large, excluded from opportunities in ICT market.

As China's market continues to develop, ICT revenues will increasingly be derived from the supply of services, applications and content. The convergence of the telecommunications, consumer electronics and media





industries is transforming the ICT industry and driving a shift in value away from basic connectivity towards richer forms of services, content and entertainment. These offerings are areas where European companies are well positioned to offer value to China as it seeks, as stated in the *12<sup>th</sup> Five-Year Plan*, to transform culture into a pillar industry by 2016.<sup>20</sup>

#### a. Telecommunications basic services

Although China has been a member of the WTO since 2001, its market is still not open for European and other international companies to access telecommunications business operations and management. The *Circular of the Ministry of Information Industry on the Readjustment of the Classification Catalogue of Telecommunication Services*<sup>21</sup> (*Telecoms Catalogue*) remains very much the same as it has been. For basic telecoms services, only companies that are less than 49 per cent foreign-owned can apply for a basic telecom service licence. Only, companies that are less than 50 per cent foreign invested (with the exception of e-commerce) can apply for VAS licences.

The working group sees two positive changes in the telecom basic service sector through opening up the mobile reselling (also interpreted as mobile virtual network operator (MVNO) business) and the broadband access market by encouraging private participation, in the last two years. The MIIT released the final rules on domestic, private participation in telecommunications reselling trials in May 2013, and the *Notice on Liberalising the Broadband Access Market to Private Capital* (draft) in November 2014.<sup>22</sup>

The telecom reselling rules propose a two-year trial to allow private companies to conduct MVNO services in order to introduce competition in the mobile telecommunications industry. The broadband access liberalisation notice aims to allow privately-owned domestic companies to enter the broadband market and provide broadband connections to customers in 16 trial cities.

20 *The 12<sup>th</sup> Five-Year Plan (2011–2015)*, State Council, 2011, viewed 20<sup>th</sup> June, 2015, <[http://china.org.cn/china/NPC\\_CPPCC\\_2011/2011-03/05/content\\_22059883.htm](http://china.org.cn/china/NPC_CPPCC_2011/2011-03/05/content_22059883.htm)>

21 *Circular of the Ministry of Information Industry on the Readjustment of the Classification Catalogue of Telecommunication Services*, Ministry of Information Industry (now the MIIT), 2003, viewed 15<sup>th</sup> July, 2015, <<http://www.china.com.cn/chinese/PI-c/300857.htm>>

22 *Notice on Liberalising the Broadband Access Market to Private Capital* (draft), 25<sup>th</sup> December, 2014, viewed 30<sup>th</sup> May, 2015, <<http://www.miit.gov.cn/n11293472/n11293832/n12845605/n13916898/16353296.html>>

European ICT companies welcome such a change and would like to bring more international experience and technology to enrich such MVNO and broadband trials. However, the newly-enacted trial policies are still seen to be favouring domestic, privately-owned businesses over FIEs. Foreign companies are still prohibited from direct participation in the MVNO or broadband trials. Experience from various European countries shows that MVNO is a cost-effective solution to increase competition that benefits consumers while limiting the risks and costs associated with the deployment of new networks. And introducing more international broadband providers will bring their experience in international practises to China to stimulate competition and promote Chinese broadband penetration and speed to the next level.

The working group therefore believes that European companies can make major contributions to the development of MVNO and broadband access in China and recommends that the Chinese Government opens up the MVNO business and broadband access market to European participation.

#### b. Value-added services

Foreign ICT enterprises suffer from restricted market access to the VAS market. The VAS licence application process is complicated and local practices are limited by many regulations.

Foreign ICT companies are authorised to form VAS joint ventures (JVs) and are theoretically permitted to take a 50 per cent (with the exception of e-commerce) equity JV stake and share. However, the legal representative of the VAS JV must be a Chinese citizen. These restrictions hinder foreign strategic investment and bring much uncertainty to business operations in China.

Chinese authorities only permit foreign ICT enterprises to provide services based on the *VAS Catalogue* which China agreed on within the WTO, which is more than 10 years old and doesn't suit actual business categories any more. New services should be added or specified in the catalogue.

The e-commerce business is now 100 per cent open to foreign enterprises—both FIEs and WFOEs—in China. In practise however, there are still some restrictions. For instance, in the cross-border, e-commerce sector, foreign companies face difficulties when trying to import





those products into China, this is especially the case with regard to taxation and customs declarations as well as restrictions to cross-border data flow.

Cloud computing—a dynamic industry hotspot for the China ICT market—is by default listed as a VAS with no specific regulations issued on this sector. The sector contains a wide range of service diversity and its service providers are required to apply for different licences in order to run services in the China market. Foreign companies encounter many market barriers, as per licensing requirements.

### c. Joint procurement

Global procurement of ICT infrastructure and terminals by telecommunications operators has become an international trend. Deeper partnerships between Chinese operators and foreign operators on procurement will help China-based providers to familiarise themselves with international practices and gain access to global markets. Moreover, joint procurement could serve to decrease antidumping activities that hinder the further growth of local providers in some markets.

### Recommendations

- Relax the requirements of the *Foreign Investment Industrial Guidance Catalogue (Foreign Investment Catalogue)* with regards to the telecommunication sector, by allowing more foreign participation and easier licensing.
- Further open up the mobile virtual network operator (MVNO) sector and broadband access market to encourage European players to bring more know-how and international practices to the market.
- Update the scope of coverage in the *VAS Catalogue* and allow VAS providers to suggest new services to add to the list as new technologies are developed and allow more foreign capital share in VAS JVs.
- Encourage cross-border, e-commerce business by decreasing cross-border tax and increasing customs declaration efficiency.
- Encourage foreign companies to provide cloud computing services in China.
- Streamline the complex and duplicative VAS licence application process into a simple, transparent and unified scheme for foreign companies.
- Speed up FTZ policy-making and further relax the requirements of the telecoms catalogue in FTZs.
- Facilitate global joint procurement between Chinese and foreign operators to achieve international

expansion for both Chinese and European vendors.

## 3. Encourage Enhanced Innovation and Research that Drives the ICT Industry Forward Through a Global and Cooperative Approach

### Concern

The current status of ICT research cooperation between the European Union (EU) and China is far from optimal and restricts the exploration of great opportunities that would benefit both sides.

### Assessment

#### a. Research cooperation and access to government-funded ICT research projects

The working group recognises and appreciates the Chinese Government's efforts to develop an innovative society. Over the years, foreign ICT investors have made contributions to the local economy, participated in Chinese standards development and conducted dedicated research and R&D activities in China. European ICT investors and operators have developed many patented technologies and their local Chinese presence and teams have been granted intellectual property rights (IPR) to protect these innovations. These patents are registered with the State Intellectual Property Office (SIPO), and they benefit China's indigenous innovation strategies and goals.

The working group welcomes China's progress in opening up R&D funds to FIEs through the Chinese National Significant Science and Technology Project<sup>23</sup> and the 863 Project.<sup>24</sup> However, the process for applying for these funds is still overly burdensome and often requires the disclosure of private information and unnecessary documents. Furthermore, the policy that defines IPR ownership as a prerequisite for applying for R&D funds needs to be further clarified.

Chinese ICT companies have benefited substantially from participation in European research initiatives. One notable example is the latest project of the Mobile and Wireless Communications Enablers for the Twenty-

<sup>23</sup> Circular on 'next-generation broadband wireless mobile communications network' national major science and technology issues to declare 2013 the Year, MIIT, 26<sup>th</sup> April, 2012, viewed 19<sup>th</sup> July, 2015, <<http://www.miit.gov.cn/n11293472/n11295040/n11298163/14567026.html>>

<sup>24</sup> National High-tech R&D Programme (863 Programme), Ministry of Science and Technology, 9<sup>th</sup> October, 2009, viewed 10<sup>th</sup> July, 2015, <[http://www.most.gov.cn/eng/programmes1/200610/t20061009\\_36225.htm](http://www.most.gov.cn/eng/programmes1/200610/t20061009_36225.htm)>



Twenty Information Society (METIS) for the next generation of mobile technology. The working group believes that European companies—especially those with a research base in China—should be given equal access to Chinese research programmes and funds. The working group encourages China to simplify the procedures for participation in funded programmes for European organisations that have R&D investments in China. The working group encourages China to study global best practices, such as the EU's 7<sup>th</sup> *Framework Programme for Research and Technological Development*, and incorporate these practices into its national R&D fund application procedures.

#### b. Indigenous innovation that drives the ICT industry

China's drive for indigenous innovation has seen successful results in China's recent contribution to the development of TD-LTE. This has paved the way for the global next-generation mobile LTE system, which will bring huge benefits to end users around the world. These types of globally-coordinated, indigenous innovation programmes should be encouraged as such global collaboration allows technologies to be comprehensively assessed and harmonised, leading to easier and wider adoption of the technology and standards for solutions that really drive the industry forward.

In contrast, the working group discourages the promotion of unproven, and sometimes low-quality, locally-mandated innovation in the Chinese market through mechanisms such as local standards, and other mandatory measures as outlined in Key Recommendation 1, for the sole purpose of claiming indigenous innovation. Such promotion of inferior quality innovation only benefits the short-term finances of domestic companies that develop the technologies, with end-users ultimately suffering from a poor quality experience. China has proven that it is more than capable of world-class ICT innovation, as acknowledged by peers and discussed in global standardisation organisations.

#### Recommendation

- Encourage greater reciprocity in the field of ICT research and engage in further collaboration with EU organisations with a view to developing mutually beneficial international standards.
- Streamline the application process for foreign companies applying for Chinese ICT R&D programmes by removing unnecessary and overly burdensome

document requirements.

- Focus the build-up of indigenous innovation capabilities on enhancing technological innovation that drives the ICT industry forward and benefits end-users in the long term, rather than delivering short-term benefits for domestic enterprises.
- Encourage the build-up of indigenous innovation capabilities through a global and collaborative innovation approach, where global stakeholders—including academia, government, industry and other experts—communicate and cooperate on international research and standardisation in order to maximise end-user benefits.

## 4. Improve the Business Environment with Regard to Information Security, Data Protection and User Privacy

#### Concern

The restrictions in recent laws and regulations, with specific reference to cyber security and data protection, make China an unattractive investment destination to foreign ICT enterprises.

#### Assessment

In relation to information security, there are growing concerns over the amalgamation of China's national security interests with commercial security interests. This amalgamation has led to the mandating of the use of domestic technologies for commercial information security solutions through initiatives such as the Multi-Level Protection Scheme (MLPS). Such measures do not necessarily guarantee the optimum level of security for commercial businesses in China and we would like to point towards global activities on product security such as Security Assurance Methodology (SECAM) in the Groupe Spéciale Mobile Association (GSMA) and 3GPP. Good collaboration is again the rule for success.

Recently, the working group has witnessed that the government's awareness of cyber security issues has increased. The working group recognises and appreciates the Chinese Government's efforts to develop a safe society. However, there is a tendency that these efforts encourage ICT localisation and restrict the operations of foreign ICT enterprises.

#### Data localisation policy

In accordance with *Notice of the People's Bank of China on Urging Banking Financial Institutions to Do a*



*Good Job in Protecting Personal Financial Information* issued by the People's Bank of China (PBOC) on 3<sup>rd</sup> September, 2014, personal financial information acquired inside China shall be stored, processed and analysed inside China. Unless it is otherwise provided by any law, regulation or the provisions of the PBOC, no banking financial institution may provide personal financial information acquired inside China to any party outside China.

According to China's CTL (draft), Internet service providers and telecom operators who operate in the territory of China must not store relevant equipment and user data of Chinese consumers outside the territory of China. Otherwise, they will be barred from providing the relevant services in China. Similar requirements were also identified in the draft CSL and the already promulgated NSL.

The working group understands that in principle these measures are represented as enhancing cyber security and information protection and these motivations are understandable. However, as a matter of fact, these requirements create a harmful barrier to foreign ICT providers.

A survey of a market research company, International Data Corporation, shows that the investment in ICT in China will surpass EUR 286 billion. European companies have played an important role in supplying ICT infrastructure and devices to China. These above-mentioned policies, if fully implemented, will not only undermine the ability of European companies to participate in the ICT market in China and to serve banks in general—and EU banks in particular—but they will also hurt the development and integration of the Chinese banking sector into the global market.

More importantly, restricting the storage and processing of data within the territory does not equate to enhanced security. Threats can just as easily be domestic as international. In fact, data localisation policies have much potential to be inadvertently counterproductive in achieving cyber security. Storing data in a single location may actually render data more vulnerable to hacking, unforeseen catastrophic loss or other endemic risks. It is the working group's understanding that it is more helpful to focus on how the data is processed, encrypted, stored and maintained rather than forcibly restricting cross-border data flow.

#### a) Provider localisation

On 3<sup>rd</sup> September, 2014, the CBRC—in conjunction with the MIIT—issued the *Guiding Opinions of the China Banking Regulatory Commission on Strengthening the Banking Network Security and Information Technology Construction through the Application of Secure and Controllable Information Technologies (CBRC Guiding Opinions)*, which provides for certain generic requirements in terms of improving banking security. As a follow-up, on 26<sup>th</sup> December, 2014, the CBRC and the MIIT jointly issued the *Guidelines for Promoting the Application of Secure and Controllable Information Technology in Banking Sector (2014–2015) (CBRC Guidelines)* and their annex *Classification Catalogue of Banking Information Technology Assets and Indexes of Security and Controllability (2014–2015) (Classification Catalogue)*, which included a list of product categories in its annex that was not published but merely disseminated to Chinese banks through the CBRC's internal channels. The *Classification Catalogue* lays out further details to facilitate the implementation of the *CBRC Guiding Opinions*.

The *CBRC Guiding Opinions* emphasise secure and controllable technology. They stipulate that by the end of 2019, the usage rate of secure and controllable technology must reach 75 per cent and banks shall allocate at least five per cent of their IT budget on an annual basis for R&D of “secure and controllable” systems.

The *CBRC Guiding Opinions* and the *CBRC Guidelines*, however, do not provide any clarification or guidance on what technology would qualify as “secure and controllable”. There is a reasonable understanding that the Chinese Government might intend to enhance financial security by encouraging the development of national enterprises and constraining the dominant position of foreign enterprises in the market.

Based on the information which has been made public, the *CBRC Guidelines* provide for some controversial requirements. The *CBRC Guidelines* require ICT service providers to file the source code of software used by IT products procured by banks with the CBRC Technology and Information Department. Moreover, registering independent IP rights used in IT products is required, and secure and controllable IT products to the Chinese banking refer to those that have their R&D centres in China.



Although “secure and controllable” is a requirement of both Chinese and foreign enterprises, foreign enterprises may confront many more difficulties in meeting it. Generally, foreign enterprises in China shall not only obey Chinese laws and regulations, but also shall abide by those in their home countries. The above-mentioned requirements may conflict with the laws and regulations in their home countries. The relevant IP rights are another concern.

Therefore, some of the above requirements could be challenging for international companies to accept and will have a huge impact on way they do business in China. Implementing these requirements would unnecessarily restrict the ability of Chinese entities to source the most reliable and secure technologies, which are developed in the global supply chain.

Responding to these concerns, the CBRC published a clarification notice on 12<sup>th</sup> February, 2015, that the solution of how to fulfil source code requirements in the *CBRC Guidelines* is still under study and the solution and procedures will be implemented after hearing the opinions of all parties concerned.

Later, the CBRC and the MIIT jointly stated that the *CBRC Guidelines* will be revised and perfected, after which they will be reissued for implementation. However, the statement is not publicly available yet. The working group appreciates the effort that Chinese Government made to fully hear the opinions of all parties concerned and mitigate the concerns. For further information, please see Key Recommendation 6 of the *Information Security Position Paper 2015/2016*.

#### b) National-security related laws

Requirements for IT service providers to hand over the source code of their encryption systems to Chinese regulators can also be found in the CTL (draft). Internet service providers and telecom operators must report their encryption systems plans for examination and approval by the authorities. The use of encryption systems which have not been reported to the authorities would become illegal. Similar issues also arise from the CSL (draft) and NSL.

It is widely understood that the ‘reporting’ mentioned in the CTL (draft) will include the obligation for ICT suppliers to hand over their encryption keys to the Chinese authorities, which would allow these authorities

to intercept private communications to prevent acts of terrorism, by building in ‘back doors’ for government surveillance. Enterprises worry that this will put their trade secrets in jeopardy and in this way harm the market’s perception of them and their credit rating. Many companies have become reluctant to invest in China and some companies are actively scaling back investment and expansion, and are diverting their spending to other markets.<sup>25</sup>

The Chinese Government believes that this CTL (draft) is in line with the administrative regulations in China and international practices and will not negatively impact technology companies. The working group appreciates this promise and hopes that the Chinese Government will promulgate appropriate rules and procedures to implement the CTL (draft), the CSL (draft), etc. in such a way.

#### c) Transparency

The *Regulation of Commercial Encryption Codes* (CECs) were issued by the State Council on 7<sup>th</sup> October, 1999. The Commercial Encryption Regulations (CERs), released in 2006 and 2007, built upon the CECs by setting out licensing requirements for products that use encryption technology.<sup>26</sup>

The OSCCA's *Year 2000 Clarification* specifies that only products of which the core functionality is encryption will be covered by the CERs.<sup>27</sup> Organisations and individuals who use commercial cipher products or equipment containing techniques of commercial cipher product in China must apply to the OSCCA for permission, except for foreign diplomatic agencies and foreign consul agencies in China.

In practice, this approval procedure is hard to go through. This is therefore an effective prohibition for the production, distribution and sales of encryption products by foreign-owned or foreign-invested enterprises. Restricted access to high-tech cipher products will also prevent Chinese companies from importing advanced

<sup>25</sup> *European Business in China Business Confidence Survey 2015*, European Union Chamber of Commerce in China, June 2015, <<http://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

<sup>26</sup> For a full timeline and more detail on the CERs, please refer to the European Union Chamber of Commerce in China *Information Security Working Group Position Paper 2011/2012*, <[http://www.europeanchamber.com.cn/en/publications-archive/85/Information\\_Security\\_Position\\_Paper\\_2011](http://www.europeanchamber.com.cn/en/publications-archive/85/Information_Security_Position_Paper_2011)>

<sup>27</sup> In March 2000, the OSCCA released the so-called *Year 2000 Clarification: Relevant Questions Regarding Commercial Use Encryption Management*, which clarifies that the OSCCA's 1999 Commercial Encryption Codes only applies to “specialised hardware and software for which encryption and decoding operations are core functions”.



foreign technology so as to strengthen their market competitiveness. For more information, please see Key Recommendation 1 of the *Information Security Position Paper 2015/2016*.

#### Recommendations

- Relax the rigid requirement of storing and processing data within the territory of China and allow more flexibility for cross-border data flows.
- Create a more business-friendly IT environment by either removing the requirement that Internet service providers and telecom operators must submit the source codes and encryption keys for filing with regulators, or by outsourcing this task to trusted, independent, third-party testing labs for verification.
- Improve transparency in relation to making and implementing rules and policies for information security and data privacy and encourage greater stakeholder participation.
- Provide clear guidance on what constitutes “secure and controllable technology” for IT procurement by banks and financial institutions, and remove the tendency of favouring local suppliers of ICT products and services.
- Enhance the reciprocity and cooperation between Chinese and foreign ICT suppliers on information and cyber security and data privacy and simplify the homologation procedures.

### 5. Speed Up Internet Access in Support of Corporate Business Development

#### Concern

The China-wide phenomenon of slow Internet speeds and restrictions on access to legitimate sources of information impedes normal business functions as well as critical functions such as R&D, finance, trade and e-commerce – areas that are crucial to China’s economic growth.

#### Assessment

The working group greatly appreciates the State Council’s decision to increase China’s Internet speeds, to lower prices for Internet services and to further develop China’s national broadband network.<sup>28</sup> This is further proof that China is pursuing innovation-driven growth. Nevertheless, Internet restrictions still remain, and they are hampering the development of China’s

ICT ecosystem.

The *Business Confidence Survey 2015*<sup>29</sup> revealed that 86 per cent of respondents reported a negative effect on their business as a result of certain websites and online tools being blocked, a 15 per cent increase compared to June 2014. Similarly, 80 per cent of respondents have recorded a worsening business impact as a result of the recent further tightening of Internet controls beginning in early 2015. Thirteen per cent of respondents have recently deferred R&D investment or have become unwilling to set up R&D operations in China since Internet restrictions were tightened in early 2015. The tight controls can choke business growth and stifle investment in technology and R&D – areas which are crucial for China’s development. The working group hopes that the Chinese Government can ensure that Internet supervision does not hamper legitimate, value-added commercial activity.

Internet speeds are slowed down due to the massive apparatus that China uses to carry out its content filtering efforts, and lack of interoperability between the local Internet providers. Large amounts of perfectly legitimate content falls by the wayside as collateral. This has in recent years rendered usage of some search engines impossible, tools that are necessary to undertake research for virtually any business.

Such restrictions have a deeply negative effect on the ability of businesses to undertake research, conduct e-commerce transactions or even divert business from online vendors, due to the long loading times of websites. They fundamentally impact companies’ productivity and ease of conducting business, and they also hamper China’s ability to attract and retain global R&D talent. Technically speaking, advanced technology and access to information play an essential role in R&D in certain areas of China. Low network connection speeds can influence the flow of information and companies are unable to react efficiently as a result.

Poor broadband penetration is also considered an obstacle to conducting business in China. Broadband

28 *Guideline to improve Internet speed, lower prices*, State Council, 20<sup>th</sup> May, 2015, viewed 30<sup>th</sup> May, 2015, <[http://english.gov.cn/policies/latest\\_releases/2015/05/20/content\\_281475111283130.htm](http://english.gov.cn/policies/latest_releases/2015/05/20/content_281475111283130.htm)>

29 *Internet Restrictions Increasingly Harmful to Business, say European Companies in China*, European Union Chamber of Commerce in China, 12<sup>th</sup> February, 2015, viewed 10<sup>th</sup> May, 2015, <[http://www.eurochamber.com.cn/en/press-releases/2235/internet\\_restrictions\\_increasingly\\_harmful\\_to\\_business\\_say\\_european\\_companies\\_in\\_china](http://www.eurochamber.com.cn/en/press-releases/2235/internet_restrictions_increasingly_harmful_to_business_say_european_companies_in_china)>



has been dubbed an “enabler of changes”,<sup>30</sup> as high rates of broadband access translate into a tangible impact on economic productivity and restructuring, in combination with other ICT.<sup>31</sup> Slow Internet connection speeds and comparatively low broadband penetration are strong disincentives for highly-courted software companies to undertake investment or relocate R&D capabilities to places such as Beijing’s Zhongguancun. The lack of an affordable, reliable and quick Internet connection adversely affects business operations. In this technological era the Internet, via both wired and wireless connections, is a necessary tool that influences all organisations’ efficiency and eventually their bottom line.

### Recommendations

- Improve communication services support to corporate business intranets, especially for foreign enterprises in China.
- Upgrade network infrastructure premises to meet the growing corporate need for high-speed global Internet access in support of sustainable business development in China.
- Maintain stable access to global legitimate Internet resources critical for corporate business development.

### Abbreviations

3GPP	Third Generation Partnership Project
4G	Fourth Generation
5G	Fifth Generation
CBRC	China Banking Regulatory Commission
CCC	China Compulsory Certification
CCSA	China Communications Standards Association
CEC	Commercial Encryption Codes
CERs	Commercial Encryption Regulations
CSL	Cyber Security Law
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
CTL	Counter-terrorism Law
EU	European Union
EUR	Euro
FIE	Foreign-Invested Enterprise
FTZ	Free Trade Zone
FYP	Five-Year Plan

GB	Gigabytes
GSMA	Groupe Spéciale Mobile Association
IDC	Internet Data Centre
IMT	International Mobile Telecommunications
IPR	Intellectual Property Rights
ISP	Internet Service Provider
ITU	International Telecommunications Union
IMT-2020	International Mobile Technology-(IMT)-2020 Promotion Group,
IoT	Internet of Things
JV	Joint Venture
M2M	Machine to Machine
METIS	Mobile and Wireless Communications Enablers for the Twenty-Twenty Information Society
MIIT	Ministry of Industry and Information Technology
MLPS	Multi-Level Protection Scheme
MOST	Ministry of Science and Technology
MVNO	Mobile Virtual Network Operator
NAL	Network Access License
NDRC	National Development and Reform Commission
NSL	National Security Law
OSCCA	Office of the State for Commercial Cypher Administration
PBoC	People’s Bank of China
R&D	Research and Development
RTA	Radio Type Approval
SAC	Standardisation Administration of China
SDO	Standards Development Organisations
SECAM	Security Assurance Methodology
SHFTZ	Shanghai Free Trade Zone
SIPO	State Intellectual Property Office
TC	Technical Committee
TD-LTE	Time Division Long Term Evolution
UHF	Ultra High Frequency
VAS	Value-added Service
VPN	Virtual Private Network
WFOE	Wholly Foreign-Owned Enterprise
Wi-Fi Aps	Wireless Access Points
WLAN	Wireless Local Area Network
WTO	World Trade Organisation
WTO/TBT	World Trade Organisation Technical Barriers to Trade committee
ZUC	Zuchongzhi

30 *Broadband and the Economy*, OECD, 2007, viewed 10<sup>th</sup> June, 2015, <<http://www.oecd.org/internet/ieconomy/40781696.pdf>>

31 *Impact of Broadband on the Economy*, ITU, April 2012, viewed 10<sup>th</sup> July, 2015, <[http://www.itu.int/ITU-D/treg/broadband/ITU-BB-Reports\\_Impact-of-Broadband-on-the-Economy.pdf](http://www.itu.int/ITU-D/treg/broadband/ITU-BB-Reports_Impact-of-Broadband-on-the-Economy.pdf)>



## Information Security Working Group

### Key Recommendations

- ▶ **1. Release Revised Commercial Encryption Regulations (CERs)**
  - Engage in a timely and meaningful consultation process with all relevant stakeholders well in advance of the publication of the revised *Commercial Encryption Regulations* (CERs).
  - Revise the CERs in such a way that they:
    - do not regulate products with cryptographic capabilities that are, or will be, widely available and deployed – whether as a result of sales through normal or common retail channels, original equipment manufacturer (OEM) sales or other means of distribution; and
    - are non-discriminatory towards business, imports, operations or market access of foreign-invested enterprises (FIEs) and in line with international regulations, specifically the World Trade Organisation's *Technical Barriers to Trade Agreement* (WTO/TBT) and the WTO's *Government Procurement Agreement* (WTO/GPA)<sup>1</sup> and international best practices.<sup>2</sup>
  - Allow FIEs to obtain licences for commercial information security products.
  
- 2. Align Domestic Standards and Algorithms with International Norms**
  - Align domestic standards and algorithms with international standards and best practices.<sup>3</sup>
  - Make information accessible to all interested parties, i.e. China's National Algorithms and all related, relevant information should be disclosed publicly and available for anyone, including FIEs, to implement.
  - Allow interested parties to participate in security-related technical and standardisation committees.
  
- ▶ **3. Remove the Discriminatory Procurement Restrictions of the Multi-level Protection Scheme (MLPS)**
  - Remove discriminatory procurement restrictions of the Multi-Level Protection Scheme (MLPS).
  - Do not restrict or regulate the procurement of products with cryptographic capabilities except in narrow and justifiable circumstances.
  - Delineate clearly between commercial and military uses of encryption products.
  - Join/follow the WTO/GPA.
  - Allow FIEs to participate in indigenous innovation programmes.
  
- ▶ **4. Allow Independent Centres to Conduct Testing and Certification**
  - Allow independent, non state-owned laboratories to conduct testing and certification.
  - Ensure protection and non-disclosure of intellectual property (IP).
  - Acknowledge certificates of other internationally-recognised test laboratories and consider them to be sufficient in fulfilling Chinese testing requirements.
  - Safeguard and ensure an open and published procedure for the accreditation of independent laboratories is put in place.

<sup>1</sup> It should be noted that China has not acceded to the WTO/GPA yet.

<sup>2</sup> "International best practices" refers specifically to the 14<sup>th</sup> and 15<sup>th</sup> *World Semiconductor Council Joint Statements, Joint Statement of the 14<sup>th</sup> Meeting of the World Semiconductor Council*, 27<sup>th</sup> May, 2010, viewed 29<sup>th</sup> June, 2014, <[http://www.semiconductorcouncil.org/wsc/uploads/seoul\\_2010.pdf](http://www.semiconductorcouncil.org/wsc/uploads/seoul_2010.pdf)> and *Joint Statement of the 15<sup>th</sup> Meeting of the World Semiconductor Council*, 26<sup>th</sup> May, 2011, viewed 29<sup>th</sup> June, 2014, <[http://www.semiconductorcouncil.org/wsc/uploads/WSC\\_2011\\_Joint\\_Statement.pdf](http://www.semiconductorcouncil.org/wsc/uploads/WSC_2011_Joint_Statement.pdf)>.

<sup>3</sup> Ibid



## 5. Increase the Participation of Chinese Institutions Within International Dialogues

- Engage more actively in dialogues and/or workshops as well as standardisation bodies and international agreements with European counterparts to promote cooperation and the removal of barriers.
- Engage in technical cooperation with European and other global stakeholders in industry, government and academia.
- Allow FIEs to participate as equal partners in all information security-related standardisation technical committees in order to assist with the development of the most advanced and robust algorithms for use in China's commercial encryption sector.

## 6. Prevent the Implementation of Regulations Referring to ITC Security or Controllability Which Would Result in the Requirement to Purchase Domestic Technology or Other Local Content Requirements and Allow for Timely and Due Consultation with Relevant International Stakeholders

- Publish in a timely fashion any forthcoming implementation guidelines in adherence with China's WTO/TBT commitments and allow foreign industry and other relevant stakeholders to comment.

 Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.

## Introduction to the Working Group

The European Chamber's Information Security Working Group was established in 2009, to support the regulatory, information and advocacy needs of European Chamber members in the smart card and semiconductor industries. Members in these industries face an increasingly complex and inhospitable regulatory environment that risks severely curtailing their business activities and future investments. The Chinese Government's approach to encryption regulation differs markedly from the international norm by handling encryption as a unified concept encompassing commercial and state security applications. The lack of distinction between different levels and applications of encryption has also led to it being handled as a priority by the Chinese leadership.<sup>4</sup>

The overarching regulatory and certification framework for information security products and technologies in China, the *Commercial Encryption Regulations (CERs)*, are still under revision, and—to the best of the working group's knowledge—have been so since 2010.

<sup>4</sup> Encryption in China is regulated by the State Encryption Management Bureau (SEMB) and the Communist Party of China (CPC) Central Cryptography Administration Authority (CCAA) which report directly to the State Council and the Central Committee of the CPC, respectively. The Office of the State Commercial Cypher Administration (OSCCA) is a subordinate organisation to the SEMB and the CCAA and is responsible for policy execution. As such, OSSCA is industry's principle interlocutor on encryption matters.

## Market Developments

According to Information Security Working Group estimates, the Chinese market for information security could be in the order of over euro (EUR) 13 billion annually. The market will continue to grow over the coming years, driven by strategically important developments such as the Internet of Things (IoT), smart grids and cloud computing. The annual market for smart cards and directly-related products is estimated to be EUR 3 billion alone.



## Regulatory Developments

The OSSCA issued a call for comments in February 2014, with regards to moving some of the items in its catalogue from an 'administrative approval' procedure to a simple filing procedure.<sup>5</sup> The notice was promulgated as per the requirements of the State Council, which has asked all agencies in China to review their administrative licensing schemes and eliminate those that are either unnecessary or that negatively impact China's economic development. The Information Security Working Group regards this call for comments, as well as China's overall administrative approval reform, as positive. The working group furthermore believes that a reduction of OSSCA administrative approvals would be beneficial for FIEs and Chinese

<sup>5</sup> OSSCA Notice of Public Administrative Examination and Approval Catalogue, OSSCA, 16<sup>th</sup> February, 2014, viewed 20<sup>th</sup> March, 2014, <[http://www.oscca.gov.cn/News/201402/News\\_1261.htm](http://www.oscca.gov.cn/News/201402/News_1261.htm)>



### Third Plenum Reality Check

What did the Third Plenum's Decision <sup>6</sup> say?	What is the reality?	Status
Adherence to 'rule of law'  Article 2: "We must ... govern the country according to the rule of law."	The China Banking Regulatory Committee's (CBRC's) <i>Guidelines on the Application of Secure and Controllable Information Technology to Strengthen Banking Industry Network Security and Informatisation (CBRC Guidelines)</i> were never published and stakeholders were not given the opportunity to comment, as rule of law would dictate. This is particularly significant for the industry, as the <i>CBRC Guidelines'</i> emphasis on products being "secure and controllable" could serve to severely curtail access to the Chinese market to foreign producers.	
	The OSCCA's <i>Year 2000 Clarification: Relevant Questions Regarding Commercial Use Encryption Management, (Year 2000 Clarification)</i> <sup>7</sup> states that only products of which the <i>core function</i> is encryption are under the jurisdiction of the OSCCA's <i>CERs</i> . It is at present unclear whether the <i>Year 2000 Clarification</i> is still adhered to, yet rule of law dictates that any regulation needs to be formally repealed in order to be no longer applicable by law.	

companies as well as the overall information technology market development in China.

China's State Council Internet Information Office (SCIIO)—now known as the Cyberspace Administration of China—announced on 22<sup>nd</sup> May, 2014, that a "network security screening regime" would be established in the near future for all IT companies operating in China, a move that could put foreign IT product and service providers at a significant disadvantage in the Chinese marketplace.<sup>8</sup> The state-run *People's Daily* stated that the vetting process would focus on the "security and controllability"<sup>9</sup> of products and services used for

government procurement and critical industries "related to national security and the public interest",<sup>10</sup> including communications, transportation, finance, and energy. The system is intended to "prevent product suppliers from illegally controlling, interfering in or interrupting user systems, or illegally collecting, storing, handling or exploiting user information."<sup>11</sup> The review itself would include a testing and certification process, ongoing monitoring and administrative punishment. According to the report, any company, product or service that fails the test would be excluded from the Chinese market. The working group regards this development with great concern, especially in light of recent developments, such as the attempt to promulgate regulations regarding the procurement of IT products in the Chinese banking sector (see Key Recommendation 6), and the drafting of China's Counter-terrorism Law (CTL) and Cyber Security Law, and the promulgation of the National Security Law (NSL). All of these policy initiatives referred to the security and controllability of products.

6 The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.

7 In March 2000, the OSCCA released the so-called 'Year 2000 Clarification: *Relevant Questions Regarding Commercial Use Encryption Management*, which clarifies that the OSCCA's 1999 Commercial Encryption Codes only apply to "specialised hardware and software for which encryption and decoding operations are core functions".

8 *China's cyber move in the right direction*, *China Daily*, 24<sup>th</sup> May, 2014, Beijing, viewed 24<sup>th</sup> May, 2014. <[http://usa.chinadaily.com.cn/business/2014-05/24/content\\_17538783.htm](http://usa.chinadaily.com.cn/business/2014-05/24/content_17538783.htm)>

9 *Internet Security Review is in Response to the Current Situation*, *People's Daily*, 23<sup>rd</sup> May, 2014, viewed 27<sup>th</sup> May, 2014, <<http://politics.people.com.cn/n/2014/0523/c1001-25053486.html>>

10 Ibid

11 Ibid



On 19<sup>th</sup> May, 2014, the National Development and Reform Commission (NDRC) and the People's Bank of China (PBOC) officially announced that the algorithm for mobile payments will be one of the existing series of *Shangyong Mima* (SMx) national algorithms,<sup>12</sup> but which of the national algorithms will be selected will be dependent on the application environment.<sup>13</sup> The working group is concerned about this development as the requirement to use a particular national algorithm could potentially work to effectively exclude FIEs from offering their products and solutions in the Chinese mobile payments sector.

## Key Recommendations

### 1. Release Revised Commercial Encryption Regulations (CERs)

#### Concern

The current CERs effectively exclude FIEs from some areas of the Chinese market, including some product markets in which they had been active for a considerable amount of time.

#### Assessment

The CERs constitute the overarching regulatory and certification framework for information security products and technologies in China. They date back 15 years to 1999, when the State Council issued the *Regulation of Commercial Encryption Codes* (CECs), which clearly stated that foreign companies could not, among other things, sell products with commercial encryption technology in China. The CERs, released in 2006 and 2007, built upon the CECs by setting out licensing requirements for products that use encryption technology.<sup>14</sup>

The OSCCA's *Year 2000 Clarification* specifies that only products of which the core functionality is encryption will be covered by the CECs.<sup>15</sup> In granting an encryption

testing licence to a foreign manufacturer for a smart card for the first time in 2012,<sup>16</sup> the OSCCA itself seemed to correctly acknowledge that the core function of smart cards is not encryption. It should also be noted that cryptographic functionality is also not the primary or core function of integrated circuit chips. Chips provide various functionalities, with a portion of the chip area used for cryptographic functionality generally ranging from below one to 13 per cent. This can be contrasted to the approximate 35 to 55 per cent of chip space consumed by memory functions and the 15 to 20 per cent of area given to logic functionality. Therefore, according to the OSCCA's own regulations, neither smart cards nor integrated circuit (IC) chips intended for smart cards should be covered by the OSCCA's encryption regulations because encryption is not the core function of both products.

The inability of European semiconductor manufacturers to gain relevant encryption licensing may be explained by the OSCCA no longer internally applying the *Year 2000 Clarification*. The working group hopes that this is not the case. The *Year 2000 Clarification* is an important rule that, if properly followed, should serve to limit the scope of coverage of the CERs and therefore safeguard legitimate access to the Chinese marketplace for European smart card and semiconductor manufacturers. While the working group would strongly oppose a repeal of the *Year 2000 Clarification*, it is still important to note that rule of law dictates that any formally-adopted regulations or notices must be formally repealed in order to stop being applicable by law. Therefore, by Chinese law, the *Year 2000 Clarification* should continue to be applied.<sup>17</sup>

The OSCCA, an organisation that reports directly to both the State Council and the Central Committee of the Communist Party of China, is tasked with regulating encryption in China, which is reflective of China's handling of encryption as a unified concept encompassing commercial and state security applications.

The process to revise the CERs is still ongoing. During a meeting with the State Council Legislative Affairs

<sup>12</sup> The *Shangyong Mima* series of algorithms includes approximately 10 distinct algorithms. In the literature these are commonly referred to as 'SMx', where the 'x' is a placeholder for the individual number of the algorithm, e.g. SM1, SM2, etc.

<sup>13</sup> *Circular on financial technology in mobile e-commerce service innovation pilot work*, National Development and Reform Commission, 2014, viewed 20<sup>th</sup> May 2014, <[http://www.sdpc.gov.cn/zcfb/zcfbtz/201405/t20140528\\_613258.html](http://www.sdpc.gov.cn/zcfb/zcfbtz/201405/t20140528_613258.html)>

<sup>14</sup> For a full timeline and more detail on the CERs, please refer to the European Union Chamber of Commerce in China's *Information Security Position Paper 2011/2012*, <[http://www.europeanchamber.com.cn/en/publications-archive/85/Information\\_Security\\_Position\\_Paper\\_2011](http://www.europeanchamber.com.cn/en/publications-archive/85/Information_Security_Position_Paper_2011)>

<sup>15</sup> In March 2000, the OSCCA released the so-called *Year 2000 Clarification: Relevant Questions Regarding Commercial Use Encryption Management*, which clarifies that the OSCCA's 1999 Commercial Encryption Codes only apply to "specialised hardware and software for which encryption and decoding operations are core functions".

<sup>16</sup> *Information Security Position Paper 2014/2015*, European Union Chamber of Commerce in China, 2014, [http://www.europeanchamber.com.cn/en/publications-archive/298/Information\\_Security\\_Position\\_Paper\\_2014\\_2015](http://www.europeanchamber.com.cn/en/publications-archive/298/Information_Security_Position_Paper_2014_2015)

<sup>17</sup> In a meeting with the United States Information Technology Office (USITO) on 10<sup>th</sup> December, 2009, the OSCCA itself confirmed that the *Year 2000 Clarification* has never changed, and will continue to be effective.



Office (SCLAO) in December 2014, the working group was informed that the CERs now have a tier II status (tier I pending) – this could potentially lead to the revised CERs finally being released in the fourth quarter of 2015 or early 2016.<sup>18</sup>

Under the CERs, FIEs are barred from obtaining licences to sell, produce and carry out research and development (R&D) for encryption technology, as well as to gain the product type licence from the OSCCA, as only applications from companies with a majority Chinese stake have been accepted. Indeed, of all the 1,202 products to have gained the OSCCA product licensing, all of the companies developing these products are Chinese domestic companies.<sup>19</sup> Likewise, all of the 687 companies to have been granted a sales licence are Chinese domestic companies.<sup>20&21</sup>

Enforcement of the CERs remains selective and opaque, with most commercial contracts remaining accessible. However, by simply requiring procuring agencies to demand that suppliers have Chinese encryption licences, China's CERs effectively allow for the situation whereby foreign companies' market access could be cut off practically instantaneously for various encryption products that they are currently being sold in the Chinese marketplace.

The European Commission has identified this information security issue as a key market access barrier with China, alongside less than a dozen other sectoral and horizontal investment issues. Europe believes in open markets and remains resolutely open to investment. Chinese companies gain all required licences or authorisations, if any are required, in Europe to manufacture and sell commercial encryption products in

EU Member States. As such, the issue of China's CERs should be taken up during the negotiations for the EU-China Comprehensive Agreement on Investment (CAI).

In turn, the multilateral rules of the WTO that have served to propel China's economic growth over the last decade require China to take various actions related to the revision and implementation of the CERs:

- In terms of the revision process, as a technical regulation,<sup>22</sup> China is obligated to ensure that the CERs are non-discriminatory and "shall not be more trade-restrictive than necessary to fulfil a legitimate objective".<sup>23</sup> In addition, China is also obliged to notify all technical regulations not based on international standards that have a significant impact on trade to the WTO/TBT Committee.<sup>24</sup>
- In terms of implementation of the regulation, China's central government is required to ensure that conformity assessment procedures<sup>25</sup> grant access for suppliers of like products from other WTO members no less favourable than those conditions accorded to suppliers from China, including a supplier's right to an assessment of conformity under the rules of the procedure. Furthermore, China must ensure that each applicant must be given information necessary to assess conformity and that the standard processing period of each conformity assessment procedure be published; or that the anticipated processing period is communicated to the applicant upon request.<sup>26</sup> However, the OSCCA has never released such information to foreign suppliers of commercial encryption products. Moreover, the OSCCA does not even accept applications from FIEs for conformity assessment to the commercial

18 The tier status is related to the prioritisation of the regulation. In the Information Security Working Group's understanding, a tier I regulation has the highest priority and should therefore be released in that calendar year, whereas a tier III regulation is regarded as less of a priority for the calendar year and is therefore likely to be delayed until the following year for formal promulgation.

19 *List of General Commercial Encryption Products*, Office of the State Commercial Cypher Administration, viewed on 28<sup>th</sup> February, 2015, <[http://www.oscca.gov.cn/News/201110/News\\_1202.htm](http://www.oscca.gov.cn/News/201110/News_1202.htm)>

20 *List of Companies with Commercial Encryption Sales Licences*, Office of the State Commercial Cypher Administration, 31<sup>st</sup> May, 2014, viewed 22<sup>nd</sup> May, 2015, <[http://www.oscca.gov.cn/News/201110/News\\_1123.htm](http://www.oscca.gov.cn/News/201110/News_1123.htm)>

21 Although FIEs can obtain an import licence this does not provide access to the Chinese market as the import licence can only be used for an import item which will remain within the importing company and which needs to be re-exported after use, testing or processing. The import licence requirements are burdensome, in particular because the import licence obtained is for a single shipment and is held by the OSCCA. This practice creates significant uncertainty for international business, as well as additional costs as any delay in the application procedure affects down-stream activities.

22 The WTO/TBT states that a technical regulation is a document which lays down product characteristics or its related processes and production methods, including the applicable administrative provisions with which compliance is mandatory, <[https://www.wto.org/english/docs\\_e/legal\\_e/17-tbt\\_e.htm](https://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm)>

23 *WTO/TBT*, WTO, 1995, Article 2.2, viewed 8<sup>th</sup> July, 2015, <[https://www.wto.org/english/docs\\_e/legal\\_e/17-tbt\\_e.htm](https://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm)>

24 In accordance with Article 2.9 of the WTO/TBT <[https://www.wto.org/english/docs\\_e/legal\\_e/17-tbt\\_e.htm](https://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm)>, China is obliged to notify all technical regulations whenever a relevant international standard does not exist or the technical content of a proposed technical regulation is not in accordance with the technical content of relevant international standards, and if the technical regulation may have a significant effect on trade. This notification should be carried out at an "early draft stage" so that comments made by WTO members can be taken into account before a draft is adopted. The notification should thus provide in principle at least 60 days for WTO members' comments and, once adopted, the implementation date should be no sooner than six months, unless not possible for specific grounds of urgency.

25 Annex 1 of the WTO/TBT states that conformity assessment procedures are any procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled. As an explanatory note, the WTO/TBT states that conformity assessment procedures include, *inter alia*, procedures for sampling, testing and inspection; evaluation, verification and assurance of conformity; registration, accreditation and approval as well as their combinations.

26 WTO/TBT Articles 5.1 to 5.3.



encryption regulations, nor does the OSCCA explain in writing why it does not accept licence applications from FIEs. The OSCCA categorises the national algorithms that are frequently and increasingly required for access to the market as state secrets and therefore does not publicly release many of the algorithms or allow foreign companies to implement the algorithms in encryption products.

Although Europe remains open to Chinese companies operating in such fields and has so far resisted calls to close markets owing to such concerns, there is the real risk that such calls and related fears will grow and escalate if China does not become more open and transparent, including in terms of reciprocal access to its own markets in information security and related fields.

#### Recommendations

- Engage in a timely and meaningful consultation process with all relevant stakeholders well in advance of the publication of revised CERs.
- Revise the CERs in such a way that they:
  - do not regulate products with cryptographic capabilities that are, or will be, widely available and deployed—whether as a result of sales through normal or common retail channels, OEM sales or other means of distribution; and
  - are non-discriminatory towards business, imports, operations or market access of FIEs and in line with international regulations, specifically the WTO/TBT and WTO/GPA and international best practices.
- Allow FIEs to obtain licences for commercial information security products.

## 2. Align Domestic Standards and Algorithms with International Norms

#### Concern

There has been a trend in recent years towards an increasing implementation of indigenous national algorithms that are defined in closed processes and that have not undergone peer review in international standardisation organisations. Foreign-invested enterprises are often pushed out of the market when national algorithms are implemented, either because the standards are kept as state secrets or because approval is not granted for foreign companies to implement the algorithms and to gain certification.

#### Assessment

The Ministry of Industry and Information Technology's (MIIT's) *12<sup>th</sup> Five-Year Plan for the Development of the Information Security Industry*<sup>27</sup> sets out industrial policies to promote the development of an indigenous information security industry in the mistaken belief that China should stop utilising foreign information security products in order to protect national security. These discriminatory industrial policies include the government procurement of domestic products,<sup>28</sup> national and local fiscal funding schemes that are only accessible to domestic firms and the formulation of domestic national standards, including national algorithms.

These national algorithms are formulated in a closed process and are usually regarded as state secrets. With the exception of the Zu Chongzhi (ZUC) 4G time division (TD) long-term evolution (LTE) algorithm that was submitted to the third generation partnership project (3GPP) and accepted as a voluntary international standard in September 2011, none of the additional nine national algorithms have been peer reviewed at an international level.<sup>29</sup> This poses potentially great security risks for China's information security systems, including much of China's critical infrastructure where these national algorithms are implemented. It is not possible to assure the robustness of China's national algorithms without rigorous scrutiny at an international level where all the leading global actors come together using the globally most advanced methods and techniques to test resistance of the standards to attack. Without this rigorous level of testing, there is a real risk that the strength of China's information security solutions will fall behind the rest of the world. Therefore, such an isolationist policy intended to promote information security will, conversely, likely serve to threaten the security of the systems that it intends to protect.

There have, however, been some positive steps taken towards disclosing a number of national algorithms. Following the public disclosure of the SM2 and SM3 national algorithms in 2010, the SM4 algorithm was

27 *12<sup>th</sup> Five-Year Plan for the Development of the Information Security Industry*, MIIT, 2011, viewed 8<sup>th</sup> July, 2015, <[http://www.gov.cn/gzdt/2011-12/08/content\\_2014739.htm](http://www.gov.cn/gzdt/2011-12/08/content_2014739.htm)>

28 This is in spite of the fact that the State Council issued a notice in November 2011, which directs all government entities to remove any mention of linkages between indigenous innovation policy and government procurement incentive measures within regulatory documents and to stop such implementation by 1<sup>st</sup> December, 2011.

29 It is the understanding of the Information Security Working Group that there are ten national encryption algorithms, although this figure may be inaccurate because the OSCCA has not disclosed any information on Chinese national encryption algorithms other than for the four algorithms which have been fully publicly released.



also released as a new *Guojia Mima Tuijian* (GM/T)<sup>30</sup> standard, meaning that four of the ten national algorithms are publicly available.

The rationale for publicly opening these standards is unknown. Despite the measure to open these three SM series national algorithms, an FIE has yet to be certified by the OSCCA in China to implement these algorithms. Even where the OSCCA product type certification may not be required by the procuring agencies issuing tenders for commercial encryption products, it may still be impossible for some foreign firms to sell cryptographic products where national algorithms are required. This is because Chinese testing agencies in different sectors may require OSCCA approval before even being able to perform application-level or hardware security algorithm testing for conformity assessment.

In alignment with the mistaken belief put forward in the MIIT's 12<sup>th</sup> FYP that national security can be improved by developing and mandating domestic indigenous standards and algorithms, a trend had been initiated to extend the implementation of national algorithms in a number of information security products.

A marketplace where a requirement to use a particular national algorithm could potentially work to effectively exclude FIEs in mobile payments. In January 2012, the China National Information Technology Standardisation (NITS) committee released a draft *National Standard for Mobile Payments*. The standardisation process was closed to FIEs. Although many FIEs are members of the Multi-Functional Smart Card Alliance (MFSCA) which drafted the standard, these FIE members were left out of the drafting process.<sup>31</sup> On 19<sup>th</sup> May, 2014, the NDRC and the PBOC officially announced that the algorithm for mobile payments will be one of the existing SMx national algorithms,<sup>32</sup> but which of the national algorithms will be selected will be dependent on the application environment. Without knowing the

algorithm, it is impossible for any FIE to comply with the standard and therefore access the mobile payments market. Mobile payments is clearly an example of a purely commercial application and does not affect state security. The encryption required for safe and secure mobile payments is not the core function of the product, meaning its core commercial functionality. In this regard, the production of mobile payment products should be open equally to both domestic Chinese companies and FIEs.

#### Case Study: People's Bank of China Banking Integrated Circuit Card Specifications (PBOC3.0)

The PBOC formally promulgated PBOC3.0 specifications on 7<sup>th</sup> February, 2013. These specifications allow the chip card technology of Chinese bank payment cards to run on two dual systems of algorithms (PBOC and EMV). The PBOC algorithms include three Chinese SM series algorithms (SM2, SM3 and SM4) developed by the OSCCA. The PBOC standards are very similar to the EMV (Europay, MasterCard, Visa) global standards for credit and debit payment cards based on chip card technology that were developed within the EMVCo.<sup>33</sup> These algorithms can be used in various industries and applications and are being positioned by the PBOC as indigenous Chinese IC card payment standards.

To implement the PBOC3.0 specifications, China's current payment eco-system needs to be upgraded to include the PBOC Chinese national SM series algorithms in addition to the EMV standards. Implementing the SM series algorithms will require an update or upgrade to all the front-end, point-of-sale (POS) terminals that interface with the bank payment cards, as well as the hardware security module (HSM). For now, banks have the option to use either the EMV global standard algorithms or the PBOC algorithms, or could accept using both. As execution of PBOC3.0 rolls out, more and more banks will adopt the PBOC algorithms.

As was mentioned in the original plan for PBOC3.0, as given by China Union Pay (CUP) and the China

30 'Guojia Mima Tuijian', commonly abbreviated in the literature as 'GM/T' stems from the Chinese name, which translates into English as 'National Encryption/Recommend'. The new GM/T standards were potentially issued by the new Chinese National Cryptography Industry Standards Technical Committee established under the OSCCA in October, 2011. However, the Information Security Working Group cannot be sure of this as a meeting request to meet with the technical committee was rejected.

31 *Information Security Position Paper 2013/2014*, European Union Chamber of Commerce in China, 2014, <[http://www.europeanchamber.com.cn/en/publications-archive/298/Information\\_Security\\_Position\\_Paper\\_2014\\_2015](http://www.europeanchamber.com.cn/en/publications-archive/298/Information_Security_Position_Paper_2014_2015)>

32 *Circular on financial technology in mobile e-commerce service innovation pilot work*, National Development and Reform Commission, 19<sup>th</sup> May, 2015, viewed 20<sup>th</sup> May, 2015, <[http://www.sdpc.gov.cn/zcfb/zcfbtz/201405/t20140528\\_613258.html](http://www.sdpc.gov.cn/zcfb/zcfbtz/201405/t20140528_613258.html)>

33 SM2 is the equivalent of Elliptic Curve Cryptography/ Rivest, Shamir and Adleman algorithm, commonly known as 'ECC/RSA' SM3 is the equivalent of the Secure Hash Algorithm 1/Data Encryption Standard, commonly known as 'SHA1/DES'; and SM4 is the equivalent of the Triple Data Encryption Standard, commonly known as '3-DES'.



Bank Card Testing Centre (BCTC, under the PBOC), it is expected that the SM series PBOC algorithms will *replace* the global EMV standards and eventually be made mandatory. Although the national Chinese algorithms are not currently mandatory for bank cards, a similar precedent has already been set in the example of e-tokens (USB-key).<sup>34</sup>

It is the understanding of the Information Security Working Group that the Chinese national PBOC algorithms will be mandated for bank payment cards integrated circuit chips as soon as domestic chip vendors can produce secure chips for bank cards and the HSM can be manufactured by domestic companies. The working group estimates that this period could be as short as one to two years before a technical switch can start to be implemented.

While the working group believes it is not possible to assure the robustness of these national algorithms if they have been defined in closed processes and not undergone rigorous scrutiny during peer review in international standardisation organisations, the working group does regard the PBOC3.0 specifications as positive in some regards. First, the working group welcomes the increase in the level of security and quality required in the products within the PBOC3.0 specifications. At the same time, the working group regards it as positive that the three SM series algorithms to be used in PBOC3.0 have all been publicly disclosed by the OSCCA, meaning that any person or company can gain access to and knowledge about the algorithms and can thus implement the algorithms as they please.

Therefore, it should still be possible for FIEs to produce products implementing the SM algorithms, thus allowing foreign firms to continue their contributions towards improving and maintaining the security of China's bankcard payments system by providing the highest quality, most secure and most functional products.

The PBOC—via CUP—mandated a Chinese state-owned testing laboratory (BCTC) to conduct application-level testing and hardware security testing for the products of FIEs implementing these national algorithms. However, some of the testing requirements seemingly require disclosure of security-relevant source code material that would be impossible for European companies to provide. Furthermore, the working group is concerned about issues such as cost duplication that BCTC testing, as an additional layer of testing on top of international testing, would require. Also, as for all issues relating to commercial encryption in China, the market could also be closed to foreign companies simply by the procuring agencies (in this case, banks) requiring OSCCA-level certification during the procurement process.

#### Recommendations

- Align domestic standards and algorithms with international standards and best practices.
- Make information accessible to all interested parties, i.e. China's National Algorithms and all related, relevant information should be disclosed publicly and available for anyone, including FIEs, to implement.
- Allow interested parties to participate in security-related technical and standardisation committees.

### ▶ 3. Remove the Discriminatory Procurement Restrictions of the Multi-level Protection Scheme

#### Concern

China's Multi-level Protection Scheme (MLPS) prevents certain businesses and administrations from using IT products containing foreign intellectual property (IP), and its implementation is becoming increasingly common. The MLPS not only openly discriminates against FIEs, it also jeopardises China's overall information security and risks slowing the informatisation of China's economy as aimed for in the 12<sup>th</sup> FYP.

#### Assessment

The MLPS is a policy framework designed by China's Ministry of Public Security (MPS) that, like various schemes around the world, aims to legitimately impose information security compliance requirements on information systems in enterprises and administrations that the government considers to be of essential security interest. The MLPS states that information

<sup>34</sup> In 2007, the SM2 algorithm was included for e-tokens, although not on a mandatory basis. In 2012, following the imposition of regulations to stringently implement the SM2 algorithm in e-tokens, it was finally mandated that all second-generation e-tokens must implement the national algorithm.





security components in critical information systems cannot contain foreign IP. However, the scope of application of these requirements extends vastly beyond both provisions required to protect essential national security interests<sup>35</sup> as well as the scope of government procurement. As such, the MLPS acts as a trade barrier to restrict foreign information security technology gaining access to large sections of the Chinese marketplace. The working group recommends that this issue is taken up during the negotiations for the EU-China CAI.

#### a) MLPS regulations

The *Administrative Measures for the Multi-Level Protection of Information Systems*, a document issued jointly by the MPS, the State Encryption Management Bureau (SEMB), the Ministry of State Security (MSS), and the State Council Information Office (SCIO) in June 2007, sets the foundation for the programme and requires information systems to be inspected and classified according to a five-level system.

The scheme is based on five ascending levels of classification of IT systems based on the level of threat posed in the event of the system being compromised. For example, damage to level-one classified systems—the least critical—would lead to harm to private and company interests. Damage to level-five systems—the most critical—would threaten national security (for more information see Figure 1 on the opposite page).

Key elements in the directive:

- System administrators for level three and above systems are required to procure products, the core technology and key components of which need to have independent Chinese IP and a China Compulsory Certification for Information Security Products (CC-IS) certification.
- To sell cryptograph-relevant information security products based on the MLPS regulation, OSCCA approval is required to attain the sales certificate issued by the MPS.

The following two requirements are barriers to FIEs wishing to sell their products for level three and above systems:

- Product R&D and manufacturing must be carried out by Chinese controlled enterprises.
- The core technology and key parts of the product should have indigenous IP.

The MLPS regulations emphasise that encryption technology products must be approved by encryption regulatory authorities. As the MLPS also specifies that just the core technology and key parts of the products should have indigenous IP, in light of the previous CC-IS certification of a wholly foreign-owned enterprise (WFOE) in the smart card sector, the MPS should also recognise that the core functionality of many information security products covered under the MLPS is not encryption. In this regard, as the aim of the MLPS is to guarantee security of information systems, those information security products for which the core functionality is not encryption should be permissible for inclusion under the MLPS, irrespective of the origin of the IP and irrespective of the nationality of the company that carried out the R&D and manufacturing of the product.

#### b) Unprecedented broad scope of application

The major concern regarding the MLPS is the scope of coverage of administrations and businesses in level three, for which it is stated that a compromise of these IT systems would cause damage to social order and public interest. The Chinese definition of level-three, critical infrastructure encompasses information systems of government and businesses in non-security-related areas including commerce, culture, healthcare, transport and education, among others.

The MPS has stated that the scope of level three and above in the MLPS is small and should therefore not create market access issues as a result of the requirement to use domestic IP. As a written response to a question posed during a Trade Policy Review under the WTO between 12<sup>th</sup>–14<sup>th</sup> June, 2012, Chinese authorities stated that as level three and above of the MLPS covers a very limited portion of China's information systems, foreign products will hardly be affected. However, in reality, requests for proposals (RFPs) that reference MLPS-related requirements are increasingly prevalent and are applied extremely broadly in information systems across a large range of

<sup>35</sup> Article XXI of the General Agreement on Tariffs and Trade (GATT) stipulates "Security Exemptions" from the general legal obligations in the GATT when WTO members need to take independent security and defense policy measures for the "protection of its essential security interests: (i) relating to fissionable materials or the materials from which they are derived; (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment; and (iii) taken in time of war or other emergency in international relations" – *General Agreement on Tariffs and Trade 1994*, World Trade Organisation, 1994, viewed 8<sup>th</sup> July, 2015, <[https://www.wto.org/english/docs\\_e/legal\\_e/06-gatt\\_e.htm](https://www.wto.org/english/docs_e/legal_e/06-gatt_e.htm)>



Figure 1: Analysis of the five levels of classification under the MLPS

MLPS Level	Harm Caused by Damage	Object of Damage	
Level 1	Harm	Lawful rights of private persons, companies and other organisations	
Level 2	Serious harm	Lawful rights of private persons, companies and other organisations	
Level 3	Damages	Social order and public interests	Critical Infrastructure: ● Administration, management, production and logistics operations for government bodies and businesses in the following industries: ● Commerce, banking, insurance, securities, utilities, civil aviation, rail, customs, taxation, finance, audit, national resources, transportation, culture, education, statistics, postal service, science & technology, development & reform, foreign affairs, public security, national defence science & technology ● Information industries: broadcasting, telecommunications, data networks, Internet companies, Internet service providers ● All Party and government information systems and websites at central, provincial and municipal levels ● All information systems relating to state secrets
Level 4	Very Serious Damages	Social order and public interests	
Level 5	Very Serious Damages	National Security	

sectors. Moreover, the State-owned Assets Supervision and Administration Commission (SASAC), together with the MPS, have called for even greater implementation of the MLPS in SOEs.<sup>36</sup>

Through online searches identifying hundreds of requests for proposals stipulating MLPS compliance for certain IT products,<sup>37</sup> many of which are at level three or above, it can be seen that the scope of the sectors and government units referencing the MLPS requirements in RFPs are very broad. Sectors covered by SOEs range from power grids to banking, and from hospitals to tobacco companies; and government units range from hydrology bureaus to television stations, and from industry and commerce bureaus to food and drug administrations. Furthermore, these RFPs referencing the MLPS also cover a wide array of commercially-

deployed products and applications.<sup>38</sup>

The MLPS, like other information security policies in China, is designed with the aim of protecting social order, public interests and national security through secrecy. By requiring that all products procured by agencies in level three and above be domestic IP, these same agencies are restricted from procuring the most secure technologies in the global marketplace, thus reducing the security of these information systems, some of which are in critical infrastructure. It has also long been demonstrated that competition leads to innovation and robust solutions. Using claims of national security to close competition to foreign providers will reduce innovation and security in the Chinese marketplace, ultimately impacting the competitiveness of Chinese companies abroad.

### Recommendations

- Remove discriminatory procurement restrictions of the MLPS.
- Do not restrict or regulate the procurement of products with cryptographic capabilities except in

36 For examples of Requests for Proposals from State-Owned Enterprises that have closed the market to foreign suppliers under MLPS see the European Union Chamber of Commerce in China's *Information Security Working Group Position Paper 2011/2012*, p. 239, <[http://www.europeanchamber.com.cn/en/publications-archive/85/Information\\_Security\\_Position\\_Paper\\_2011](http://www.europeanchamber.com.cn/en/publications-archive/85/Information_Security_Position_Paper_2011)>

37 *Written Comments to the U.S. Government Interagency Trade Policy Staff Committee In Response to Federal Register Notice Regarding China's Compliance with its Accession Commitments to the World Trade Organization (WTO)*, USITO, 20<sup>th</sup> September, 2013, viewed 8<sup>th</sup> July, 2015, <<http://www.tiaonline.org/sites/default/files/pages/2013%20USITO%20China%20WTO%20Compliance%20Filing%20-%20Final.pdf>>

38 The most common products in the RFPs include firewalls, vulnerability scanning systems, database auditing systems and intrusion detection systems, while service and maintenance components are also included in some announcements.



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- narrow justifiable circumstances.
- Delineate clearly commercial and military uses of encryption products.
- Join/follow the WTO/GPA.
- Allow FIEs to participate in indigenous innovation programmes.

#### 4. Allow Independent Centres to Conduct Testing and Certification

##### Concern

Foreign-owned laboratories are prohibited by law from conducting conformity assessments to Chinese standards—due to China not acknowledging the validity of internationally-recognised testing laboratory certificates—which deters FIEs from submitting to testing in China, as they are concerned about stipulated IP disclosure requirements, a lack of IP protection and the possibility of disclosure of IP to a third party.

##### Assessment

Although there are foreign testing laboratories in China, only state-owned laboratories are legally allowed to conduct testing and certification according to Chinese standards. The Chinese authorities do not acknowledge the validity of internationally-recognised certificates of testing laboratories, as China is not a signatory to the Common Criteria Recognition Agreement (CCRA). Hence, only Chinese government-accredited information security testing laboratories are able to undertake conformity assessment to Chinese standards and schemes.

The testing requirements of such state-owned testing laboratories differ sometimes markedly from internationally recognised testing conventions, such as the CCRA or the International Organisation for Standardisation (ISO). The working group shares the concerns of FIEs about the requirements regarding the disclosure of their respective trade secrets and having to share IP with these state-accredited testing laboratories. Hence the working group recommends that independent testing laboratories should receive official accreditation in China, and that this accreditation process should be transparent.

##### Recommendations

- Allow independent, non state-owned laboratories to conduct testing and certification.
- Ensure protection and non-disclosure of IP.

- Acknowledge certificates of other internationally-recognised test laboratories and consider them to be sufficient in fulfilling Chinese testing requirements.
- Safeguard and ensure an open and published procedure for the accreditation of independent laboratories is put in place.

#### 5. Increase the Participation of Chinese Institutions Within International Dialogues

##### Concern

Chinese institutions and ministries dealing with encryption are not involved, or not involved enough, in international dialogues and other initiatives: this negatively impacts FIEs and is to the detriment of the Chinese institutions themselves, as they effectively exclude themselves from international best practices and their dissemination, preventing mutual understanding and convergence.

##### Assessment

The working group is trying to initiate activities to bring Chinese institutions such as the OSCCA into the fold in order to increase their participation in the multilateral discourse on encryption. This should also involve opening up China's national algorithms to international peer review.

As mentioned in Key Recommendation 2, until now only the ZUC 4G TD-LTE algorithm has been peer reviewed at an international level. Although it was originally developed in a closed standardisation process by the Chinese Government, thus missing out on expert input from international actors, the step to submit the Chinese national algorithm to 3GPP represented an internationalisation that not only meant that it would be possible for FIEs to implement the standard and gain licensing if stringent source code disclosure requirements were not enforced, it also meant that the Chinese standard underwent rigorous scrutiny at an international level to ensure its security.

The additional step followed in the example of the ZUC algorithm—undergoing peer review at the international level—not only allows for greater assuredness of security, it also goes a long way towards levelling the playing field and attaining global interoperability. The OSCCA has noted that FIEs will be able to implement the algorithm and gain the OSCCA product licensing in China.



### Recommendations

- Engage more actively in dialogues and/or workshops as well as standardisation bodies and international agreements with European counterparts to promote cooperation, convergence and the removal of barriers.
- Engage in technical cooperation with European and other global stakeholders in industry, government and academia.
- Allow FIEs to participate as equal partners in all information security-related standardisation technical committees in order to assist with the development of the most advanced and robust algorithms for use in China's commercial encryption sector.

## 6. Prevent the Implementation of Regulations Referring to ITC Security or Controllability Which Would Result in the Requirement to Purchase Domestic Technology or Other Local Content Requirements and Provide for Timely and Due Consultation with Relevant International Stakeholders

### Concern

The so-called 'network security screening regime' as envisaged by the Cyberspace Administration of China (CAC) is of great concern to European industry, as its emphasis on products being "secure and controllable" could serve to severely curtail access to the Chinese market to foreign producers.

### Assessment

The CAC's network security screening regime emphasises the security and controllability of products and services used for government procurement and critical industries "related to national security and the public interest".<sup>39</sup> Seemingly, a preliminary introduction of this regime was put forward by the CBRC and the MIIT through a set of regulations, the *Guidelines on the Application of Secure and Controllable Information Technology to Strengthen Banking Industry Network Security and Informatisation* (CBRC Guidelines)<sup>40</sup> in

<sup>39</sup> *Internet Security Review is in Response to the Current Situation*, *People's Daily*, 23<sup>rd</sup> May, 2014, viewed 27<sup>th</sup> May, 2014, <<http://politics.people.com.cn/n/2014/0523/c1001-25053486.html>>

<sup>40</sup> The *Guidelines on Banks Using Secure and Controllable Information Technology 2014-2015*, were promulgated to CBRC branches and local banks—though apparently not to the banks' IT suppliers— and became effective on 26<sup>th</sup> December, 2014, (Yin Jian Ban Fa [2014] No. 317). The *CBRC Guidelines* are in turn based on the *Guidelines for Applying Secure and Controllable Information Technology to Enhance Banking Industry Cybersecurity and Informatisation Development* (CBRC No. [2014]39) issued on 3<sup>rd</sup> September, 2014. However, as these documents were not published, there are no online links.

September 2014, in order to require China-incorporated banks, irrespective of nationality, to overhaul their procurement of information security and information and communication technology (ICT) products.

Worryingly, the key document, dated December 2014, the *Guidelines for Promoting the Application of Secure & Controllable Information Technology in Banking Sector (2014–2015)* and its annex *Classification Catalogue of Banking Information Technology Assets and Indexes of Security and Controllability (2014–2015)* (*Classification Catalogue*), which included a list of product categories in its annex, was not published but only disseminated to Chinese banks as well as some foreign banks through the CBRC's internal channels.

While the implementation of the *CBRC Guidelines* was halted in April, 2015, they could still be enacted or phased in at a later stage. Likewise, the overall 'network security screening regime' could still be implemented in other sectors of the economy, as originally envisaged by the CAC.

### Recommendation

- Publish in a timely fashion any forthcoming implementation guidelines in adherence with China's WTO/TBT commitments and allow foreign industry and other relevant stakeholders to comment.

## Abbreviations

3-DES	Triple Data Encryption Standard
3GPP	3 <sup>rd</sup> Generation Partnership Project
BCTC	China Bank Card Testing Centre
CBRC	China Banking Regulatory Commission
CAC	Cyberspace Administration of China
CCAA	CPC Central Cryptography Administration Authority
CC-IS	China Compulsory Certification for Information Security Products
CCRA	Common Criteria Recognition Agreement
CECs	Commercial Encryption Codes
CERs	Commercial Encryption Regulations
CNY	Chinese Yuan
CPC	Communist Party of China
CTL	Counter-Terrorism Law
CUP	China Union Pay
ECC/RSA	Elliptic Curve Cryptography/ Rivest, Shamir and Adleman algorithm



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EMV	Europay, MasterCard, Visa	SMx	<i>Shangyong Mima</i> series of algorithms
EMVCo	Global standardisation body for credit and debit payment cards based on chip card technology	SOE	State-Owned Enterprise
ETSI	European Telecommunications Standardisation Institute	TD	Time Division
EUR	Euro	USB	Universal Serial Bus
FIE	Foreign-Invested Enterprise	WFOE	Wholly Foreign-Owned Enterprise
FYP	Five Year Plan	WTO	World Trade Organisation
GM/T	<i>Guo Mi Tuijian</i> or <i>Guojia Mima Tuijian</i>	WTO/GPA	World Trade Organisation Government Procurement Agreement
HSM	Hardware Security Module	WTO/TBT	World Trade Organisation Technical Barriers to Trade Agreement
IC	Integrated Circuit	ZUC	Zu Chongzhi
ICT	Information and Communications Technology		
IoT	Internet of Things		
IP	Intellectual Property		
IT	Information Technology		
ISCCC	China Information Security Certification Centre		
ISO	International Standards Organisation		
LTE	Long-Term Evolution		
MFSCA	Multi-Functional Smart Card Alliance		
MOF	Ministry of Finance		
MIIT	Ministry of Industry and Information Technology		
MLPS	Multi-Level Protection System		
MPS	Ministry of Public Security		
MSS	Ministry of State Security		
NDRC	National Development and Reform Commission		
NIST	China National Information Technology Standardisation		
NSL	National Security Law		
OEM	Original Equipment Manufacturer		
OSCCA	Office of the State Commercial Cypher Administration		
PBOC	People's Bank of China		
PBOC3.0	People's Bank of China Banking Integrated Circuit Card Specifications 3.0		
POS	Point of Sale		
R&D	Research and Development		
RFP	Request for Proposal		
SASAC	State-owned Assets Supervision and Administration Commission		
SCIO	State Council Information Office		
SCIIO	State Council Internet Information Office		
SCLAO	State Council Legislative Affairs Office		
SEMB	State Encryption Management Bureau		
SHA1/DES	Secure Hash Algorithm 1/Data Encryption Standard		





# Logistics Working Group

## Key Recommendations

### 1. Customs Issues

#### 1.1 Improve Enterprise Grading Management (EGM) and the Authorised Economic Operator (AEO) Programme

- Implement more lenient measures for enterprises with higher compliance records (e.g. Advanced Certified Enterprises) and encourage enterprises to rely more on Enterprise Resource Planning (ERP) and internal control systems to comply with customs requirements.

#### 1.2 Further Promote Processing Trade Reform

- Design a new reconciliation model which relies on enterprises' ERP and internal control systems for handbook reconciliation and tracking the processing trade handbook, bonded assets and consumables.

#### 1.3 Simplify the Bonded Transfer Process Between Bonded Zones

- Speed up the development of the system solution for the new bonded transfer process so that it can be rolled out nationwide.

#### 1.4 Incorporate Voluntary Disclosure (VD) into Customs Management and Provide Specific Details on the Mitigation of Punishments

#### 1.5 Improve the New Manifest System

- Work with enterprises to assess the system's constraints and strengthen the operational efficiency of the system.

#### 1.6 Accelerate the Introduction of the Deepening Reform Initiative

- Continue to involve and get feedback from the enterprises regarding the execution plan of the Deepening Reform Initiative.

#### 1.7 Implement E-freight

- Work with airlines and forwarders to redesign the system so that it can accept paperless Air Waybills (AWBs) and other declaration documents.

### 2. Tax Issues

#### 2.1 Establish an Integrated Value-added Tax (VAT) Category for the Express Industry

- Establish an integrated VAT category that applies to all express-based services.

#### 2.2 Clarify the VAT Treatment Between Headquarters and Branches for Logistics Companies

- Clarify the VAT treatment for logistics service companies in the context of the headquarter-branch structure.

#### 2.3 Clarify the VAT Sourcing Rule on Offshore Services

### 3. Express Delivery Services (EDS) Issues

#### 3.1 Improve Transparency of the New Express Regulations

- Grant more opportunities for foreign express companies to participate in the legislative process.
- Provide timely feedback to enterprises' recommendations in the form of a symposium or through other channels.

#### 3.2 Implement Administrative Licensing System Reforms

- Clearly define the permit examination process and approval for intra-provincial, trans-provincial



and international business.

- Clarify the permit procedures of trans-provincial and international express business.

### 3.3 Reduce Administrative Surcharges for Cross-border Business

- Improve pricing transparency in the cross-border services market.
- Introduce competition to the cross-border services market and give logistics companies more choices.

### 3.4 Avoid Over-regulating the Express Delivery Industry due to Security Concerns

- Adjust the regulations to strike a balance between operational feasibility and security requirements.

### 3.5 Improve Access to Cities for Express Vehicles

- Enact relevant laws and regulations to make it legal for express delivery vehicles to enter and drive in cities.

## Introduction to the Working Group

The Logistics Working Group was founded in 2003, and represents a diverse spectrum of logistics service providers in freight forwarding, including sea, air and land, express delivery, warehousing and distribution as well as customs brokerage, transportation services, contract logistics and consumers of logistics services from different sectors. At present, more than 250 member companies participate in the working group, which currently operates in the European Chamber's Beijing, Shanghai and South China chapters.

The working group provides a platform for companies to discuss and share best practices, experiences and recommendations and to exchange views on the regulatory framework of the logistics industry. It maintains a constructive dialogue between relevant governments and industry stakeholders to discuss and provide comments on regulations and standards.

## Recent Developments

### Industry Development

China's logistics industry remains a key driver for China's long-term economic growth. In 2014, the total revenue of China's logistics sector projected a 6.9 per cent year-on-year growth. Meanwhile, the value of goods transported by the logistics industry reflected a 7.9 percent year-on-year growth.<sup>1</sup>

China's online sales of consumer goods, a boon to the logistics industry, soared a staggering 49.7 percent to

<sup>1</sup> *China's logistics revenue surges in 2014*, *China Daily*, 17<sup>th</sup> April 2015, viewed 3<sup>rd</sup> July, 2015, <[http://usa.chinadaily.com.cn/business/2015-04/17/content\\_20459045.htm](http://usa.chinadaily.com.cn/business/2015-04/17/content_20459045.htm)>

Chinese Yuan (CNY) 2.79 trillion in 2014. China has now surpassed the United States as the largest express delivery market in the world.<sup>2</sup>

### The Regulatory Environment of the Logistics Industry




The Chinese Government has identified the logistics industry as a key driver for economic growth and has promised to help advance the development of e-commerce, logistics, and express delivery services by lowering costs and streamlining the administration for foreign players in the market. In December 2014, the National Development and Reform Commission (NDRC) released a three-year action plan for the development of the logistics industry, which includes designating pilot cities for modern logistics development, building national demonstration logistics parks and establishing a shared logistics information platform.<sup>3</sup>

In addition, China has also offered policy support to enhance trade facilitation. In 2014, in view of reducing administrative burdens on importers and exporters, as well as expediting customs clearance, China's General Administrative of Customs (GAC) also started deepening reforms to streamline the customs clearance process and promote trans-regional cooperation. In early 2015, the State Council released the *Opinions on Improving Port Management and Enhancing Foreign Trade*, which outlined the measures to improve port services and support foreign trade. According to this document, the fee of moving and storing qualified cargo will be waived, cargo examination procedures will be

<sup>2</sup> *Ibid*

<sup>3</sup> *Report on the implementation of the 2014 plan for national economic and social development and on the 2015 draft plan for national economic and social development*, *People CN*, 16<sup>th</sup> March 2015, viewed 3<sup>rd</sup> July, 2015, <<http://en.people.cn/n/2015/0316/c90785-8863798-14.html>>



Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Streamline administration for foreign enterprises.	Given the rising concerns over terrorism, the requirements for tighter security have placed increased administrative and operational burdens on the logistics industry.	
Improve the transparency of governmental control.	The logistics industry's involvement in the legislation and standards setting is very limited.	
Reduce the governmental control over investment access.	Domestic express companies still receive preferential treatment in certain areas related to investment.	

streamlined and all fees will be standardised to tackle the prevalence of irregular charges. These changes indicate the governments' determination to cut red tape and provide easier and better customs clearance services.

China held the Third Plenum in late 2013, which reinforced China's commitment towards becoming a more market-based economy through the release of the *Decision on Some Major Issues Concerning Comprehensively Deepening the Reform (Decision)*.<sup>4</sup> The abovementioned policies reflected recent developments in this direction. However, due to rising concerns over terrorism in recent years, strict requirements for security control have added additional burdens on the logistics industry, which run contrary to the spirit of Third Plenum. The above table highlights a reality check on the current regulatory environment.

## Key Recommendations

### 1. Customs Issues

#### 1.1 Improve Enterprise Grading Management (EGM) and the Authorised Economic Operator (AEO) Programme

##### Concern

Enterprises with high compliance records still face heavy administrative burdens from customs.

##### Assessment

Enterprise Grading Management (EGM) is an advanced customs management method which is widely applied

among global customs. The GAC has adopted this management system and has put efforts into driving EGM reform in recent years. In 2014, the GAC updated its EGM system and launched the Authorised Economic Operator (AEO) Programme, which reflected a comprehensive upgrading of regulations on customs risk management and import and export supervision.

While the updated EGM system was certainly a step forward, the working group would urge the GAC to expedite further EGM reform to grant more leniency to the enterprises with higher compliance records, such as Grade AA Enterprises. Due to fast volume growth, more and more companies have adopted Enterprise Resource Planning (ERP) and internal control systems to better comply with the customs requirements. The working group believes that the use of ERP should be encouraged and that the enterprises with a higher grading should be given more lenient punishment measures.

As for the newly-launched AEO program, which aims to get all national programmes mutually recognised, the working group encourages China Customs to continue pursuing potential agreements with other countries.

##### Recommendation

- Implement more lenient measures for enterprises with higher compliance records (e.g. Advanced Certified Enterprises) and encourage enterprises to rely more on ERP and internal control systems to comply with customs requirements.

<sup>4</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.





## 1.2 Further Promote Processing Trade Reform

### Concern

Compared with enterprises in non-bonded areas, the requirements and procedures of customs reconciliation and bonded assets tracking are more complicated for those in bonded zones.

### Assessment

Challenges still exist in operating processing trade businesses. Enterprises with very good compliance records often need to invest a great deal of resources for trade handbook reconciliation, tracking and reconciling bonded assets and consumables. However, those well-performing enterprises are still confronted with certain discrepancies in treatment from customs and may even face penalties.

In late 2014, the GAC launched its *Regarding Deepening Reform on Regional Customs Clearance*, which introduced new measures that encourage enterprises to use ERP and internal control systems to reconcile and balance the customs handbook.<sup>5</sup> The Logistics Working Group supports this direction and urges China Customs to expedite the process of designing and launching such a model.

### Recommendation

- Design a new reconciliation model which relies on enterprises' ERP and internal control systems to reconcile the handbook and track the processing trade handbook, bonded assets and consumables.

## 1.3 Simplify the Bonded Transfer Process Between Bonded Zones

### Concern

The current bonded transfer process between two bonded zones remains complicated with a long lead time, which results in high costs and low supply chain efficiency.

### Assessment

The GAC developed a new bonded transfer process, which allows enterprises to do post-declarations and use a non-bonded truck for moving goods. The new process has largely enabled enterprises to shorten lead times as well as reduce logistics costs. However, the new process has only been piloted in some selected cities/zones and has

<sup>5</sup> *Regarding Deepening Reform on Regional Customs Clearance* (GAC Decree 58), GAC, 29<sup>th</sup> October 2013, viewed 3<sup>rd</sup> July 2015, <<http://www.customs.gov.cn/publish/portal0/tab49564/info631725.htm>>

not yet been implemented nationwide.

### Recommendation

- Speed up the development of the system solution or the new bonded transfer process so that it can be rolled out nationwide.

## 1.4 Incorporate Voluntary Disclosure into Customs Management

### Concern

Voluntary disclosure (VD) presents enterprises a transparent and straightforward process for noncompliance-related punishments. Although China already encourages enterprises to adopt VD for customs practices, the regulations regarding the mitigation of punishments are still not clear.

### Assessment

Voluntary Disclosure is a widely-accepted, international customs practice, which encourages enterprises to disclose their mistakes voluntarily to customs. Starting from 2014, both the GAC and local customs bureaus started encouraging enterprises to do VD. However, due to the lack of details on excusable items, most enterprises were still hesitant to do so. Therefore, it is necessary for the GAC to offer detailed description on the VD procedures. The Logistics Working Group believes that providing transparent and systemic rules would incentivise enterprises to disclose information and contribute to improving import and export compliance in China.

### Recommendation

- Incorporate VD into customs management and provide specific details on the mitigation of punishment.

## 1.5 Improve the New Manifest System

### Concern

The new manifest system was put into use in 2014, however, due to unreasonable requirements, many enterprises are struggling with even longer lead times and higher costs for customs clearance.

### Assessment

It was reported that certain requirements in the new manifest system were either very costly or impossible to meet.

Taking air waybills (AWBs) as an example, an AWB is a





receipt issued by an international airline for goods and provides evidence of the contract of carriage. According to the new manifest system, each AWB is only allowed to apply for one Customs Declaration Sheet (CDS). However, it is possible that there are more than twenty line items in one carriage, which means more than one CDS will be needed during clearance. The current system requirements make it very difficult to follow.

#### Recommendation

- Work with enterprises to assess the system's constraints and strengthen the operational efficiency of the system.

### 1.6 Accelerate the Introduction of the Deepening Reform Initiative

#### Concern

At the end of 2014, the GAC launched a Deepening Reform Initiative, which outlined the major reform direction of customs management. While this potential reform sounds inspiring for industry operators, details regarding operational measures and an execution timeline still remain unclear.

#### Assessment

The GAC set up the Customs Deepening Reform Office in early 2014, and started consulting with industry stakeholders for suggestions on reform plans. While the industry acknowledged the establishment of this initiative as a strategic move for the GAC to strengthen the capacity of customs in China, there has yet to be much concrete progress since its launch. The information about what the reforms will entail is still at the conceptual level and no specific plans regarding when and how the reforms will be carried out has been disclosed.

#### Recommendation

- Continue to involve and get feedback from the enterprises regarding the execution plan of the Deepening Reform Initiative.

### 1.7 Implement E-freight

#### Concern

The implementation of e-freight can enable forwarders and airlines to save tons of paper for administration, reduce operational costs and increase profits. However, China Customs is slow in implementing e-freight.

#### Assessment

E-freight has become a global trend in the air cargo industry in recent years. E-freight means air cargo is not accompanied by paper AWBs or invoices, which are replaced by electronic information. By replacing paper with digital documents throughout the supply chain, each party receives only those documents it needs. E-freight significantly improves the work efficiency of forwarders.

#### Recommendation

- Work with airlines and forwarders to redesign the system so that it can accept paperless AWBs and other declaration documents.

## 2. Tax Issues

### 2.1 Establish an Integrated Value-added Tax (VAT) Category for the Express Industry

#### Concern

Under the current regulations regarding Business Tax to VAT (B2V), express companies are subject to multiple ambiguous VAT categories, resulting in high administrative costs for enterprises and high service fees for customers.

#### Assessment

Express service is an integration of systematic logistics activities, which encompass pick-up and delivery (PUD), road/air transportation, depot and gateway handling, customs declaration, warehousing and other activities. According to the current VAT regulations, every step of express service falls into a specialised VAT category and is confronted with variable VAT rates and VAT exemption standards. The table on the following page presents a list of VAT charges and exemptions for express-based services.

The confusing VAT categories, rates and exemption rules have resulted in heavy cost burdens and considerably undermined the work efficiency of the industry. In certain cases, companies may encounter repeated charges over the same single activity or find themselves merely eligible for partial VAT exemption.

#### Recommendation

- Establish an integrated VAT category that applies to all express-based services.

### 2.2 Clarify the VAT Treatment Between Headquarters and Branches for Logistics Companies





VAT categories	VAT rates	Standards for VAT exemption
Transportation	11%	Both inbound and outbound China (input VAT is still applicable when output VAT is exempted)
Freight forwarding	6%	Domestic freight forwarding services: overseas-based clients International freight forwarding services: both China and overseas-based clients
Pick-up and delivery (limited to within same city)	6%	Export goods-related
Customs declaration	6%	Client is based overseas
Uploading & unloading	6%	Client is based overseas
Warehousing	6%	Warehouse is based overseas

#### Concern

The headquarter-branch structure is commonly adopted by foreign logistics companies operating in China. However, under the current VAT regulations, headquarters and branches are separate VAT payers and they pay VAT independently, which often causes confusion over VAT compliance practices.

#### Assessment

Under current Chinese tax laws, corporate income tax reporting is based on a consolidated profit basis at the legal-entity level. However, VAT reporting is dispersed across each branch. Therefore a legal entity's headquarters and its attached branches are all separate VAT payers and each of them declares VAT liability independently. Issues often arise for logistics companies with such a structure.

For Input VAT,<sup>6</sup> it is very common that the headquarters centralises all the procurement on behalf of its branches. In this case, the branches cannot credit the input VAT pertaining to the centralised purchase at the headquarters.

For Output VAT,<sup>7</sup> in China it is fairly common that a logistics company often involves its multiple branches in serving one client, thus the logistics company is requested to issue one invoice for the whole legal entity. In this case, the current VAT regulation makes it very difficult for the branches to capture their revenue in regards to their respective contributions on VAT.

<sup>6</sup> Input VAT is the value-added tax added to the price when a company purchases goods or services liable to VAT.

<sup>7</sup> Output VAT is the value added tax a company calculates and charges on its own sales of goods and services if the company is registered in the VAT Register.

#### Recommendation

- Clarify the VAT treatment for logistics service companies in the context of the headquarter-branch structure.

### 2.3 Clarify the VAT Sourcing Rule for Offshore Services

#### Concern

Under the current B2V regulations, it is not clear whether the services, which are provided by overseas service providers and entirely consumed overseas, are subject to China VAT rules. There are no official explanations about offshore services, and this lack of clear instructions often prohibits taxpayers from being able to assess proper VAT exemptions and hinders tax authorities from processing VAT-related paperwork.

#### Assessment

Foreign logistics companies in China purchase various services from overseas vendors in their daily operations. These services include: international transportation services; overseas freight forwarding; IT services; consulting services; and other logistics-based services. With 'offshore services' being vaguely defined, logistics companies often find it very difficult to judge which part could be exempted from VAT before releasing payments overseas.

#### Recommendation

- Clarify the VAT sourcing rule for offshore services.





### 3. Express Delivery Services (EDS) Issues

#### 3.1 Improve Transparency of the New Express Regulations

##### Concern

The drafting of the *Express Regulation*<sup>8</sup> has huge implications for express service standards and operation permits, which in turn greatly affects the future development of the whole industry. The Logistics Working Group is particularly concerned with the issues of burdensome administrative licensing and a non-transparent policy-making process.

##### Assessment

The Logistics Working Group recognises that the State Council-Legislative Affairs Office (SCLAO) has listed the *Express Regulation* in this year's legislative planning, and that the State Post Bureau has finished the draft and received approval from the Ministry of Transport (MOT) to pass the regulation to the SCLAO. Due to the fact that the regulation drafting process involves the State Post Bureau, the Ministry of Transportation (MOT) and the SCLAO, it seems particularly crucial for express companies to play a role in the legislative process. Industry perspectives would be valuable for such legislation in view of both legality and rationality.

##### Recommendations

- Grant more opportunities for foreign express companies to participate in the legislative process.
- Provide timely feedback to enterprises' recommendations in the form of a symposium or through other channels.

#### 3.2 Implement Administrative Licensing System Reforms

##### Concern

The operation permit for express businesses, which is required under the Postal Law and by other relevant regulations, has placed huge burdens on enterprises and has become the largest bottleneck for industry development.

##### Assessment

With respect to the government's call for streamlining administration and delegating power to lower-level governments, postal bureaus have publicised their procedures on administrative licensing review and

<sup>8</sup> *Draft Express Regulation (Call for Comments)*, State Postal Bureau, 31<sup>st</sup> July 2014, viewed 5<sup>th</sup> July 2015, <<http://www.bengbu.gov.cn/upload/html/20140813153200902.pdf>>

approval. In Article 52<sup>9</sup> of the Postal Law, it mentions that express enterprises should have adequate service capacity suitable for running business in the areas they apply for. Meanwhile, Clause 3 Article 6 of the *Express Business Operation Permit Management Method* states that enterprises should have adequate capacity to run business in a certain territorial scope as required by Articles 7, 8 and 9.

As the postal administration department has over 350 local supervision units in prefecture-level cities, the restrictions regulated by the business operation permit forces enterprises to apply one city at a time at prefecture level when applying for trans-province and international business permits. If an enterprise wants to establish an operation network covering the whole country, it must go through the review and approval process at least 350 times. This poses a huge barrier to business expansion and commodity circulation.

##### Recommendations

- Clearly define the permit examination process and approval for intra-provincial, trans-provincial and international business.
- Clarify the permit procedures of trans-provincial and international express business.

#### 3.3 Reduce Administrative Surcharges for Cross-border Business

##### Concern

Unfair and unreasonable surcharges on cross-border logistics have been rising drastically in recent years, significantly increasing operational and financial burdens for logistics companies. Given that the surcharges were set by the government, logistics players are concerned that the administrative monopoly of the government on surcharges may interfere with market functions and affect the development of the industry.

##### Assessment

In recent years, the GAC has been actively promoting trade facilitation by reducing certain administrative charges on customs clearance. While the direct charges from the government are decreasing, the charges from certain government-designated, third-party companies are increasing. In the process of cross-border logistics, the government usually designates certain local, third-

<sup>9</sup> Postal Law of the People's Republic of China (2009 Revised), China's Postal Bureau, 1<sup>st</sup> March 2014, viewed 5<sup>th</sup> July 2015, <[http://www.procedurallaw.cn/english/law/200905/t20090526\\_224670.html](http://www.procedurallaw.cn/english/law/200905/t20090526_224670.html)>





party companies to provide relevant services to logistics companies, such as electronic data interchange (EDI) transmission, formal entry and China Inspection and Quarantine Bureau (CIQ) charges. With the backup of governments, these third-party companies sometimes set the charges incredibly high. These inflated costs have impaired the competitiveness of the logistics market and distorted cross-border supply chain operations.

#### Recommendations

- Improve pricing transparency in the cross-border services market.
- Introduce competition to the cross-border services market and give logistics companies more choices.

### 3.4 Avoid Over-regulating the Express Delivery Industry Due to Security Concerns

#### Concern

Intensified security regulations, such as real name shipping, content inspection upon pick-up and requiring closed-circuit television (CCTV) monitoring systems to be installed, not only interrupt normal operations but also increase the workload and operational risks for express delivery companies in China.

#### Assessment

Article 53 of the draft *Express Regulation* released by the SCLAO in January 2015, requires express delivery companies to adopt a real name shipping system for operations. This new requirement, once promulgated, will impose serious problems to express delivery companies. On the one hand, individual shippers may be reluctant to submit their personal data to couriers, and on the other, couriers are not in the position, and don't have the capacity, to verify shippers' personal data. Therefore, express carriers should not be liable for potential security risks thereby incurred.

In the same draft, Article 54 requires express delivery companies to inspect the contents of the shipments upon shipping. This requirement is also unfeasible because couriers don't have the capacity to detect prohibited goods from shipment, particularly when the shipper deliberately conceals such items in their shipment.

Since early 2014, a number of European express delivery companies were requested by State Postal Bureaus and local postal regulators to connect their internal CCTV monitoring appliances to the regulator's system so that

postal bureaus can have real-time access to monitor companies on a regular basis. These express companies were also requested to bear the costs for network cabling and equipment installation.

With respect to security concerns, the Logistics Working Group recommends that the regulators should adjust the regulations to balance between operational feasibility and security requirements to avoid over-supervision, which in turn can interrupt the normal operations of the express delivery industry.

#### Recommendation

- Adjust the regulations to strike a balance between operational feasibility and security requirements.

### 3.5 Improve Access to Cities for Express Vehicles

#### Concern

As a result of urban transportation and air pollution problems, major cities have gradually introduced countermeasures to cope with the worsening situation, which have placed severe restrictions on the mobility of express vehicles entering cities.

#### Assessment

The express service industry has become a crucial pillar industry contributing to continuous and healthy development of the national economy. Whether express vehicles can smoothly enter cities to provide courier services to clients is a key factor that affects the core competition of the whole industry, because urban package pick-up and delivery is the most popular courier service in cities during the daytime.

Before the implementation of traffic restriction measures, there were no special limits for cargo vehicles to enter cities. According to new regulatory measures, a large number of cargo vehicles from express companies are now restricted to enter city centres for the sake of environmental protection. However, highly-developed express services, to some extent, can help reduce the use of private vehicles on the road and thereby alleviate traffic congestion. This regulation disrupts the normal package pick-up and delivery services, thus causing more traffic congestions and worse pollution for the cities.

The Logistics Working Group also notices that EMS vehicles are free from traffic restrictions, whereas both the private and international express enterprises are limited by





this regulation, which indicates policy discrimination in the field.

#### Recommendation

- Enact relevant laws and regulations to make it legal for express delivery vehicles to enter and drive in cities.

## Abbreviations

AOG	Aircraft on the ground
AEO	Authorised Economic Operator
AWB	Air Waybill
B2V	Business Tax to VAT
CCTV	Closed-Circuit Television
CDS	Customs Declaration Sheet
CIQ	China Inspection and Quarantine Bureau
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
EDI	Electronic Data Interchange
EDS	Express Delivery Service
EGM	Enterprise Grading Management
ERP	Enterprise resource planning
GAC	General Administration of Customs
IMDG	International Maritime Dangerous Goods
MOF	Ministry of Finance
MOT	Ministry of Transport
MSA	Marked Surveillance Authorities
SAT	State Administration of Taxation
SCLAO	State Council-Legislative Affairs Office
UN	United Nations
VAT	Value-added Tax
VD	Voluntary Disclosure

## Maritime Transport Working Group

### Key Recommendations

#### 1. Allow Transport of International Cargo between Chinese Ports (International Relay)

- Support the development of more efficient shipping services for China's foreign trade by permitting international cargo relay.

#### 2. Apply Non-discriminatory Treatment in China's Free Trade Zones (FTZs)

- Give all foreign-flagged vessels equal rights to tranship in China's FTZs, irrespective of the nationality of the vessels' ultimate owners.

#### 3. Issue Clear Guidance on the Collection of Local Surcharges

- Explain the principles, such as market principles, according to which shipping lines may collect surcharges.
- Produce clear guidelines on local surcharge adjustment to avoid ambiguity in their implementation.
- Provide clear explanations when surcharge adjustments are rejected.

#### 4. Allow Carriers Free Terminal Selection in China

- Change the monopolistic practice of dictating to carriers which terminal to call at, via a process of recommendations and dialogue.
- Permit carriers to choose terminals based on market supply and demand as well as conditions such as vessel tonnage, berth classification and availability.

#### 5. Permit Low Visibility Navigation

- Follow best practices of leading international ports, and enable navigation in low or no visibility conditions.

### Introduction to the Working Group

The Maritime Transport Working Group was established in 2000, to represent European maritime transport enterprises operating in China. The objective of the working group is to work towards a more efficient and competitive maritime transport environment in China. To accomplish this, the working group engages in dialogue with relevant Chinese and European government officials to contribute to the healthy development of the transportation industry and to promote the interests of European transportation companies in China.

### Recent Developments

With 80 per cent of global trade by volume carried by sea and handled by ports worldwide, the strategic

economic importance of maritime transport as a trade enabler cannot be overemphasised.<sup>1</sup> As the European Union (EU) is China's largest trading partner, and China is the EU's second largest trading partner, with daily trade exceeding euro (EUR) 1 billion, maritime transport is an essential and integrated part of EU-China economic relations.

In 2014, progress was made by Chinese ports in improving the ability of shipping lines to safely engage in low visibility navigation, saving shipping lines and ports significant costs, and, by extension, enhancing China's foreign trade environment.

<sup>1</sup> *Review of Maritime Transport 2013*, United Nations Conference on Trade and Development, United Nations, 5<sup>th</sup> December, 2013, viewed 22<sup>nd</sup> June, 2014, <[http://unctad.org/en/publicationslibrary/rmt2013\\_en.pdf](http://unctad.org/en/publicationslibrary/rmt2013_en.pdf)>



However, in some ways the commercial environment has deteriorated for foreign carriers. For example, unique to China, foreign-flagged vessels have been permitted to conduct international relay in China's six free trade zones (FTZs), but only if the vessel is ultimately Chinese owned. This puts foreign carriers at a significant disadvantage, and they are in fact worse off in this respect than before the FTZs were established.

The FTZs have introduced market openings that create an even greater divergence in market access between foreign and Chinese companies: this goes against the spirit of the *Third Plenum Decision*.<sup>2</sup>

Shipping lines are facing cost increases similar to most other industries in China. The common practice of carriers looking to recover such costs has been to increase surcharges. However, the institution supervising such surcharges in China, the Shanghai Shipping Exchange (SSE), now routinely rejects proposed surcharge increases for reasons unclear to carriers.

Also, Chinese carriers continue to receive significant subsidies, with COSCO alone reportedly receiving scrapping subsidies in the order of Chinese Yuan (CNY) 1.4 billion, putting foreign carriers at a disadvantage.

In terms of infrastructure development, the Maritime Transport Working Group hopes that relevant government authorities will continue to ensure a healthy balance between supply and demand in terms of port capacity. We also welcome a greater focus on supervision and enforcement of compliance with maritime safety rules and anti-competitive behaviour, while encouraging further deregulation to take place, enabling foreign maritime enterprises to provide commercial services on terms similar to those that apply to Chinese maritime enterprises.

## Key Recommendations

### 1. Allow Transport of International Cargo between Chinese Ports (International Relay)

<sup>2</sup> Adopted following the conclusion of the Third Plenary Session of the 18<sup>th</sup> Communist Party of China Central Committee, the Decision on Major Issues Concerning Comprehensively Deepening Reforms (*Decision*) outlined China's comprehensive reform agenda.

#### Concern

International relay may only be carried out by Chinese-flagged vessels operated by wholly Chinese-owned companies: resolving this market access barrier remains an issue of the highest priority for the EU liner shipping community in China.

#### Assessment

International relay refers to the practice of a company carrying cargo from China to an overseas destination on its own vessels, then transferring the cargo from one vessel to another owned by the same company in a Chinese port. For example, a container transported from Dalian to Africa is loaded on a vessel in Dalian servicing Europe. When this vessel en route to Europe arrives in Shanghai, the container is moved to another vessel on an Africa-bound service.

At present, EU shipping lines are forced to tranship cargo originating in China in overseas ports. Permitting international relay will create flexibility for shipping lines, allowing them to optimise route networks, leading to shorter transit times, lower transportation costs and less pollution. It will, additionally, bring significant benefits to both EU and Chinese companies:

- Increased revenue for Chinese ports: significant volumes that are currently transhipped overseas, for example in Korea and Singapore, could potentially be transhipped in China.
- Efficient utilisation of Chinese ports: as Chinese ports have excess handling capacity, allowing international relay will facilitate the development of international hub ports in China and contribute to the full utilisation of terminal capacity.
- Competitive advantages for the Chinese economy: transit times and transportation costs to and from China will be reduced, which will encourage the establishment of more direct maritime services to and from China.

Permitting international relay would only have a marginal effect on domestic Chinese shipping lines. Foreign shipping lines currently choose to tranship containers outside of China rather than use a domestic feeder service, which increases costs. This is in direct contrast to Chinese carriers, who can freely transport containers between EU ports.

#### Recommendation

- Support the development of more efficient shipping services for China's foreign trade by permitting international cargo relay.





## 2. Apply Non-discriminatory Treatment in China's Free Trade Zones (FTZs)

### Concern

Foreign-flagged vessels ultimately owned by a Chinese company may engage in international relay in China's six FTZs, while foreign-flagged vessels owned by foreign companies may not, thus creating an uneven playing field.

### Assessment

The establishment of the China (Shanghai) Pilot Free Trade Zone (CSPFTZ or Zone) in 2013, was greeted with excitement by the EU shipping community, as it appeared to be a step in the right direction from a trade policy and market access perspective. Hopes were high, in particular when it was announced that foreign-flagged vessels would be allowed to engage in international relay in the Zone.

To the disappointment of the EU shipping community, the Chinese Government clarified that foreign-flagged vessels would only be allowed to conduct international relay in Shanghai if the vessels are ultimately owned by a Chinese company. Thus, the CSPFTZ diverges from the international practice of having the flag status and not the nationality of the ship owner determine market access.

In April 2015, five other Chinese ports, namely Tianjin, Fuzhou, Xiamen, Shenzhen and Guangzhou, were granted FTZ rights similar to the CSPFTZ, thus putting foreign carriers at a disadvantage in these ports as well.

While China's FTZs provide many improvements in a number of areas, the Maritime Transport Working Group regrets that with respect to shipping the FTZs put EU companies at a further disadvantage to Chinese companies. This creates an even greater gap in market access, which goes against the spirit of the Third Plenum's *Decision*.

### Recommendation

- Give all foreign-flagged vessels equal rights to tranship in China's FTZs, irrespective of the nationality of the vessels' ultimate owners.

## 3. Issue Clear Guidance on the Collection of Local Surcharges

### Concern

The regulations related to the collection of surcharges in connection with maritime transport remain vague and unclear: shipping lines' requests to raise surcharges are routinely declined by the SSE with no explanation, reducing the ability of foreign shipping lines to recover increasing expenses in China.

### Assessment

Among foreign carriers only one has, on a single occasion, had a local surcharge filing accepted by the SSE—the entity entrusted with receiving notifications of surcharge changes—in 2014. All other filings by foreign carriers were rejected by the SSE. Foreign shipping lines are encountering the following issues:

- Lack of explanation for rejections: Local surcharge applications are rejected by the SSE without a proper explanation. The most common reasons given for rejection are a lack of explanation of the increase or an incomplete filing. Without further explanation from the SSE it is impossible for foreign shipping lines to know what criteria must be fulfilled for a local surcharge filing to be accepted. The working group hopes that the SSE will adopt the practice of fully explaining to shipping lines why filings are unsuccessful and what specific information must be supplied to them for a filing to be accepted.
- Unclear principles of surcharge adjustments: Foreign shipping lines are under the impression that surcharges are market based, as explained in the Ministry of Transport's (MOT's) Circular No. 64. However, foreign carriers have received different explanations, indicating that the SSE employs principles other than market ones when determining whether to accept a surcharge filing.

Vague and unclear regulations run contrary to the principles of rule of law—the central theme of the Fourth Plenum—and are detrimental to China's plans to ensure better application of them.

### Recommendations

- Explain the principles, such as market principles, according to which shipping lines may collect surcharges.
- Produce clear guidelines on local surcharge adjustment to avoid ambiguity in their implementation.



- Provide clear explanations when surcharge adjustments are rejected.

#### 4. Allow Carriers Free Terminal Selection in China

##### Concern

Terminal selection is being dictated to shipping lines by local port groups, which creates inefficiencies for carriers looking to optimise networks to reduce transit times, fuel consumption and costs.

##### Assessment

When calling at Chinese ports, liner shipping companies are assigned terminals at the sole discretion of local port groups. This demonstrates that decisions are frequently made that are not in the best interests of carriers from a network optimisation and efficiency perspective, resulting in unnecessary added costs and transit times. This has a negative impact on the competitiveness of Chinese exporters.

While liner shipping companies recognise that there may be physical limitations affecting the ability of certain vessels to berth at particular terminals and that certain terminals occasionally may be fully utilised at peak periods, this is not a universal situation and there are far more opportunities to accommodate the needs of shipping lines than are currently allowed.

As most port groups enjoy a monopolistic market position shipping lines are in a weak negotiating position and carrier demands are, thus, frequently disregarded. Monopolies are common within the port industry due the nature of activities, scale of operations and significant investments within China and abroad. With monopolies, however, comes risk of inefficiency and abuse. The potential deleterious effects of monopolies can be avoided, though, through enhanced dialogue and by requiring port groups not to abuse their monopolistic position at the expense of customers.

As per the *Decision*, reform of state-owned enterprises (SOEs) will be deepened to ensure fairer competition and greater efficiency. The Third Plenum also recognised the equal importance of state and non-state ownership, a shift from previous formulations. The implementation of SOE reforms should therefore allow carriers to influence the decision on which terminal to call at to ensure network optimisation and reduction of transit times, fuel consumption and costs.

##### Recommendations

- Change the monopolistic practice of dictating to carriers which terminal to call at, via a process of recommendations and dialogue.
- Permit carriers to choose terminals based on market supply and demand as well as conditions such as vessel tonnage, berth classification and availability.

#### 5. Permit Low Visibility Navigation

##### Concern

The high frequency of port closures due to adverse weather conditions creates delays and results in higher fuel costs for carriers.

##### Assessment

Low visibility navigation in adverse weather conditions remains a problem in Chinese ports, with many closures leading to inefficiencies for liner shipping companies. The port closures cause delays affecting customers, and the need to catch up with schedules gives rise to significantly higher fuel costs.

European Union shipping companies recognise that safety must take top priority, but practice in EU ports demonstrates that low or zero visibility navigation can be carried out at no added risk to safety.

The Maritime Transport Working Group encourages further exchanges between EU and Chinese maritime safety agencies to study the feasibility of safe, low-visibility navigation in China. These could include, for example, site visits by relevant Chinese regulators to modern European ports, like Bremerhaven and Rotterdam, which also suffer from low-visibility issues but still permit zero-visibility navigation.

##### Recommendation

- Follow best practices of leading international ports, and enable navigation in low- or no-visibility conditions.

#### Abbreviations

CNY	Chinese Yuan (currency)
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
EU	European Union
EUR	Euro (currency)
FTZ	Free Trade Zone
MOT	Ministry of Transport
SOE	State-Owned Enterprise
SSE	Shanghai Shipping Exchange

## Quality and Safety Services Sub-Working Group

### Key Recommendations

#### 1. Remove the Excessive Administrative Control/Approvals in the Quality and Safety Service (QSS) Industry, and Allow Market Mechanisms to Take a Decisive Role in this Sector in Order to Benefit Chinese Consumers and the Industry as a Whole

- Reform the existing system to remove excessive administrative control/approval in the quality and safety service (QSS) industry, and allow market mechanisms to take a decisive role in this sector.
- Support the State Council's endeavour to further promote the reform of the QSS sector: reduce regulatory barriers to allow equal access for duly incorporated foreign testing and certification companies to the Chinese market; reduce and eliminate repetitive administrative approvals; eradicate the practice of using 'recommended testing laboratories' as another layer of market access obstacles; and encourage public-private partnerships (PPPs) to enhance access for private enterprises and foreign stakeholders to more public procurement and consultancy projects.
- Refine the methodology for the administration of compulsory product certification and accreditation by eliminating or reducing required procedures and registrations in administrative approval processes, narrowing the scope of items or products that are required for mandated certification, and allowing certification institutions and laboratories accredited by the China National Accreditation Service (CNAS) for Conformity Assessment to carry out such business to safeguard the seriousness and authority of its accreditation decisions.
- Reduce the unified national certification standards and rules, and certification programmes jointly promoted by the Certification and Accreditation Administration (CNCA) and relevant departments under the State Council, keeping only those related to national defence and security.
- Put an end to the role of government as both the regulator and operator of the QSS industry.
- Simplify the procedures for foreign auditors or factory inspectors to obtain qualifications in China, acknowledge the qualifications they already have or develop policies for mutual recognition of qualifications.
- Focus sector-supervision measures on critical technical concerns rather than administrative issues.

#### 2. Make TIC Service Industry Issues an Independent Subject within the EU-China Comprehensive Agreement on Investment (CAI)

- Remove administrative approval processes through negotiation and adopt technology-based administrative measures.
- Remove statutory import-export commodity inspections that are not backed-up by technical standards through negotiation.

#### 3. Adopt Market-Based Mechanisms to Reform Government-affiliated TIC Institutions and Avoid a Second Monopoly Through Administrative Support

- Adopt market mechanisms to prevent rent-seeking and monopolies during the reform of government-affiliated TIC institutions.

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.

- Reduce excessive market access and regulatory barriers and conduct assessments with universally-practiced standards.
- Provide the same treatment to foreign TIC institutions so they are entitled to the same market status as their domestic peers.

#### 4. China Pilot Free Trade Zones (CPFTZs)

- Enable full functioning of the market within the CPFTZs, completely removing administrative regulatory requirements on third-party TIC service providers.
- Move product quality under civil jurisdiction (instead of administrative law) and completely eliminate the government's administrative interference in civil conflicts within the CPFTZs.

## Introduction to the Sub Working Group

The Quality and Safety Services Working Group was established in 2012, as a sub-working group to the Standards and Conformity Assessment (SCA) Working Group. Comprised of European Chamber members in the quality and safety services (QSS) sector, the Quality and Safety Services Working Group was established to provide a platform to monitor and exchange experiences on developments in the regulatory environment and business operating conditions affecting the sector. The sector is defined in this paper as independent, third-party enterprises that provide manufacturers and end-users with testing, inspection and certification (TIC) and other conformity assessment-related services in relation to their products and systems, with the aim of improving the safety and quality of products on the market.

The Quality and Safety Services Working Group identifies concerns regarding the current state of the sector and proposes constructive recommendations, with the aim of creating a QSS system that better serves society through increased transparency, coordination and market access for all players. The Standards and Conformity Assessment Working Group, comprised of manufacturers that are affected by standardisation and conformity assessment issues, works closely with the Quality and Safety Services Working Group, with the mutual aim of supporting the development of China's standardisation and conformity assessment system.

## Recent Developments

Compared with other major economies, China has a heavily regulated central certification system operated by the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) and other governmental ministries. These agencies have tremendous control over the nationwide quality and safety system, as well as standards development and enforcement by dominating mandatory TIC schemes. This restricted market enables state-owned enterprises (SOEs) and government-associated enterprises to monopolise a huge market share of China's QSS sector, while well-known and qualified foreign testing companies make up a small share of the market.

A string of quality and safety scandals, such as the Sanlu milk powder incident, has highlighted the shortcomings of a closed market. The lack of transparent regulatory processes and the poor coordination of regulatory bodies also contribute to the low quality and safety performance of the country as a whole. Furthermore, Chinese regulatory bodies are implementing stricter market access controls, such as the list of recommended laboratories, as an administrative measure to prevent market opening to foreign QSS providers.

On the following page is a list of new policies pertaining to the TIC industry, published in 2014 and 2015:



Date	Publisher	Regulations/Circulars
14/02/2014	SAIC	<i>Measures on Sampling Inspection on Quality of Commodities in Circulation</i> (SAIC Order No. 61)
21/02/2014	State Commission Office of Public Sectors Reform (SCOPSR), AQSIQ	<i>Circular on Opinions of SCOPSR and AQSIQ for Implementing the Integration of Testing, Inspection and Certification Institutions</i> (State Council General Office [2014] No. 8)
06/06/2014	CNCA	<i>Notice on Additional Certification Institutions and Laboratories Intended for Undertaking Relevant Compulsory Product Certifications</i> (CNCA Notice No. 17)
09/06/2014	AQSIQ, General Administration of Customs (GAC)	<i>Entry-Exit Commodity Catalogue for Inspection and Quarantine by CIQ</i> (Joint Order [2014] No. 62)
28/07/2014	State Council	<i>Guiding Opinions on Accelerating the Development of Production-type Service Industries to Promote Restructuring and Enhancement of Industrial Structure</i> (State Council Order [2014] No. 26)
19/11/2014	CNCA	<i>Notice on Publishing the Classified Catalogues and Key Approval Requirements for Voluntary Certification</i> (CNCA Notice No. 38)
24/11/2014	State Council	58 administrative approvals have been cancelled or delegated to local governments by the State Council
06/03/2015	AQSIQ	<i>Guiding Opinions on the Integration of Testing, Inspection and Certification Institutions Under National Quality Inspection System</i> (Guozhijianke [2015] No.86)
17/03/2015	AQSIQ	<i>Administrative Measures on Credit Adoption of Inspection Results for Entry-Exit Industrial Products</i> (draft for comments)
29/03/2015	State Council	<i>2015 Action Plan for the Implementation of Quality Development Outline</i> (Guobanfa [2015] No.19)
09/04/2015	AQSIQ	<i>Administrative Measures on Qualification Accreditation of Testing and Inspection Bodies</i> (AQSIQ Order No.163)
13/04/2015	CNCA	<i>Closer Economic Partnership Arrangements (CEPA) Between Mainland China and Hong Kong</i> (CNCA Notice No. 7)
13/04/2015	CNCA	<i>Closer Economic Partnership Arrangements (CEPA) between Mainland China and Macau</i> (CNCA Notice No. 8)
11/05/2015	AQSIQ	<i>AQSIQ's Decision on Amending the Administrative Measures for Certification Bodies</i> (AQSIQ Order No.164)
10/06/2015	AQSIQ	<i>Regulation Regarding Testing and Inspection Agencies for Imports/Exports</i> (draft for comments)
07/07/2015	AQSIQ	<i>Administrative Measures on Metrological Verification Personnel</i> (draft for comments)
13/07/2015	CNCA	<i>Guidelines on Improving Service Quality of Testing and Inspection Agencies</i> (draft for comments)

### China's Economic Reform

Since the Third Plenum of the 18<sup>th</sup> Communist Party of China Central Committee, many administrative and economic reform projects have been underway. However, in the TIC industry reform schemes have not yet been introduced. China has been working on these issues for two years and the problems have not yet been substantively resolved.

The State Council issued the *Notice of Central Office Opinions on the Implementation of Integrated Inspection and Testing Certification Institution*<sup>1</sup> on 21<sup>st</sup> February, 2014, which is not only a rational integration of the current administrative system but also a de-administration reform. There is concern that due to a lack of previous reform measures in the field and at the local level, some government functions would be transferred to some special associations or SOEs in a monopoly position. Therefore, even though the government's burden would be reduced to some extent, the market self-adjustment function would be further impaired.

### China Certification and Accreditation Association (CCAA)

In 2013, the CCAA, still under the influence of China's administrative management system, issued some drafts for comment on voluntary regulatory documents and guidance: the *Voluntary Certification Registration Personnel Code of Conduct* and the *Certification Personnel Salary Income and Stimulus System Guidance*. The documents provide 'recommended' regulations on salary, bonuses and even on the scope of mid-level management work. Such significant interference at the micro level of enterprises' operations is a rare phenomenon in light of recent reforms. The working group believes that government-affiliated associations should not act as the 'second (pseudo) government' by taking over issues that do not fall directly under the government's responsibility and which interfere with the market.

### China Food and Drug Administration (CFDA)

The CFDA has procured services from social organisations. However, as a measure to prevent state secrets being revealed, there are local government agencies claiming that technical services from third parties are not

allowed. As part of China's World Trade Organisation (WTO) agreement, the Chinese Government promised that some restrictive policies would become transparent and policies would not be implemented without announcement. However, the above-mentioned restrictive measures on third parties were implemented internally with no official accompanying documentation. This is inconsistent with the government's commitment to the WTO.

According to the State Secret Law,<sup>2</sup> inspection services from third-party inspection institutions have nothing to do with state secrets. Third-party institutions operate under the following procedure: clients or government offer samples, the institution then tests and offers a technical explanation and reports. Thus the institutions are solely responsible for the samples and the consigned clients. Based on international rules, the third party is not allowed to release report results independent of their clients. A confidentiality agreement must be signed between the third party and the client. Under the agreement, the only exception is under the term of a 'special condition', where the institutions must report to the government according to the Food Safety Law.<sup>3</sup>

### China Pilot Free Trade Zones (CPFTZs)

The China (Shanghai) Pilot Free Trade Zone (CSPFTZ) was approved by the central government in 2013. On 1<sup>st</sup> March, 2015, the National People's Congress Standing Committee authorised the State Council to establish a further three free trade zones in Tianjin, Guangdong and Fujian. The decisions on temporarily adjusting relevant regulations on administrative approvals in free trade areas<sup>4</sup> will be implemented formally. On 20<sup>th</sup> April, 2015, the State Council issued the notice on deepening the reform and opening of pilot free trade zones in China (including Shanghai, Tianjin, Guangdong and Fujian), directing the next steps for reform. With respect to the TIC sector, only favourable policies for approval of incorporation have been issued so far, while there are no signs of improvement on those related to administrative regulations – each inspection carried out by the inspection laboratory has to be approved by







<sup>1</sup> *Notice of Central Office Opinions on the Implementation of Integrated Inspection and Testing Certification Institution*, State Council, 21<sup>st</sup> February, 2014, viewed 13<sup>th</sup> April, 2015, <[http://www.gov.cn/zhengce/content/2014-03/11/content\\_8707.htm](http://www.gov.cn/zhengce/content/2014-03/11/content_8707.htm)>

<sup>2</sup> *State Secret Law of People's Republic of China*, NPC, 29<sup>th</sup> April, 2010, viewed 13<sup>th</sup> April, 2015, <[http://www.gov.cn/jffig/2010-04/30/content\\_1596420.htm](http://www.gov.cn/jffig/2010-04/30/content_1596420.htm)>

<sup>3</sup> *Food Safety Law of People's Republic of China*, NPC, 25<sup>th</sup> April, 2015, viewed 26<sup>th</sup> April, 2015, <[http://www.gov.cn/zhengce/2015-04/25/content\\_2853643.htm](http://www.gov.cn/zhengce/2015-04/25/content_2853643.htm)>











<sup>4</sup> *Decisions on temporarily adjusting relevant regulations on administrative approval in China (Guangdong) Free Trade Pilot Zone, in China (Tianjin) Free Trade Pilot Zone, China (Fujian) Free Trade Pilot Zone and the Extended Area of China (Shanghai) Free Trade Pilot Zone*, NPC, 28<sup>th</sup> December, 2014, viewed 17<sup>th</sup> March, 2015, <<http://finance.people.com.cn/n/2014/1229/c1004-26291103.html>>



Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> <sup>5</sup> say?	What is the Reality?	Status
We will implement a unified market access system; and on the basis of making a negative list, all kinds of market players may enter areas not on the negative list on an equal basis and according to law.	The general negative list has not been released yet. The new rules published by the AQSIQ this year still distinguish between foreign and domestic investments. Moreover, the new rules will apply until 2020.	
We will explore a management model for foreign investors with pre-entry national treatment plus the negative list. We will make the business registration system more convenient by reducing the number of items that require qualification verification, turning certification before licensing into licensing before certification, and gradually changing the paid-in capital registration system into a subscribed capital registration system.	The new <i>Foreign Investment Catalogue</i> has removed the inspection and certification industry from the 'restricted' category, but in reality, this is not reflected in the practice of the AQSIQ, even in the CSPFTZ. The management model has not yet been made public, and the number of items that require qualification verification has not been reduced. The system of certification before licensing was turned into licensing before certification with respect to the certification industry and the registration of import and export product testing institutions.	
We will reform the market oversight system, implement uniform market oversight, tidy up and annul all sorts of regulations and methods that impede the national unified market and fair competition, strictly ban and punish all unlawful acts extending preferential policies, combat regional protection, and oppose monopoly and unfair competition.	For foreign institutions, there are no clear rules with regard to how to apply for state-promoted certification qualifications. So far, only domestic certification institutions have obtained such qualifications. The inspection and certification industry is still characterised by market interference by government-designated agencies as well as monopolies under administrative support.	
We will establish and improve a social credit system to commend honesty and punish dishonesty.	Fake reports and certificates of internationally well-known inspection and certification institutions still exist. A social credit system in the field of product safety should run as a supplement to civil dispute settlement without overly involving public powers in the prevention and settlement process.	
We will improve the market exit system in which the good eliminates the bad, and perfect the enterprise bankruptcy system.	No clear progress has been observed so far, since the function of the market requires the absence of administrative interference, including the administrative approval of qualifications.	
We will further streamline the administration and delegate more power to lower levels, deepen the reform of the system concerning matters subject to government examination and approval, and reduce the central government's administration in micro affairs to the greatest extent.	There are no substantial changes in the inspection and certification industry. Significant reduction in the number of administrative approval items and application documents has not been realised yet.	

<sup>5</sup> The Third Plenum of the 18th National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.



We will cancel all administrative approval procedures for economic activities under the effective regulation of the market mechanism.	The government still has doubts with regards to the market's ability to effectively regulate economic activities.	
We will manage matters that require administrative approval according to procedures and with high efficiency.	There are no sufficient facts to indicate that the management is being regulated and the efficiency is improved.	
We will promote government purchases of public services by means of contract and entrustment, and introduce a competition mechanism into general-affairs management services.	There are some symbolic projects but with many restrictions.	
We will accelerate the reform of public institutions based on the classification of their functions, increase government purchases of public services, straighten up the relationship between public institutions and their competent administrative departments, and promote de-administration of public institutions.	Though there has been ample public discourse on this matter, little has been done to put it into practice.	
We will improve the government's organisational structure, function composition, and work procedures so that we will have a good administrative system with decision-making, executive, and oversight powers checking each other and operating in concert with one another.	The tasks are heavy and will take time.	
We will have strict management on performance, fulfil government responsibilities, and ensure the integration of power and responsibility.	No clear progress has been observed so far.	
We will introduce a list of the powers of local governments and their working departments at all levels, and publicise the power-exercise process in accordance with the law.	It is uncommon that such information is made public.	
We will improve information disclosure in the Party, government and other fields, so as to promote transparency in decision-making, management, services and results.	No clear progress has been observed so far.	
We will speed up institutional reform to fight formalism, bureaucracy, hedonism and extravagance.	Formalism and bureaucracy still exist, but in a form less obvious than previously.	
We will improve the system under which officials take the lead to improve work style and stay close to the community to conduct research, and perfect the system of keeping in close contact with and serving the people.	Staying close to the community to conduct research does not always lead to satisfactory results.	

the relevant authority, subject to the mandated China Metrology Accreditation (now the China Inspection Body and Laboratory Mandatory Approval) (CMA) Capacity Inventory, and product certification has to be approved individually, based on CNCA procedures. Existing administrative restrictions still apply to micro-operation of all enterprises doing business in all of the CPFTZs.

#### Reform in Process

In the past, China's market restricted foreign enterprises from entering the voluntary product certification business. As far as the working group is concerned, the market should play the decisive role in the TIC service market. It is recommended that reforms should take place to reduce government interference in the market on a micro level, to avoid market segmentation; and that





transformation from administrative approval approaches to market self-regulation should be facilitated, so that the current condition of quality and safety in China can be improved.

From 2014 to 2015, the working group did not witness any positive changes in terms of the key concerns addressed in the previous position paper. The working group believes that market-based reforms will allow better transparency, coordination and competition that will benefit the entire society. The working group hopes the listed key recommendations will provide solutions and contribute to China's transition to a more safe and sustainable society.

## Key Recommendations

### 1. Remove the Excessive Administrative Control/Approvals in the Quality and Safety Service (QSS) Industry, and Allow Market Mechanisms to Take a Decisive Role in this Sector in Order to Benefit Chinese Consumers and the Industry as a Whole

#### Concern

The government plays a triple role of enabler, regulator and operator and gives precedence to administrative requirements over technical requirements. This hinders the market's healthy development and deprives foreign QSS providers from a level playing field.

#### Assessment

In major economies, such as Europe, the QSS market is open to both local providers and international investors. The role of government focuses on policy-making, regulating and implementing controls based on reasoning and observation. This is a different story in China where the government plays multiple roles in the market, and its highly-regulated certification system has a huge influence over product quality and safety.

The government's role as enabler, regulator and operator jeopardises the healthy development of the QSS industry and society as a whole. State-owned enterprises and state-associated enterprises monopolise the Chinese market while independent foreign providers are unable to compete equally. The outcome of this situation is a poor perception of the Chinese testing and certification market, both at home and abroad. Foreign companies and local Chinese

companies often do not trust certificates issued by small local certification providers.

The recent development, with the release of *Notice No. 8* issued in 2014, by the State Council General Office on *The Opinions on Implementing the Integration of Testing, Inspection and Certification (TIC) Institutions*<sup>6</sup> seems to go in the right direction by stating the intention to break state-associated enterprises' monopoly, but its implementation needs to be monitored closely. This point will be developed further in the third key recommendation of this paper.

#### a) Accreditation difficulties for testing laboratories and certification bodies

There are two accreditation systems for testing laboratories in China: the technical system managed by the China National Accreditation Supervision Commission (CNAS) and the administrative system established by the CMA. The CMA system works as a testing laboratory regulator that approves every testing method and product for testing laboratories of companies nationwide. All foreign competitors are required to apply for accreditation from the CMA. In particular, administrative bodies have developed the *Competency List* which goes beyond the China Metrology Law, with this self-empowered administrative approval system covering every test item. As a result, the non-transparent certification process, undefined implementation policies from local BQTs and the time-consuming application process (the CMA's approval on new items takes several months), as well as the cost associated with this practice, pose a significant burden to foreign companies. *The Administrative Measures for Qualification Accreditation of Testing and Inspection Agencies* released in 2015, did not reform the CMA system according to the State Council's requirement for streamlining administrative approval items. Instead, it changed the CMA's English translation into the "China Inspection Body and Laboratory Mandatory Approval" without legal basis. If the CMA's *Competency List* used to be regarded as the result of administrative bodies' self-empowerment aimed at collecting more fees, thus contrary to the China Metrology Law's definition of compulsory calibration services as public goods, the *Administrative Measures* failed to increase its legitimacy, and created a new administrative

<sup>6</sup> The Opinions on Implementing the Integration of Testing, Inspection and Certification (TIC) Institutions, State Council, 11<sup>th</sup> March, 2014, viewed 28<sup>th</sup> April, 2015, <[http://www.gov.cn/zhengce/content/2014-03/11/content\\_8707.htm](http://www.gov.cn/zhengce/content/2014-03/11/content_8707.htm)>



approval system lacking legal basis instead. This is clearly contrary to the State Council's requirement for streamlining administrative approval items.

Certification bodies applying to a new certification scheme in China (such as the Food Safety Management System) first need to comply with a number of administrative constraints issued by the Certification and Accreditation Administration (CNCA), including, but not limited to, recruiting a minimum number of 10 qualified employees before they even have a chance to go for technical accreditation. This demonstrates that China's administrative bodies interfere with technical issues beyond their competence. The working group is convinced that technical qualification should take precedence over administrative barriers of entry and is closely following reform progress in this regard, hoping for a complete change of the current situation.

#### b) Recommended providers and other administrative restrictions

Upon the release of new laws relevant to quality and safety, regulatory authorities will generally seize the chance to enforce compulsory testing and certification of new products, and develop a list of so-called recommended testing laboratories or certification institutions that are allowed to engage in relevant businesses. Due to lack of transparency in the selection process and eligibility criteria, independent foreign service providers are often excluded from the recommendation list. Thus, independent service providers are unable to compete on new product testing, and will even be replaced by those on the list because customers often prefer not to use multiple service providers simultaneously. Therefore, the working group perceives such lists as market access obstacles in nature, denying equal access for independent service providers to the quality and safety-related market. Similar barriers can be found in other regulations, which include China Compulsory Certification (CCC), photovoltaic products and low carbon products certification, the *Administrative Measures on Restriction of Hazardous Substances in Electrical and Electronic Products*, as well as food and dangerous chemicals management-related regulations.

#### Case Study

A total of more than 40 local certification bodies or verification companies have been approved so far to conduct verification activities in the context of the newly-created seven Carbon Emissions Trading Pilots across China. Thus far, not a single foreign organisation has been approved in any of the pilot regions despite a number of them having applied and met the application criteria. For more information on carbon market-related issues, please refer to the *Carbon Market Working Group Position Paper*.

The ambiguous role of the government has ultimately encouraged a lack of market competition which has led to poor services and unsafe products, and has also resulted in heavier and more complex mandatory testing and certification schemes, producing revenues for certain government-associated players but badly hindering innovation. Certain certifications have to be approved by both the CNCA and industrial regulators.

#### Case Study

Applicants for the qualification of inspection institutions engaged in the quality control of construction projects<sup>7</sup> need to submit the following documents: the CMA qualification certificate (delivered by a provincial-level quality supervision department), a specific qualifications certificate and the witnessed sampling qualification certificate (delivered by provincial-level housing and urban-rural development departments).

The working group believes that the above-mentioned regulatory trend is not in line with China's economic reform goals and the concept of building a safe and harmonious society. These restrictions hinder the annual 18 per cent growth target of the high-tech services industry (including testing and certification services sector) stated in the *12<sup>th</sup> Five-Year Plan*.<sup>8</sup> This target can only be achieved by moving towards a market-based quality and safety system where the

<sup>7</sup> *Examination and Approval of Qualifications of Inspection Institution Engaged in Quality Control of Construction Projects*, Liaoning People's Government, viewed 5<sup>th</sup> May, 2015, <[http://www.ln.gov.cn/wsbs1/bmbs/sjst/sjst\\_1/](http://www.ln.gov.cn/wsbs1/bmbs/sjst/sjst_1/)>

<sup>8</sup> *12<sup>th</sup> Five-Year Plan on the Service Industry*, State Council, 1<sup>st</sup> December, 2012, viewed 29<sup>th</sup> April, 2015, <[http://www.gov.cn/zwqk/2012-12/12/content\\_2288778.htm](http://www.gov.cn/zwqk/2012-12/12/content_2288778.htm)>



regulator and service providers are truly independent, in order to prevent groups profiting from increasing the number and scope of mandatory TIC schemes; hindering qualified foreign, legitimate, independent service providers in the market; and encouraging a market monopoly of government-affiliated service providers.<sup>9</sup>

#### Case Study

In order to encourage the use of environmentally-friendly coatings, the State Administration of Taxation (SAT) has exempted volatile organic compound (VOC)-free coatings from consumption tax, provided that qualified testing laboratories have issued test reports on the products concerned. Some local BQTs and taxation bureaus decided that only test reports issued by testing laboratories qualified for the China Accredited Laboratory (CAL) accreditation can be accepted. This is a typical type of administrative intervention in the functioning of the market, so as to acquire a larger market share for government-affiliated bodies.

Granting independent foreign services providers equal market access will bring benefits to the market, industry, society and end-users, and will enable much healthier and more sustainable development of China as a whole.

#### Case Study

When it comes to complete machine certification, CCC product certification only acknowledges the results of the China Quality Certification Centre (CQC) voluntary certification for components and parts and does not adopt testing or certification results at state level.

#### c) Restrictions on voluntary certification schemes

Administrative approval requirements for new voluntary certification schemes hinders healthy market development and blocks access to the best international practices and quality benchmarks. For example, new international voluntary schemes, *ISO 14064 Carbon Life-cycle Measurement* and *ISO 14046 Water Footprinting* were

<sup>9</sup> *Petrochemical Association propose to suspend the law review of petrochemical products*, *China Energy News*, 30<sup>th</sup> April, 2012, viewed 22<sup>nd</sup> May, 2015, <[http://paper.people.com.cn/zgnyb/html/2012-04/30/content\\_1043446.htm?div=-1](http://paper.people.com.cn/zgnyb/html/2012-04/30/content_1043446.htm?div=-1)>

introduced and recognised worldwide. The excessive certification registration and approval process deprives Chinese companies of the access to the latest global practices. It creates a fragmented China market with additional market barriers for companies.

Voluntary certification schemes have contributed to the Chinese economy and helped Chinese companies engage with international standards, such as the *ISO 9000 Quality Management System*. The working group recommends the removal of unnecessary mandatory approaches, and shortening the time-consuming application process for the introduction of new voluntary certification schemes into China, or at least allowing authorised companies to issue certification while they go through the lengthy registration process. The CNCA has consulted certification bodies in March 2013 for advice on the removal of administrative barriers, however, administrative barriers have not been removed from any new regulations so far.

#### d) Auditor qualification requirements create bottlenecks in resources

Obtaining and maintaining the Auditor or Inspector Qualification for the QSS industry in China is a burdensome process. Once auditors or inspectors leave the industry for a year, they will automatically lose their qualification and must go through the qualification process again if they want to practice the same business.

The China Certification and Accreditation Association (CCAA) would benefit from following auditor and inspector qualification processes in other countries, where auditors and inspectors are encouraged to move between industries, and such experience is considered as beneficial to their overall skill sets.

A more streamlined process for recognising the qualifications of foreign auditors and inspectors would also benefit the sector by meeting the demands of auditors and inspectors, and exposing Chinese companies and relevant personnel to advanced auditing know-how, management theories and tools.

#### Recommendations

- Reform the existing system to remove excessive administrative control/approval in the QSS industry, and allow market mechanisms to take a decisive role in this sector.



- Support the State Council's endeavour to further promote the reform of the QSS sector: reduce regulatory barriers to allow equal access for duly incorporated foreign testing and certification companies to the Chinese market; reduce and eliminate repetitive administrative approvals; eradicate the practice of using 'recommended testing laboratories' as another layer of market access obstacles; and encourage PPPs to enhance access for private enterprises and foreign stakeholders to more public procurement and consultancy projects.
- Refine the methodology for the administration of compulsory product certification and accreditation by eliminating or reducing required procedures and registrations in administrative approval processes, narrowing the scope of items or products that are required for mandated certification, and allowing certification institutions and laboratories accredited by the CNAS for Conformity Assessment to carry out such business to safeguard the seriousness and authority of its accreditation decisions.
- Reduce the unified national certification standards and rules, and certification programmes jointly promoted by the CNCA and relevant departments under the State Council, keeping only those related to national defence and security.
- Put an end to the role of government as both the regulator and operator of the QSS industry.
- Simplify the procedures for foreign auditors or factory inspectors to obtain qualifications in China, acknowledge the qualifications they already have or develop policies for mutual recognition of qualifications.
- Focus sector-supervision measures on critical technical concerns rather than administrative issues.

## 2. Make TIC Service Industry Issues an Independent Subject within the EU-China Comprehensive Agreement on Investment (CAI)

### Concern

The TIC industry is a specialised service industry relating to quality and safety issues and using standard technologies that are easily identifiable. The leading EU enterprises maintain major investment interests in this sector in China, and the service market in this field may impact the technology advancement and productivity promotion in other sectors such as trade, agriculture, manufacturing, retail and services industries.

### Assessment

The TIC service sector is an industry of great significance to China's economic transformation and enhancement in the long run. To successfully transition from economic growth based on labour-intensive production to a more advanced, qualitative economic growth model based on consumption and services, China will need to rely more on strong technological expertise and standard services rather than existing administrative enforcement placing a priority on supervision coupled with service functions. In the *12<sup>th</sup> Five-Year Plan*, published three years ago, the Chinese Government stressed that the standard technology service market shall achieve an increase in multiples of gross domestic product (GDP) growth up to 18 per cent each year.<sup>10</sup>

The State Council's decision to cancel the mandated commodity inspection charges<sup>11</sup> indicates that provision of public goods by the government shall not be deemed as an act that is subject to compulsory administrative charges. All administrative departments are required to re-examine the legitimacy of their approval procedures and shall terminate those with no legal basis to unleash suppressed market dynamics. More efforts are given to speed up the reform of bulky, inefficient and non-market-based public entities related to technology standard services, in the hopes of fostering a unified, open and competitive market without sector fragmentation and driving aforesaid entities to fully switch to a service model. In addition, administrative departments should understand where to set boundaries on their powers.

The EU's and other western QSS companies have been important service providers to EU enterprises in China in terms of technical standards services and providing strong technological support to EU-China trade and investment activities. The large-scale manufacturing industry in China is also eager to acquire critical support and services in its process of transforming and upgrading to a modernised business model. Such service providers carry out business by: (1) receiving the standards specified by its customers, whether they are globally or locally practiced, mandated, or defined by associations or enterprises; (2) conducting conformity assessments, based on contract terms and taking advantage of their own professional expertise,

10 *12<sup>th</sup> Five-Year Plan on the Service Industry*, State Council, 1<sup>st</sup> December, 2012, viewed 29<sup>th</sup> April, 2015, <[http://www.gov.cn/zwqk/2012-12/12/content\\_2288778.htm](http://www.gov.cn/zwqk/2012-12/12/content_2288778.htm)>

11 *State Council Executive Meeting*, 24<sup>th</sup> July, 2013, viewed 2<sup>nd</sup> May, 2015, <[http://www.gov.cn/guowuyuan/2013-07/24/content\\_2591129.htm](http://www.gov.cn/guowuyuan/2013-07/24/content_2591129.htm)>



equipment and service network; and (3) providing independent and fair conformity assessment reports. There exists a nationalistic mentality in favour of the restriction of foreign technical standards service providers, according to which foreign service providers will destroy national industry by promoting technical standards that don't correspond to China's stage of development. Such a false perception is rendered groundless by the business model described above. Therefore, politically, the working group does not think there will be any conflicts between the EU and China in this respect. The parties can negotiate to build a foundation that will eventually produce a win-win outcome.

China is in great need of developing its technical standards market, speeding up the improvement of product and service quality, reforming the low-standard quality and safety management system, emphasising administrative quality supervision—a legacy of the planned economy era—and creating a new methodology for reform. The foreign technical standard service providers led by EU enterprises could provide services in the course of the government's release of market space through reforms, assisting the government with transformation and upgrading of administrative management. The 'survival of the fittest' principle should play a fundamental role in this sector characterised by creditability, professionalism and fairness. The parties at the negotiation table could identify common interests through exchange of best practices and find solutions to commonly faced issues, thereby satisfying the increasing quality and service demands of Chinese society.

The working group suggests discussing TIC industry issues separately in the ongoing EU-China CAI negotiations provided that the market-based mechanism is adopted by both governments. A high priority should be given to the issues of extensive SOE monopoly, government procurement of relevant services and opening-up a free, competitive environment.

#### Recommendations

- Remove administrative approval processes through negotiation and adopt technology-based administrative measures.
- Remove statutory import-export commodity inspections that are not backed-up by technical standards through negotiation.

### 3. Adopt Market-Based Mechanisms to Reform Government-affiliated TIC Institutions and Avoid a Second Monopoly Through Administrative Support

#### Concern

The government directly interferes with the TIC services industry, which should be covered by civil-law jurisdiction: TIC industry reforms should avoid creating chaotic market fragmentation and industry monopoly that results from excessive administrative interference.

#### Assessment

On 21<sup>st</sup> February, 2014, the State Council promulgated the *Notice on the Notification of SCOPSR AQSIQ Comments on Implementing Integration of Testing, Inspection and Certification Institution* (State Council, *Guobanfa* [2014] No.8) (*Notice*).<sup>12</sup> Guided by the State Council's *Institutional and Administrative Reform Plan*,<sup>13</sup> the *Notice* is a strong step forward for the reform of government-affiliated TIC institutions. Based on the *Notice*, the AQSIQ issued the *Guiding Opinions on Integration of Testing, Inspection and Certification Institutions under the AQSIQ System* (AQSIQ QSIQ Dept. [2015] No.86)<sup>14</sup> on 6<sup>th</sup> March, 2015, which explicitly states that the total of over 3,500 TIC institutions under the AQSIQ system will be classified into two categories—public welfare-based and operation-based—and by 2020, the separation of administrative and supervisory functions from service functions, as well as business transformation and restructuring, shall basically be completed. A group of branded, comprehensive TIC corporations should take shape by then.

Based on previous experience, the working group believes that the current market-oriented reform in the TIC industry is just the beginning and by no means the final reform outcome. When implementing regulations, it is essential to effectively prevent government-affiliated institutions from abusing power to ensure the success of institutional and market-orientated reform.

<sup>12</sup> *Notice on the Notification of SCOPSR AQSIQ Comments on Implementing Integration of Testing, Inspection and Certification Institution* (State Council, *Guobanfa* [2014] No.8), State Council, 21<sup>st</sup> February, 2014, viewed 10<sup>th</sup> March, 2015, <[http://www.gov.cn/zhengce/content/2014-03/11/content\\_8707.htm](http://www.gov.cn/zhengce/content/2014-03/11/content_8707.htm)>

<sup>13</sup> *Institutional and Administrative Reform Plan*, State Council, 14<sup>th</sup> March, 2013, viewed 10<sup>th</sup> March, 2015, <[http://www.gov.cn/2013/03/content\\_2354443.htm](http://www.gov.cn/2013/03/content_2354443.htm)>

<sup>14</sup> *Guiding Opinions on Integration of Testing, Inspection and Certification Institutions under the AQSIQ System* (AQSIQ QSIQ Dept. [2015] No.86), AQSIQ, 16<sup>th</sup> March, 2015, viewed 17<sup>th</sup> March, 2015, <[http://www.aqsiq.gov.cn/xxgk\\_13386/jgjl/tzbaqj/tzdt/201503/t20150316\\_434296.htm](http://www.aqsiq.gov.cn/xxgk_13386/jgjl/tzbaqj/tzdt/201503/t20150316_434296.htm)>



The working group expresses great concern about the risk of an administrative-supported monopoly driven by state-owned TIC service companies absorbing the 'reform vacuum' during ongoing administrative reforms, which is a breach of the Anti-Monopoly Law and further hinders the development of a competitive market environment. Market fragmentation and an industry monopoly by SOEs deviates from the aim of market-orientated reform and can even jeopardise the reform process itself – it would not help to substantially resolve China's pressing quality and safety issues.

During the ongoing reform process, the working group has noted that the Chinese Government pays close attention to the macro management of the whole service industry. European enterprises have advanced management concepts and market experience in this regard, as well as positive experiences that have assisted the EU and its Member States to reform the TIC service industry in the past. The working group would like to offer industry suggestions on administrative reform via various channels in order to improve the entire quality and safety environment in China, to increase the competitiveness of 'made-in-China' products and to achieve win-win situations for EU-China trade and investment. This experience sharing would be mutually beneficial for the negotiations, and would help decrease EU-China trade conflicts and upgrade the China quality and safety level for products and services.

#### Recommendations

- Adopt market mechanisms to prevent rent-seeking and monopolies during the reform of government-affiliated TIC institutions.
- Reduce excessive market access and regulatory barriers and conduct assessments with universally-practiced standards.
- Provide the same treatment to foreign TIC institutions so they are entitled to the same market status as their domestic peers.

## 4. China Pilot Free Trade Zones (CPFTZs)

### Concern

The testing, inspection and certification (TIC) service sector within the China Pilot Free Trade Zones (CPFTZs) is still subject to administrative approvals, with market mechanisms not playing a decisive role.

### Assessment

The China (Shanghai) Pilot Free Trade Zone (CSPFTZ) reform plays a highly strategic role for the overall reform of the TIC service sector in China. On 20<sup>th</sup> April, 2015, the State Council presented its guiding opinions on the TIC field in the *Overall Plans for the Development of Pilot Free Trade Zones in Shanghai, Tianjin, Guangdong and Fujian*.<sup>15</sup> These included promoting enterprise energy management certification in Shanghai; requiring the handover of TIC functions from government departments to professional institutions in Tianjin; adopting the policy of one-time inspection and certification in Guangdong, Hong Kong and Macao; and allowing relevant institutions from Taiwan recognised by accreditation institutions in Taiwan, and having demonstrated capacities to conduct CCC, to undertake compulsory product certification and inspection activities in Fujian. All such measures demonstrate the central government's resolution to work towards system reform and the complete removal of administrative control over trade-related technical services. The working group believes that the quality and safety concerns of the TIC industry, such as quarantine, sanitary and phytosanitary services, should be managed and supervised by China civil affairs laws and regulations.

The updated *Negative List for Foreign Investment in Pilot Free Trade Zones*,<sup>16</sup> issued in April 2015, has removed certain restrictions on foreign TIC institutions. However, the working group expects more innovative breakthroughs, as well as more clarity, so that the actual details of the reforms can be fully explained. The working group has only witnessed improved policy and streamlined administrative approvals for enterprise establishment, and no actual administrative approval improvements in related industries. Each test issued by testing laboratories within the CPFTZs is still subject to administrative approval according to the *CMA Competency List* which is enforced by regulatory authorities; and each certification scheme is subject to the CNCA's administrative and personnel qualification approvals.

On 22<sup>nd</sup> April, 2014, the Shanghai Municipal People's Congress published a call for comments notice on the

<sup>15</sup> *Overall Plans for the Development of Pilot Free Trade Zones in Shanghai, Tianjin, Guangdong and Fujian*, State Council, 20<sup>th</sup> April, 2015, viewed 21<sup>st</sup> April, 2015, <[http://www.gov.cn/xinwen/2015-04/20/content\\_2849703.htm](http://www.gov.cn/xinwen/2015-04/20/content_2849703.htm)>

<sup>16</sup> *Negative List for Foreign Investment in Pilot Free Trade Zones*, State Council, 20<sup>th</sup> April, 2015, viewed 21<sup>st</sup> April, 2015, <[http://www.gov.cn/zhengce/content/2015-04/20/content\\_9627.htm](http://www.gov.cn/zhengce/content/2015-04/20/content_9627.htm)>



*China (Shanghai) Pilot Free Trade Zone Administration Regulation (Draft)*. Article 19, on the TIC industry, did not fully take into consideration the special features of the TIC industry and it also failed to reflect real industry issues. The Shanghai Municipal Government should take the opportunity to make innovative reform suggestions on critical issues so that the CSPFTZ model can be promoted nationwide. Nevertheless:

- The draft *Regulation* does not provide constructive reform suggestions in accordance with the reality of China's international trade management. A large amount of administrative approvals have been implemented on TIC services concerning import and export businesses, including administrative law enforcement, regulation rights combined with implementation rights, and administrative division of the market. This excessive government interference harms bilateral trade relations and trade growth. With previously-released policies on the CSPFTZ for the TIC sector that is directly involved in import and export issues, the working group witnessed no further easing of administrative regulations, and this sector is still under heavy administrative regulatory control. The working group believes that the priority task should be to fully promote a free-trade model, relax regulations in the trade-related services sector, and remove all administrative regulations from the CSPFTZ. The successful operational and managerial model of Hong Kong's free trade experience should be used as reference to enhance the CSPFTZ's competitiveness on product quality and trade growth.
- Article 19 of the draft obfuscates the concept of health, animal and plant quarantine with the nature of product quality and fails to effectively distinguish between the two concepts, instead setting management boundaries that are based on the current administrative department's jurisdiction.

With respect to issues related to health, and animal and plant quarantine, the CSPFTZ authorities should provide more appropriate and convenient measures with the premise of maintaining management enforcement, with the management of product quality being treated differently. Issues of product quality are civil and commercial matters between two trading parties by nature. In China, however, the government still interferes in issues of product quality by utilising administrative measures and public power for approval. This approval method is a special product for a planned economy, or the transition period from a planned

economy to administrative management. The CSPFTZ should have advanced reform methods to remove detrimental policies that are used for a transitional period and go against trade liberalisation. Clear differentiation between product quality and quarantine is needed.

Issues concerning product quality should be covered by civil jurisdiction rather than administrative approvals. Relevant judicial departments should be authorised to solve product quality-related issues. The phenomenon of government interference in civil conflicts should be completely abolished within the CSPFTZ. From a legal point of view, China civil legislation and judicial practices have undergone rapid developments and have gradually reached the capacity to solve quality disputes between civil parties. The Tort Law, promulgated in 2010, has provided a solid foundation for the removal of administrative intervention concerning product quality.

Overly-excessive administrative intervention is one of the market access barriers that the European Chamber pays close attention to. For product quality services within the CSPFTZ, the working group is disappointed to witness that the overall administrative approval methods in the TIC service sector are still being implemented. For every testing covered by the CMA *Competency List*, the testing institution needs to receive administrative approvals from a government department or they will face a penalty. Besides, administrative approval also covers the China Metrology Law, which is not in the *Competency List*.

For independent TIC service providers, a company's integrity and compliance are of utmost importance. The 'survival of the fittest' principle should prevail based on company reputation and market feedback. Administrative interventions will only destroy the moral foundations of this industry and can easily lead to polarisation, vicious competition and harm the self-elimination function of the market. Being the most active free trade harbour, Hong Kong's reputation and practice in trade and product quality have proven to be a good example of how survival of the fittest works for the TIC industry, and how the market can play a decisive role.

The working group encourages the AQSIQ and the regulatory authorities CPFTZs in each region to consider the above-mentioned suggestions for the purpose of better managing the issue of health, animal and plant



quarantine by advanced management methods, and completely remove administrative interventions related to issues of product and service quality. This would help to foster an open, market-oriented, competitive environment for the TIC services industry, and allow for healthy business growth free from administrative interference or government approvals.

SOE	State-owned Enterprises
TIC	Testing, Inspection and Certification
WTO	World Trade Organisation

#### Recommendations

- Enable full functioning of the market within the CPFTZs, completely removing administrative regulatory requirements on third-party TIC service providers.
- Move product quality under civil jurisdiction (instead of administrative law) and completely eliminate the government's administrative interference in civil conflicts within the CPFTZs.

## Abbreviations

AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
BQTs	Bureaus of Quality Technical Supervision
CAI	EU-China Comprehensive Agreement on Investment
CAL	China Accredited Laboratory
CCAA	China Certification and Accreditation Association
CCC	China Compulsory Certification
CFDA	China Food and Drug Administration
CIQ	Inspection and Quarantine Bureaus
CMA	China Inspection Body and Laboratory Mandatory Approval/China Metrology Accreditation
CNAS	China National Accreditation Service for Conformity Assessment
CNCA	Certification and Accreditation Administration of the People's Republic of China
CPFTZ	China Pilot Free Trade Zone
CQC	China Quality Certification Centre
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
GAC	General Administration of Customs
PPP	Public-Private Partnership
QSS	Quality and Safety Services
SAIC	State Administration for Industry and Commerce
SAT	State Administration of Taxation
SCOPSR	State Commission Office of Public Sectors Reform





**European Chamber**  
中国欧盟商会

# **Section Five:**

# **Financial Services**



## Financial Services

In the area of financial services the European Chamber has four separate working groups that present position papers for the following sectors:

- Banking and Securities
- Consumer Finance and Non-Banking Financial Institutions
- Insurance
- Private Equity and Strategic Mergers & Acquisitions

China is in the process of slowly opening its capital account and has pledged to drop controls on the movement of capital and make the *renminbi* (RMB) fully convertible. The significant step of slowly moving towards promoting market-based capital allocation took place in 2015, with the introduction of the deposit insurance scheme. This scheme lays the foundation for freeing up rates by ensuring that savers are protected, even if competition for deposits leads to excessive risk-taking and bank failure. The reform also sets the stage for full liberalisation of deposit rates, a move that would allow smaller banks to compete on the basis of deposit yields, which is seen as a key step towards letting the market—not the state—set the price of capital and risk.

The draft Foreign Investment Law (FIL) was released in 2015. The new laws aims to create the conditions for more equal treatment for foreign and domestic companies and contains several fundamental changes to the Chinese foreign investment regime. This is discussed in more depth in the *Private Equity and Mergers & Acquisitions Position Paper*.

Although 61 per cent of the respondents from the financial services industry to the European Chamber's *Business Confidence Survey 2015* reported that they were optimistic in terms of growth of financial services in China, only 20 per cent were optimistic in terms of profitability. The financial services sector has seen some slight opening but has not seen significant developments with regards to market access, and market share has been dwindling. Restrictions to market access, obstacles for organic and non-organic growth and a lack of regulatory coordination are the main factors contributing to their lack of growth and decreasing market share.

The financial services working groups, through their observations and detailed recommendations in the following position papers, hope to make significant contributions to the development of China's financial services sector.

# Banking and Securities Working Group

## Key Recommendations

### ▶ 1. Restraints Affecting Non-Organic Growth

#### Lift Restrictions on Ownership and Business Scope

- Allow foreign banking, securities and fund management enterprises to compete on an equal footing with domestic institutions, including ownership structures and access to all lines of business.
- Allow foreign banks to acquire equity stakes of more than 20 per cent (for single foreign shareholders) and 25 per cent (for multiple foreign shareholders) in local Chinese banks.
- Allow foreign securities firms to set up 100 per cent owned securities subsidiaries in China with a full securities licence comparable to that of local Chinese securities firms and acquire equity stakes of more than 49 per cent of local Chinese securities firms.
- Allow foreign fund management firms to set up 100 per cent owned fund management subsidiaries in China with a full fund management licence comparable to local Chinese fund management firms and acquire equity stakes of more than 49 per cent of local Chinese fund management firms.

### ▶ 2. Restraints Affecting Organic Growth

#### ▶ 2.1 Allow Easier Branch/Sub-Branch and Business Expansion

- Enable locally-incorporated banks to provide annual master plans for branch and sub-branch expansion to be pre-agreed in principle.
- Allow multiple, simultaneous branch and sub-branch expansion submissions.

#### ▶ 2.2 Increase Access to the Bond Underwriting Market

- Grant foreign banks the same rights as local banks, as is practice in the EU.
- Lower the access criteria for foreign banks and accelerate the approval of foreign banks and securities companies to underwrite Chinese Government Bonds (CGBs), People's Bank of China (PBOC) bills and financial and corporate bonds in the inter-bank market.
- Build the basic framework of a normal liquid government bond market with: active and liquid government bond futures markets; a broad range of liquid Over the Counter (OTC); a broad and active investor base, both onshore and offshore; and competitive tax rates.

#### ▶ 2.3 Remove the Foreign Debt Quota

- Remove the foreign debt quota and guarantee quotas for foreign financial institutions in China.

#### ▶ 2.4 Review Prudential Ratios

- Remove the net of long-term borrowings from overseas branches from current liabilities, to compare assets and liabilities with the same tenor and ensure equal treatment for Chinese and foreign banks.





### 2.5 Address Funding Limitations in the China Foreign Exchange Trade System Interbank Market

- Remove the two times capital limitation for all banks in China.

### 2.6 Allow Financial Institutions Flexibility in the Adaptation of their Local Set-up, Making it Possible to Downsize or Exit Some Activities or Unprofitable Segments/Locations.

- Publish comprehensive guidelines for selling/closing a business with a step-by-step approach.

Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.

## Introduction to the Working Group

The Banking and Securities Working Group represents more than 50 banking and securities financial institutions in China. The working group looks to engage with the China Banking Regulatory Commission (CBRC) and the other financial services regulators in order to improve the operating environment for European banking and securities enterprises in China.

## Recent Developments

### Market Overview

- According to the Forbes Global 2000, there are 13 Chinese banks among the world's largest 100 banks, the most of any country.<sup>1</sup>
- The net profit for commercial banks in 2014 grew 9.7 per cent to Chinese Yuan (CNY) 1.55 trillion.<sup>2</sup>
- The total assets both in CNY and foreign currency of China's banking system reached CNY 172.3 trillion, marking 13.9 per cent year-on-year growth. While total liabilities both in CNY and foreign currency reached CNY 160 trillion, with a growth of 13.3 per cent year-on-year.<sup>3</sup>
- The total assets of large commercial banks reached CNY 71 trillion, accounting for 41.2 per cent of the total assets, equal to a growth of 8.25 per cent year-on-year. Liabilities amounted to CNY 65.7 trillion, accounting for 41.1 per cent of the total liabilities, equal to a growth of 7.4 per cent year-on-year.<sup>4</sup>

1 Chen, Liyan, *2015 Global 2000: The World's Largest Banks*, *Forbes*, 5<sup>th</sup> June, 2015, viewed 9<sup>th</sup> June, 2015, <http://www.forbes.com/sites/liyanchen/2015/05/06/2015-global-2000-the-worlds-largest-banks/>

2 The CBRC-released supervisory statistics for 2014, China Banking Regulatory Commission, viewed 13<sup>th</sup> February, 2015, <<http://www.cbrc.gov.cn/chinese/home/docView/8997215386094C44BB1D69864308B6EB.html> >

3 Ibid

4 Ibid

Breakdown of Market Share by Type of Bank, 2014

Type of Institution	Total assets (CNY billion)	Share (per cent)
State-owned commercial banks*	71,014	41.2
Shareholding commercial banks	31,380	18.2
City commercial banks	18,084	10.5
Rural banking institutions**	22,116	12.8
Other banking institutions***	29,740	17.3
<b>Total</b>	<b>172,335</b>	<b>100</b>

\* This means large commercial banks, including ABC, BOC, ICBC, CCB and BoCom.

\*\* Including rural commercial banks, urban and rural credit-cooperatives, rural cooperative banks and new rural financial institutions

\*\*\* Including policy banks, the CDB, foreign banks, non-banking financial institutions and postal savings banks

Source: CBRC

- The liquidity ratio was 46.4 per cent, a 2.4-point decrease from the beginning of 2014. Loan-to-deposit reached 65.1 per cent, a one-point increase through 2014.<sup>5</sup>

### Status Quo for Foreign Banks in China<sup>6</sup>

By the end of 2014, the total number of foreign banking institutions in China was 1,000 banks from 47 countries and regions, including 41 locally-incorporated institutions, 97 foreign bank branches, and 563 branches and subsidiaries of locally-incorporated institutions. Foreign banks maintained outlets in 27 provinces and 69 cities.

By the end of 2014, 35 locally-incorporated foreign banks and 62 foreign bank branches were approved

5 Ibid

6 *CBRC 2014 Annual Report*, China Banking Regulatory Commission Publicity Department, China Financial Publishing House, Beijing, 2015, pp 44-46.





to conduct *renminbi* (RMB) business, 31 locally-incorporated foreign banks and 28 foreign bank branches were authorised to engage in derivatives transactions, six locally-incorporated foreign banks were authorised to issue RMB financial bonds and four locally-incorporated foreign banks were authorised to issue credit cards.

At the end of 2014, the total assets of foreign banks increased by 9.16 per cent year-to-year to CNY 2.79 trillion. Foreign bank deposits grew 3.74 per cent to CNY 1.55 trillion and loans grew 7.22 per cent to CNY 1.19 trillion.



The development of market share in terms of total banking assets has slowed down, from 1.73 per cent in 2013 to 1.62 per cent in 2014. This is extremely low compared to other emerging markets (e.g. 30 per cent in Indonesia, 22 per cent in Brazil, five per cent in India) and the Organisation for Economic Cooperation and Development (OECD) average (20 per cent).<sup>7</sup>

### Reform Progress and Negotiations for the EU-China Comprehensive Agreement on Investment (CAI)

The working group acknowledges the efforts of the authorities in implementing parts of the Third Plenum's *Decision*,<sup>8</sup> for instance, in areas such as deposit insurance, formation of the RMB exchange rate based on market based criteria, and interest rate liberalisation. There have also been certain developments towards the opening up of China's financial services sectors, although it needs to be seen how these will be implemented in practice. However, in terms of market share foreign banks are still far below the minimum five to eight per cent for foreign banks, which is

<sup>7</sup> Claessens, Stijn & van Horen, Neeltje, *Foreign Banks: Trends, Impact and Financial Stability*, International Monetary Fund, January 2012, viewed 23<sup>rd</sup> June, 2015, <<http://www.imf.org/external/pubs/ft/wp/2012/wp1210.pdf>>

<sup>8</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.

required for a healthy banking system as stated by financial regulators during different meetings with the European Chamber. Meanwhile, members of the working group have observed how Chinese banks show notable growth and expansion, both domestically and internationally.

Foreign banks in China believe there are several reasons preventing them from reaching their natural growth potential. The most important is the fact that they are limited mainly to organic growth as they are not allowed to acquire more than 20 per cent of a local bank. Besides this, there are a series of measures that hinder their growth, i.e. the Loan-to-Deposit (LDR) ratio. Although applied equally to all players, this ratio puts banks that have not reached a critical geographical branch/office network at a clear competitive disadvantage. In the case of foreign banks, their relatively small presence can be explained by some of the constraints that this paper analyses. Many of these limitations were addressed by the *Decision*, particularly in relation to opening-up, the development of new products, development of the bond market, financial innovation and the introduction of a risk management approach.

The Banking and Securities Working Group hopes that all these issues will be addressed during the negotiations of the EU-China CAI and that effective national treatment will be achieved. The working group believes that foreign banks operating in China should be treated in the same way that Chinese banks are treated when they establish themselves in Europe.

### Policy and Market Developments

In the past year, the working group has seen a number of developments that have created high expectations among its members regarding the further opening up and liberalisation of the financial sector. The most significant of these are listed below:

- The start of the EU-China CAI negotiations, January 2014.<sup>9</sup>
- China allows cross-border stock investment between Shanghai and Hong Kong, April 2014.<sup>10</sup>
- CBRC release guidelines on trust companies, April

<sup>9</sup> *EU and China begin investment talks*, European Commission, Press Release Database, 20<sup>th</sup> January, 2014, viewed 27<sup>th</sup> April, 2015, <[http://europa.eu/rapid/press-release\\_IP-14-33\\_en.htm](http://europa.eu/rapid/press-release_IP-14-33_en.htm)>

<sup>10</sup> *China to allow cross-border Hong Kong, Shanghai stock investment*, Reuters, 10<sup>th</sup> April, 2014, viewed, 27<sup>th</sup> April, 2015, <<http://www.reuters.com/article/2014/04/10/china-crossborder-idUSL3T0N248J20140410>>





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Establishing a unified, open, competitive and orderly market system is the basis for the market to play a decisive role in the allocation of resources.	Foreign banks face restrictions to their organic and non-organic growth which considerably limits their market share and contribution to the Chinese economy. Foreign entities also find it more difficult to access funding for their operations compared to domestic entities.	
Relaxing control over investment access. We will have the same laws and regulations on Chinese and foreign investment, and keep foreign investment policies stable, transparent and predictable.	The industry remains over-regulated when it comes to investments, especially regarding limitations on investment in domestic players, setting up operations or obtaining licences (i.e. restrictions on ownership, setting joint-ventures).	
... improve the government organisational structure, function composition and work procedures so that we will have a good administrative system with decision-making.	A lack of coordination among the various authorities results in laws and regulations being applied and interpreted differently. This leads to difficulties in understanding how to fully comply.	

2014.<sup>11</sup>

- Implementing rules of the China (Shanghai) Free Trade Zone during 2014, such as cross-border RMB payment and forex management.
- New nine initiatives (NNIs) for efficient capital markets by 2020, May 2014.<sup>12</sup>
- Regulators lower the threshold for banks to enter the foreign exchange market and remove a layer of approvals, June 2014.
- China gives the green light to three banks wholly funded with capital from private firms, to be the country's first private lenders, July 2014.<sup>13</sup>
- Banks are allowed to set their own exchange rates for the CNY against the United States Dollar (USD) in over-the-counter deals with clients, July 2014.<sup>14</sup>
- The CBRC releases *Implementation Rules for*

*Administrative Licensing of Foreign Banks*, September 2014 – foreign banks can open more than one sub-branch in each Chinese city and the minimum operating capital for setting a sub-branch was abolished.<sup>15</sup>

- The PBOC announce the new Deposit Insurance, December 2014.<sup>16</sup> In December, 2014, the State Council released the *Amendments to the Foreign Bank Administrative Regulations of China* (Circular 657) which further open foreign banks' market access<sup>17</sup> by:
  - No longer requiring them to allocate a minimum of CNY 100 million working capital to their China branches;
  - No longer requiring a representative office as a precondition for setting up a foreign-invested bank or branch; and
  - Reducing the requirement of having had to have operated business in China for three years, with

11 *China targets trust firms in shadow-bank crackdown*, Reuters, 14<sup>th</sup> April, 2014, viewed 21<sup>st</sup> April, 2015, <<http://www.reuters.com/article/2014/04/14/us-china-regulations-shadowbanking-idUSBREA3D09H20140414>>

12 *Capital market initiatives to have profound impact*, Xinhuanet News, 24<sup>th</sup> May, 2014, viewed 21<sup>st</sup> April, 2015, <[http://news.xinhuanet.com/english/china/2014-05/24/c\\_133358337.htm](http://news.xinhuanet.com/english/china/2014-05/24/c_133358337.htm)>

13 *China gives green light for three private banks*, Reuters, 25<sup>th</sup> July, 2014, viewed on 21<sup>st</sup> April, 2015, <<http://www.reuters.com/article/2014/07/25/china-banking-idUSL4N0Q029V20140725>>

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15 *Implementation Rules for Administrative Licensing for Foreign Banks*, China Banking Regulatory Commission, 18<sup>th</sup> September, 2014, viewed 21<sup>st</sup> April, 2015, <<http://www.cbrc.gov.cn/chinese/home/docView/EB491305C6054846ADD1B0992F082D10.html>>

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profits for two consecutive years before applying for the RMB business licence.

- The CBRC release the *Implementing Rules for the Administrative Regulations of the People's Republic of China on Foreign-Invested Banks* (Revised Draft for Comments), March 2015.
- On 24<sup>th</sup> June, 2015, the State Council issued a draft proposal to relax the loan-to-deposit ratio of 75 per cent.<sup>18</sup> The working group welcomes this proposal and considers this as a very positive development. This ratio has a significant impact on overall operations, and loan growth in particular, of locally-incorporated foreign banks and is a barrier to other foreign banks considering incorporation.

Another important development during this year was the *Notice on the Promotion Guidelines for Banking Applications of Secure and Controllable Information Technology (2014–2015)* (CBRC Guidelines). The European Chamber appreciates the open and constructive dialogues that it has had with the Chinese authorities in order to clarify these guidelines and it welcomes the temporary suspension of the guidelines in 2015. Foreign banks are committed to the highest standards of security for their information technology (IT) systems and believe that an open procurement environment leaves banks with the choice of selecting the best and most secure hardware and software that is globally available.

The *Decision* states as one of its goals the development of the financial industry and capital markets in China. Through the observations and recommendations of this position paper, the Banking and Securities Working Group wants to contribute to this process. For this reason, the members of the working group are also eager to hold more frequent meetings with China's financial regulators in order to contribute their know-how and expertise to the development of the financial sector.

Finally, the working group welcomes and recognises the improvements resulting from the implementation of the *Administrative Regulations of the People's Republic of China on Foreign-Invested Banks*, [2014] No. 657, effective on 1<sup>st</sup> January, 2015. Among other changes,

the three-year waiting period for the RMB licence and subsequent RMB clearing facility has been shortened to one year and the precondition for the RMB licence to show profits for two consecutive years has been cancelled. This change is a big step into the right direction and due to this reason the working group has decided to remove the key recommendation that dealt with this issue from this year's position paper.

Nevertheless the working group hopes that the new regulation will also in practice improve the speed and transparency of the general licence approval processes for the foreign banking in China.

## Key Recommendations

### 1. Restraints Affecting Non-Organic Growth Lift Restrictions on Ownership and Business Scope

#### Concern

Foreign banks, securities and fund management companies are subject to a number of rigid market access restrictions in terms of ownership and business scope.

#### Assessment

Foreign banks in China are subject to rules that set a 20 per cent ownership limit imposed on any single foreign investor into a Chinese bank (with a cap of total foreign ownership at 25 per cent). These limits were implemented in conjunction with China's entry into the World Trade Organisation (WTO) in 2001, and have been kept ever since. The limitations have restricted foreign banks' capacity to grow in the Chinese market, which is evidenced by their total market share of 1.6 per cent by the end of 2014. In contrast, the five largest Chinese commercial banks are increasingly acquiring or investing in foreign banks in Europe and elsewhere without similar ownership restrictions and without these foreign banks being deprived of their status as domestic banks in their respective countries of operation.

In May 2011, it was announced that the ceiling for foreign ownership in joint venture (JV) securities and futures brokerages would be raised from 33 per cent to 49 per cent. However, despite the promotion of the services sector in China being stated as one of the primary goals of the 12<sup>th</sup> Five-Year Plan (FYP), the newly-revised *Foreign Investment Catalogue* included very little regarding further opening up of financial

<sup>18</sup> Hughes, Jennifer & Wildau, Gabriel, *China moves to scrap long-held cap on loan-to-deposit ratio*, *Financial Times*, 25<sup>th</sup> June, 2015, viewed 25<sup>th</sup> June, 2015, <<http://www.ft.com/cms/s/0/49955320-1ad4-11e5-8201-cbdb03d71480.html#axzz3e7z5qMW6>>



services to foreign institutions.

The business scope of a securities joint venture (SJV) is limited to underwriting and distributing securities. For brokerage services, SJVs are restricted to B share trading (which would also be subject to the State Administration of Foreign Exchange's (SAFE's) foreign exchange operation permit). In comparison with the business undertaken by a domestic securities company there are other limitations, for example, warrants, convertibles, exchange-traded commodities options, securities lending and margin financing, all of which are inaccessible to SJVs.

#### Recommendations

- Allow foreign banking, securities and fund management enterprises to compete on an equal footing with domestic institutions, including ownership structures and access to all lines of business.
- Allow foreign banks to acquire equity stakes of more than 20 per cent (for single foreign shareholders) and 25 per cent (for multiple foreign shareholders) in local Chinese banks.
- Allow foreign securities firms to set up 100-per-cent-owned securities subsidiaries in China with a full securities licence comparable to that of local Chinese securities firms and acquire equity stakes of more than 49 per cent of local Chinese securities firms.
- Allow foreign fund management firms to set up 100-per-cent-owned fund management subsidiaries in China with a full fund management licence comparable to local Chinese fund management firms and acquire equity stakes of more than 49 per cent of local Chinese fund management firms.

## 2. Restraints Affecting Organic Growth

### 2.1 Allow Easier Branch/Sub-Branch and Business Expansion

#### Concern

Foreign banks face difficulties in business planning and resource management due to a complex system of submissions to expand their branch and sub-branch network.

#### Assessment

There are a number of complex and often unnecessary submissions that need to be made in order to expand a locally-incorporated bank's branch and sub-branch network. These submissions are time-consuming for

both the bank and the regulator and do not provide sufficient information on the future strategic direction of the bank.

Furthermore, the official wording of the regulations does not always lead to clear interpretation. Banks often lack a thorough understanding of how many branches they can apply for each year, and how concurrent applications will be treated. This uncertainty is contrary to China's objective of increasing foreign participation and developing the banking sector in western and north-eastern provinces. European banks have an interest in expanding into western China; however many may be reluctant to apply for branches if these risks cause unplanned delays to their expansion strategies in the eastern provinces.

While the working group understands the need for detailed submissions, it recommends a planned strategic approach whereby multiple branch and sub-branch applications will be allowed on an annual basis, in order to facilitate the locally-incorporated bank's branch network expansion strategies in a more transparent and planned manner. Consequently, this will allow locally-incorporated banks to strategically expand their branch and sub-branch network in a more timely and efficient manner.

#### **Chinese banks setting-up operations in Europe**

The Member States' regulations on this matter are based on European Directives that have to be transposed into their national legal systems in order to establish a harmonised framework. The basic rule is that the licence approval has a silent/tacit authorisation after a certain period of time (i.e. 120 days in the case of most European Union (EU) Member States) from the moment of application. Although there could be a need for requesting more than one licence if different banking businesses are covered, each of them follow the same terms.

#### **Case of ICBC in Europe**

ICBC opened their Milan Branch on 21<sup>st</sup> January, 2011. In that same week, it opened four other branches in Madrid, Amsterdam, Paris and Brussels.

With regards to the Milan Branch, the time taken to obtain the licence was one month. This is due to the fact that European regulations allow the establishment of a subsidiary with much shorter





application procedures when that entity has already been established in another EU country.

If ICBC wanted to set up a new independent branch (as opposed to a sub-branch dependent on the Luxembourg subsidiary), it would have to wait for a period of around seven months—a period still shorter than that faced by foreign banks in China.

#### Recommendations

- Enable locally-incorporated banks to provide annual master plans for branch and sub-branch expansion to be pre-agreed in principle.
- Allow multiple, simultaneous branch and sub-branch expansion submissions.

## 2.2 Increase Access to the Bond Underwriting Market

#### Concern

Access to the bond underwriting market is difficult to obtain and subject to a number of strict limitations that are not always transparent.

#### Assessment

Chinese Government Bond (CGB) underwriting is under the scope of the Ministry of Finance (MOF), the PBOC and the China Securities Regulatory Commission (CSRC). There are about 50 member banks of CGB underwriting in total, of which only three are foreign. Since the first foreign bank obtained CGB underwriting membership in 2004, only two others have been granted this (in early 2008). Specific requirements for membership are given in written form, but regulators also apply stricter criteria to keep the total number under 60, and these are not disclosed.

The PBOC bills underwriting market is only open to players with Primary Dealer (PD) certification. It has been stated that the total number of PDs would not change as the current number is already large by international standards. There are strict requirements to become a qualified PD, and again, in practice, the actual requirements are stricter than those given in written form. Also, the requirements are even stricter for foreign banks than for domestic ones. Out of the 46 current PDs, only three are foreign banks.

The National Association of Financial Market Institutional Investors (NAFMII) issued new underwriting

rules for corporate bonds in 2010. However, only one foreign-invested bank has been granted a sub-underwriter licence by the NAFMII by end of 2011. The NAFMII optimised the application scoring mechanism and accepted the application of several foreign banks in November 2013. However, no license has been granted to any foreign banks since then, while a number of local applicants without a demonstrable track record were approved. The results of the scoring-based review have not been transparently communicated with the foreign banks, and it is unclear why they failed and what improvement or qualification is further needed in order to receive an approval.

Working group members welcome the efforts made so far by financial regulators to establish a strong liquid domestic bond market. The working group supports the government in its step-by-step approach, but at the same time, would like to encourage regulators to lower the access criteria for foreign banks with strong credentials in other markets, give more clarity to the approval process and grant faster access to qualified foreign banks.

The willingness to give access to the onshore domestic interbank market for foreign investors is clearly a very progressive step towards improving the liquidity of the domestic interbank bond market. Foreign banks can bring their expertise and technology to this market. Allowing foreign banks to fully participate in the underwriting will offer domestic issuers more choices, leading to more cost-effective options, expanded distribution channels, improved quality of service to clients and will encourage foreign banks to accelerate the required transfer of know-how.

In the long run, the regulators may consider stopping the licensing practice to allow issuers to freely choose issuing agencies in the market while the regulators can focus on updating the rules and ensuring compliance.

#### Recommendations

- Grant foreign banks the same rights as local banks, as is practice in the EU.
- Lower the access criteria for foreign banks and accelerate the approval of foreign banks and securities companies to underwrite CGBs, PBOC bills and financial and corporate bonds in the inter-bank market.
- Build the basic framework of a normal liquid



government bond market with: active and liquid government bond futures markets; a broad range of liquid Over the Counter (OTC); a broad and active investor base, both onshore and offshore; and competitive tax rates.

### 2.3 Remove the Foreign Debt Quota

#### Concern

The limitations imposed by the short-term and long-term foreign debt quotas and the foreign guarantee quota are an obstacle to serving businesses with genuine financing needs.

#### Assessment

In recent years the SAFE—responsible for the short-term foreign debt quota and the foreign guarantee quota—and the National Development and Reform Commission (NDRC)—responsible for the long-term foreign debt quota—have maintained strict foreign debt and guarantee quota limits. This limitation goes against the trend of increasing foreign direct investment (FDI) that is the core activity of foreign banks and against the trend of increasing expansion abroad by Chinese corporates. It also makes foreign currency funding unnecessarily expensive for foreign and Chinese enterprises.

The access to liquidity provided by foreign currency interbank international markets is of paramount importance for proper and prudent asset and liabilities management. Foreign banks are concerned about funding genuine, trade-related financing as the onshore foreign currency market is at a comparative disadvantage to the offshore market due to a lack of liquidity for tenors above one week.

The working group commends the regulations that have been promulgated to remove lending for less than 90 days from the quota for trade-related uses. Banks are willing to move towards onshore funding. However, unless the onshore market presents a competitive and liquid position at tenor, up to at least one year, banks in China will depend on access to the international market. Clients that have genuine foreign currency funding needs currently see their related costs significantly increasing because foreign banks are unable to support their foreign currency funding requirements from inter-group sources.

Not only are the small quotas a burden, the additional

liquidity ratio requirement limits the available funding for clients.

Removing the foreign currency quotas would certainly support the development of Shanghai as an international financial centre and, by helping Chinese exporters and importers to get less expensive trade financing, also support China's foreign trade.

Besides the foreign debt quotas of banks, foreign-invested companies are very much restricted in their financing possibilities through their foreign debt quota. This system was introduced in 1987, but with the development of the Chinese economy it is now inadequate for the current financing needs of foreign-invested companies in China. Furthermore, no similar restrictions are imposed on Chinese banks operating in Europe, which is a clear demonstration of uneven treatment of European banks – the rules hinder European banks from expanding in China.

- Direct financing through foreign shareholder loans are restricted through the foreign debt quota of foreign-invested companies. These quotas are consumed if the foreign financing in foreign exchange has a term longer than one year or is currently consumed by any foreign loan in RMB. Once the foreign debt quota is consumed, it cannot be renewed under the current regulations.
- Financing for foreign-invested companies, especially small- and medium-size enterprises (SMEs) within China, often depends on collaterals by guarantee of foreign banks or their parent companies. Since foreign guarantees to secure this financing are counted indirectly in the individual foreign debt quota, methods of local financing are also strongly limited, thus making it impossible for foreign-invested companies that have already used their foreign debt quota to obtain local financing with a foreign guarantee.

#### Recommendation

- Remove the foreign debt quota and guarantee quotas for foreign financial institutions in China.

### 2.4 Review Prudential Ratios

#### Concern

The net of long-term borrowings financed from overseas branches are treated as current liabilities, which



unnecessarily reduces the liquidity ratio, as the current assets only cover short-term lending.

#### Assessment

The purpose of liquidity ratios is to ensure a bank's ability to pay short-term obligations. To achieve this in an efficient manner it is essential that the ratio captures actual solvency. It is international practice to compare assets and liabilities with the same tenor. In the absence of large retail customer deposits, foreign banks, especially smaller branches, rely on overseas intragroup funding, including long-term borrowing.

Even handled under the long-term foreign debt quota of the NDRC, in China the net of long-term borrowings from overseas branches is treated as current liability. This reduces the liquidity ratio in an unfair way, although no immediate demand for repayment is given.

No similar rules are imposed on Chinese banks operating in Europe.

#### Recommendation

- Remove the net of long-term borrowings from overseas branches from current liabilities, to compare assets and liabilities with the same tenor and ensure equal treatment for Chinese and foreign banks.

## 2.5 Address Funding Limitations in the China Foreign Exchange Trade System Interbank Market

#### Concern

Access to the China Foreign Exchange Trade System (CFETS) interbank market is limited to two times the RMB capital of banks in China. Foreign bank branches, by nature, have limited RMB capital in China and are therefore impacted heavily by this regulation.

#### Assessment

The two times capital restriction is preventing many foreign banks from more active participation in this market. Lifting the restriction would result in a more active and liquid RMB interbank market that will benefit all banks.

#### Recommendation

- Remove the two times capital limitation for all banks in China.

## 2.6 Allow Financial Institutions Flexibility in the Adaptation of Their Local Set-up, Making it Possible to Downsize or Exit Some Activities or Unprofitable Segments/Locations.

#### Concern

While applying for new licence(s) is a long and complex process, the process of exiting some activities is even more complex and lacks clear rules. As a result, financial institutions are often forced to continue providing banking services even though there is no more group support.

#### Assessment

Two concrete examples:

- Having obtained a license for a branch in a province, it is almost impossible to close it, even if after several years it has not become profitable. Financial institutions are expected to demonstrate their long-term commitment to the province and maintain an overly-large minimum set-up – usually around 10 people, including branch manager, deputy-branch manager, operations, compliance, finance and relationship managers.
- The same applies to new products or client segments: exit barriers are important as financial institutions are prohibited from selling some portfolio (basically, client consent is required and a tri-partite agreement needs to be signed), transferring some assets to other institutions, or ceasing some activities for which a licence had been obtained.

Exit barriers are leading foreign institutions to be non-performing in China and reducing their risk appetite to explore opportunities in new locations, clients or products.

For this purpose, there should be comprehensive guidelines for selling or closing business with a step-by-step approach that takes the following into consideration:

- A minimum investment period before the decision to restructure or close is possible.
- Restructuring of branches with minimum set up (like a rep office) to optimise costs.
- Setting timelines for government or regulators to organise it.
- Two years trial for sell down (better for clients).
- Systematic authorisations after two years.



### Recommendation

- Publish comprehensive guidelines for selling/closing a business with a step-by-step approach.

## Abbreviations

ABC	Agricultural Bank of China
BOC	Bank of China
BoCom	Bank of Communications
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CD	Certificates of Deposits
CDB	China Development Bank
CFETS	China Foreign Exchange Trade System
CGB	Chinese Government Bonds
CNY	Chinese Yuan (currency)
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
CSRC	China Securities Regulatory Commission
FDI	Foreign Direct Investment
FYP	Five-Year Plan
ICBC	Industrial and Commercial Bank of China
JV	Joint Venture
LDR	Loan-to-Deposit Ratio
MOF	Ministry of Finance
MSE	Micro and Small Enterprise
NAFMII	National Association of Financial Market Institutional Investors
NDRC	National Development and Reform Commission
NNIs	New Nine Initiatives
OECD	Organisation for Economic Cooperation and Development
OTC	Over the Counter
PBOC	People's Bank of China
PD	Primary Dealer
RMB	Renminbi
SAFE	State Administration of Foreign Exchange
SCLAO	State Council Legislative Affairs Office
SJV	Securities Joint Venture
WTO	World Trade Organisation



# Consumer Finance and Non-Banking Financial Institutions Working Group

## Key Recommendations

### 1. Financial Innovation

#### 1.1 Clarify the Scope for Financial Innovation

- Issue clear regulations for the peer-to-peer (P2P) lending sector and Internet finance by the end of 2015.
- Clarify the business scope, entry conditions, national expansion, business model and risk management of these kinds of online lending businesses.

#### 1.2 Clarify the Openings Available to Foreign Players

- Release clear regulations with regards to foreign enterprises operating in the P2P sector.

### 2. Licence Expansion

#### 2.1 Adjust the Criteria for Assessing the Financial Standing of the Foreign Parent Company

- Define the parent company's financial standing according to equity ratios that assess financial soundness, relying less on asset size.
- Include in the regulation the possibility for parent companies/groups to qualify on the basis of retailing turnover (for retailer-owned financial institutions), as an alternative to asset size (a balance sheet indicator not relevant to the retail industry).

#### 2.2 Relax the Requirement for Previous Presence of the Non-Banking Financial Institution (NBFI) Investor in the Chinese Market

- Relax representative office requirements for overseas NBFIs.
- Substitute the formalised branch or representative office requirement for consumer finance companies (CFCs) with a requirement to prove reasonably that the potential overseas investor has sufficiently analysed the Chinese market.

#### 2.3 Allow and Encourage NBFIs to Apply and Obtain Credit Card Issuing Licences

- Provide an explicit path for credit card licence applications by performing NBFIs, particularly CFCs.

### 3. Funding

#### 3.1 Adopt Measures to Further Expand Domestic Funding Resources for NBFIs

- Allow CFCs to conduct credit asset transfers and continue to service the portfolio.
- Abolish the ratio between total capital and inter-bank borrowing funds so as to improve the borrowing potential and liquidity management.
- Lower the thresholds for bond issuance, particularly for auto finance companies (AFCs).

#### 3.2 Allow NBFIs to Receive Direct Financing or Guarantees from their Foreign Shareholders and to Borrow from Overseas Financial Institutions

- Allow CFCs to receive direct financing or guarantees from their foreign shareholders.
- Allow AFCs to directly obtain loans from overseas shareholders or other group companies, with the approval of the State Administration of Foreign Exchange (SAFE), and without the need of a wholly Chinese-owned subsidiary.

### 4. Relax Prudential Requirements on NBFIs for Issuing Small-sum Loans to Individuals via Online Channels

- Abolish the requirement for NBFIs to conduct face-to-face interviews with borrowers.





- Enable full online loan granting by NBFIs in cases where they have sufficient means to confirm the identity of the borrower (such as utilising big data and transaction history), and impose a maximum limit on loans issued online without a face-to-face interview (e.g. Chinese Yuan (CNY) 20,000 per borrower) to cap any systemic risks and possible abuse of online loans for illegal purposes.

## Introduction to the Working Group

The Consumer Finance and Non-Banking Financial Institutions (NBFIs) Working Group was established in 2008. It includes leading European consumer finance specialists who operate in China consumer finance companies (CFCs), auto finance companies (AFCs), small loan companies and other entities engaged in consumer finance services in cooperation with third parties (e.g. guarantee companies). The establishment of the working group is a reflection of the importance of the emerging consumer finance industry in China as well as its relevance to major policy objectives of the State Council and the attention that European players attach to this agenda.

## Recent Developments

Following the Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee, the government has continued its commitment to deepen economic liberalisation and enhance the role of market forces so as to promote domestic demand as the main driving force behind the growth of the economy. Over the past year, the Chinese Government has taken encouraging steps to liberalise the financial sector, promote financial inclusion and encourage innovative business models and practices, leveraging the rapid development of China's Internet economy. It is widely believed that with the market playing a decisive role, more Chinese consumers will have a new understanding of loans and their consumption will be stimulated.

In November 2013, the China Banking Regulatory Commission (CBRC) revised the *Administrative Measures on the Pilot Programme of Consumer Finance Companies*. The new measures, in force since 1<sup>st</sup> January, 2014, officially lifted geographical restrictions on CFCs' operations and expanded the pilot programme to new players. This decision was met with

strong interest from both domestic and foreign entities. With the ongoing CFC licensing process, we can expect new players to start operating in all 12 new pilot cities during the course of 2015. In order to achieve long-term sustainability and to promote healthy competition in the consumer finance industry, there is a need for further liberalisation for both new and existing CFCs, notably when it comes to funding and operational processes.

At the same time, the working group has seen a number of developments relating to Internet finance regulation, including the drafting of the guiding opinions on mobile and Internet payments. This provides a useful basis for the regulatory and supervisory framework for Internet finance (including peer to peer (P2P) lending, crowdfunding, etc.), expected to be released during 2015.

The Consumer Finance and Non-Banking Financial Institutions Working Group puts a special focus on monitoring developments in the area of consumer finance as it is still in its infancy and has great potential in helping the government achieve its policy objectives. Through the analysis and recommendations offered in this position paper, the working group is willing to contribute to the government's goal of rebalancing the economy and shifting it to a more sustainable and balanced model based on domestic consumption. The European Chamber always seeks dialogue with the Chinese authorities that can match their policy objectives with the advantages that European businesses may bring due to their expertise and knowledge. In this respect, the working group is very keen to explore with the authorities how to cooperate in the area of expanding domestic demand and promoting financial reform, innovation and inclusive finance.





### Third Plenum Reality Check

What did the Third Plenum's <i>Decision</i> <sup>1</sup> say?	What is the reality?	Status
<p>Financial reform and market opening reform among the main priorities.</p> <p>Rebalancing the economy towards consumption and the service sector as the overarching policy goal.</p>	<p>There has been an expansion of the CFC pilot programme to 12 cities, encouraging private capital to enter. The licensing process for new CFC companies is almost complete. A number of European players (although with minority share) now have a presence in the market. All the points above represent a positive development.</p>	
<p>'Inclusive finance' – a shift towards a more equitable and high quality growth.</p>	<p>Consumer finance companies and other NBFIs have a special role to play in the drive towards 'inclusive finance', since they often serve clients who are underserved by traditional bank providers. The expansion of the consumer finance pilot programme and the rapid development of alternative credit providers, leveraging notably online channels (with the ongoing efforts of Chinese regulators to design appropriate Internet banking regulations, which for the moment seem to be going in the right direction) are all encouraging developments.</p>	
<p>Fair competition and a better business environment in China.</p>	<p>While the CFC industry is still a state-owned enterprise- (SOE)-dominated sector (hence privileged access to information and funding), the working group also sees a number of private companies (including European players) taking their stake. There is whole range of innovative companies operating via online channels, where there is free competition – at least so far. The working group will monitor what the new regulations on Internet banking will bring.</p>	
<p>Equal market access.</p>	<p>Given that the development of consumer finance is still in the pilot phase, there are limits to the total number of players in the market as well as strict geographical restrictions for foreign companies.</p>	
<p>Equal access to funding.</p>	<p>Foreign entities still find it more difficult to access funding for their operations compared to domestic entities.</p>	

## Key Recommendations

### 1. Financial Innovation

#### 1.1 Clarify the Scope for Financial Innovation

##### Concern

The lack of regulation in the P2P lending market and the undeveloped credit risk system in China creates unduly high risks for consumer finance companies and consumers alike.

<sup>1</sup> The Third Plenum of the 18<sup>th</sup> National Congress of the Communist Party of China Central Committee was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.

##### Assessment

Innovation in the financial services sector in China is mainly about the tools and products. Mobile banking has been well developed in China and almost all banks and financial institutions are using digitalisation as a tool to attract customers, increase loyalty and to create more revenue. As for the financial products, P2P lending and crowdfunding are two of the most popular and innovative kinds of financial service. More than 2,000 platforms have been established in less than three years. An estimated Chinese Yuan (CNY) 252.8 billion was borrowed by 1.16 million P2P borrowers



from 630,000 investors at an average interest rate of 18 per cent in 2014. Outstanding P2P loans at the end of 2014 totalled CNY 103.6 billion.<sup>2</sup>

China's P2P lending market is very large and attractive to many kinds of players, such as traditional financial institutions, leading Internet players and start-ups. Risk management is the most important part of P2P lending platforms especially as the credit system is not that developed in China. This sector is developing very fast in China and we believe that in 2015, the market will become more standardised and mature.

The CBRC is responsible for supervising financial innovation. The CBRC encourages Internet finance players to establish Internet financial associations so that they can monitor and manage themselves. The regulation of P2P lending and Internet finance is currently under development. The Consumer Finance and Non-Banking Financial Institutions Working Group hopes that the regulations will be issued during the second quarter, 2015. The regulation should integrate international best practices that would support the development of an international standard framework.

#### Recommendations

- Issue clear regulations for the P2P lending sector and Internet finance by the end of 2015.
- Clarify the business scope, entry conditions, national expansion, business model and risk management of these kinds of online lending businesses.

### 1.2 Clarify the Openings Available to Foreign Players

#### Concern

There are no rules or regulations published by the CBRC with regards to foreign companies operating in the P2P sector.

#### Assessment

Many western players are very interested in investing in the P2P lending business but it is unclear whether they will be obliged to withdraw their investment when the new regulations are issued. Many foreign players have already developed businesses in the consumer finance and auto finance areas in China. According to several P2P lending firms, foreign companies are welcomed,

especially for raising capital as well as the advance tools and concepts that they can provide. Foreign companies are well placed to bring a lot of expertise and know-how to help innovate the Chinese financial markets, which is currently very short of the capital needed to develop a sustainable industry.

#### Recommendation

- Release clear regulations with regards to foreign enterprises operating in the P2P sector.

## 2. Licence Expansion

### 2.1 Adjust the Criteria for Assessing the Financial Standing of the Foreign Parent Company

#### Concern

The current regulations and practices exclude some of the best quality NBFIs from contributing to the development of the Chinese consumer finance market.

#### Assessment

By focusing on minimum asset conditions for the parent company regarding licence application, many NBFIs are unable to enter the consumer market. Only those financial requirements regarding NBFIs shareholders are necessary to achieve the objectives of financial market stability and supervision should apply. Currently, NBFIs face high financial thresholds for their operations (e.g. the minimum requirement of CNY 60 billion for shareholder's assets in the case of CFCs). However, asset size is not the best factor to indicate the financial soundness of a parent company, as it can reflect an over-stretching of the engagement of the bank, increasing its vulnerability. Instead, the regulators should focus more on equity ratios and retailing turnover, alongside further qualitative criteria such as transparency of origin.

#### Recommendation

- Define the parent company's financial standing according to equity ratios that assess financial soundness, relying less on asset size.
- Include in the regulation the possibility for parent companies/groups to qualify on the basis of retailing turnover (for retailer-owned financial institutions), as an alternative to asset size (a balance sheet indicator not relevant to the retail industry).

### 2.2 Relax the Requirement for Previous Presence of the NBFIs Investor in the Chinese Market

<sup>2</sup> Jingu, Takeshi, *Risk and Opportunities in China's growing P2P lending market*, Nomura Research Institute, 10<sup>th</sup> September, 2014, viewed 26<sup>th</sup> June, 2015, <<https://www.nri.com/~media/PDF/global/opinion/lakyara/2014/1kr2014202.pdf>>





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### Concern

The requirement for various types of NBFIs having to have had a previous presence in the Chinese market, such as a formalised branch or representative office, places unnecessary burdens on potential investors who have sufficiently analysed the Chinese market.

### Assessment

The complex nature of large international financial groups, which typically enter the NBFIs sector in China, brings the need for diversified shareholding and representative office arrangements. For example, regulations for CFCs state that the company must have had a representative office for two years or a formalised branch, which excludes potential investors who can prove by other reasonable means that they have sufficiently researched and analysed the Chinese market.

### Recommendation

- Relax representative office requirements for overseas NBFIs.
- Substitute the formalised branch or representative office requirement for CFCs with a requirement to prove reasonably that the potential overseas investor has sufficiently analysed the Chinese market.

## 2.3 Allow and Encourage NBFIs to Apply and Obtain Credit Card Issuing Licences

### Concern

The current regulations for credit cards do not explicitly permit NBFIs to apply and obtain licences to issue credit cards as products that naturally complement their current lending services, ultimately harming the sustainability of the industry.

### Assessment

In order to achieve a greater penetration into typical consumer finance segments and ensure sustainability of the industry, NBFIs—particularly consumer finance companies—should be explicitly allowed and encouraged to apply for credit card issuance licences. Credit cards and revolving cards could complement the current loan instalment services, provide continuous access to credit facilities and hence help to address unforeseen life events. In addition, credit card licences could potentially lower an NBFIs' client acquisition and servicing cost, ultimately benefiting the Chinese consumer.

### Recommendation

- Provide an explicit path for credit card licence applications by performing NBFIs, particularly CFCs.

## 3. Funding

### 3.1 Adapt Measures In Order to Further Expand the Domestic Funding Resources of NBFIs

#### Concern

In the onshore market, NBFIs face difficulties accessing funding from traditional channels and have limited access to alternative funding resources, which restricts the normal development of their business in China.

#### Assessment

Non-Banking Financial Institutions in China have jointly faced the problem of limited channels for funding and high thresholds for some funding solutions. Consumer finance companies in China are currently not explicitly allowed to conduct credit asset transfers (and keep the right to service the portfolio, which is the most practical way of conducting such an operation). However, outside China, credit asset transfers are a common method to obtain relatively cheaper funding and better support the development of their operations in the long-term (unlike for commercial banks, which sometimes use credit asset transfer for balance sheet optimisation). On the top of that, the current CFC regulation sets a limit on the interbank lending ratio at 100 per cent of total capital. This limitation negatively affects the ability of CFCs to absorb external funding needed for expansion of their consumer finance business and investments related to the growth of the business infrastructure. With standard capital adequacy ratios in place, this unusual restriction does not bring any obvious positive momentum for the stability of the financial market and therefore should be completely abolished.

Auto finance companies should also be more strongly and openly supported and be given easier access to funding. One of the major problems in the onshore financing market concerns the high threshold for issuing financial bonds. The current requirements of having registered capital of more than CNY 800 million, being profitable for the last three consecutive years—with the average distributable profits of the last three years being sufficient to pay the first year's interest of the bond issued—have stalled most quality candidates.

In the longer term, the relevant regulations would further





facilitate CFCs', AFCs' and NBFIs' access to alternative funding channels involving investors in the financial market, in line with typical worldwide practices.

#### Recommendations

- Allow CFCs to conduct credit asset transfers and continue to service the portfolio.
- Abolish the ratio between total capital and inter-bank borrowing funds so as to improve the borrowing potential and liquidity management.
- Lower the thresholds for bond issuance, particularly for AFCs.

### 3.2 Allow NBFIs to Receive Direct Financing or Guarantees from Their Foreign Shareholders and to Borrow from Overseas Financial Institutions

#### Concern

Non-Banking Financial Institutions are severely restricted from accessing financing from abroad, both from overseas financial institutions and their own overseas shareholders—including guarantees for domestic debt—constraining the healthy development of their business in China.

#### Assessment

Non-Banking Financial Institutions are significantly restricted from issuing foreign debt. According to the CFC regulations, CFCs are only allowed to borrow from domestic financial institutions. There are no specific rules for NBFIs when applying for the foreign debt quota with the State Administration of Foreign Exchange (SAFE), contrary to foreign-invested banks. In the absence of clear requirements, CFCs have not yet been able to issue foreign debt via this method.

According to Article 19 of the *Administrative Measures for Auto-Financing Companies* (revised in 2008), AFCs can only accept *Renminbi* (RMB) deposits from a Chinese wholly-owned subsidiary of the AFC's overseas shareholder. Thus, the AFC is obliged to set up this sort of entity or widen the business scope of its existing entities, having to go through a long and costly bureaucratic and legal burden, which also affects its China structure. These obstacles might deter AFCs from accessing a source of funding that otherwise, and according to international standards, they would be entitled to. This alternative source of funding would allow AFCs to decrease funding costs—subsequently allowing them to offer competitive conditions to

retail customers—diversify the financing mix and enhance funding risk management. The SAFE has the experience and power to approve these sorts of loans.

#### Recommendations

- Allow CFCs to receive direct financing or guarantees from their foreign shareholders.
- Allow AFCs to directly obtain loans from overseas shareholders or other group companies, with the approval of the SAFE, and without the need of a China wholly-owned subsidiary.

### 4. Relax Prudential Requirements on NBFIs for Issuing Small-sum Loans to Individuals via Online Channels

#### Concern

Currently, NBFIs licensed by the CBRC are required to conduct face-to-face interviews with potential borrowers of personal loans (based on the *Interim Measures for Administration of Personal Loans*).<sup>3</sup> This requirement seems to be outdated given the vast opportunities of direct online lending now occupied by the less regulated—or completely unregulated—market players such as P2P and loan broker web platforms and e-shops.

#### Assessment

Consumers in China have over recent years developed great appreciation for purely online purchases of consumer goods and services. This new online consumption trend benefits predominantly domestic producers and online retailers that cannot fully and safely utilise its momentum if qualified and experienced NBFIs require their potential customers to go to their branch for a face-to-face interview before a loan can be granted. As a result, consumers are driven towards less regulated borrowing schemes operated by entities which lack operational excellence, underwriting capabilities and risk management and data protection tools required from NBFIs through the wide range of CBRC and People's Bank of China (PBOC) regulations. Non-Banking Financial Institutions seem to be best positioned to participate in full online lending (without face-to-face interviews) thanks to their ability to utilise big data and statistical analysis of consumer behaviour available to them from their previous experience in

<sup>3</sup> *Interim Measures for Administration of Personal Loans*, CBRC, published 12<sup>th</sup> February, 2010, viewed 30<sup>th</sup> June, 2015, <[http://www.gov.cn/gongbao/content/2010/content\\_1688570.htm](http://www.gov.cn/gongbao/content/2010/content_1688570.htm)>





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offline lending, and their ability to provide borrowers quality loan-related services in both online and offline environments. Also, overdue loan collection experience and capabilities of NBFIs are by definition much higher than those of the online-only market players – this advantage of NBFIs can be a good cure to the growing moral hazard of unrepaid and uncollected online loans from unregulated lenders. At the same time, since NBFIs typically do not accept deposits from the public, the prudential reasoning for the need of a face-to-face interview seems less strong than in the case of banks.

#### Recommendation

- Abolish the requirement for NBFIs to conduct face-to-face interviews with borrowers.
- Enable full online loan granting by NBFIs in cases where they have sufficient means to confirm the identity of the borrower (such as utilising big data and transaction history), and impose a maximum limit on loans issued online without a face-to-face interview (e.g. CNY 20,000 per borrower) to cap any systemic risks and possible abuse of online loans for illegal purposes.

## Abbreviations

AFC	Auto Finance Company
CBRC	China Banking Regulatory Commission
CFC	Consumer Finance Company
CNY	Chinese Yuan (Chinese currency)
NBFI	Non-Banking Financial Institution
PBOC	People's Bank of China
P2P	Peer-to-Peer
RMB	Renminbi (Chinese Currency)
SAFE	State Administration of Foreign Exchange
SOE	State-owned Enterprise





# Insurance Working Group

## Key Recommendations

### 1. Market Access and Fair Development of the Market

#### ▶ 1.1 Increase Flexibility on Ownership for Foreign Investment in Insurance Services

- Remove the obligation for life insurers' shareholder structure.
- Create a pilot programme in China's free trade zones allowing wholly foreign life insurance investment.
- Liberalise the option of taking more than one domestic investor into joint ventures (JVs) to share part of the Chinese investment.
- Offer a level playing field to foreign insurers that allows them more than one equity engagement in the insurance sector in China, including concurrent operation of a wholly foreign-owned institution and participation in another licensed insurer, in line with the new *Regulation Guidelines for Mergers & Acquisition of Insurance Companies*.

#### ▶ 1.2 Treat Health Insurance as a Distinct Category of Insurance

- Issue mono line Property and Casualty (P&C) licences enabling health insurance operators to do short-term business.
- Amend the law so that health insurance is treated as a stand-alone category of insurance: specific regulations might also be developed to address the specific needs of the health insurance sector, such as a lower minimum capital requirement.
- Provide a platform to support the development of the health industry chain to help health insurance companies' work with medical institutions to provide affordable and quality medical services and reduce over treatment.
- Use the China (Shanghai) Free Trade Zone (CSPFTZ) and other free trade zones to pilot new regulations that allow foreign specialised health insurance providers to set up a wholly foreign-owned enterprise (WFOE) or monoline P&C insurer.
- Continue to investigate the possibility of setting up tax incentives for the development of health insurance.

#### ▶ 1.3 Treat Onshore and Offshore Reinsurers Equally Under the China Risk Oriented Solvency System (C-ROSS) and Simplify the Process for Establishing Reinsurance Branches

- Eliminate the requirement of having to complete two years with a representative office (RO) presence prior to the application for establishing a reinsurance branch.
- Treat offshore reinsurers and onshore reinsurers equally, provided they comply with the regulatory requirements in their respective countries of origin and have an adequate rating.

#### ▶ 1.4 Allow Foreign Insurers to Operate Pension Companies in order to Provide Enterprise Annuity

- Allow foreign insurers to set up specialised pension companies providing enterprise annuity services, including trustee and investment services.



### 1.5 Facilitate Geographical Network Expansion

- Continue to simplify the time-consuming licence application process for insurance companies and ensure equal treatment for all market players.
- Enforce a maximum delay of a few months (e.g three months) for the China Insurance Regulatory Commission (CIRC) to accept or refuse the preparation of a new branch, and provide objective reasons in case of refusal.
- Streamline the approval process for foreign insurers so that multiple provincial expansions may be approved in parallel.
- Lower the threshold to write large consumer businesses without a provincial licence from Chinese Yuan (CNY) 400 thousand to CNY 200 thousand, and allow insurers to write employer's liability for such customers.

## 2. Sustainable Development of the Market

### 2.1 Enlarge Access of Bancassurance Business

- Relax the restrictions on bancassurance cooperation to allow banks to cooperate with a greater number of insurers.
- Allow more access for foreign players, and make it possible for them to use their overseas experience to take a positive, leading role in setting the direction of the bancassurance market channel.

### 2.2 Abolish the Geographical Restriction on Online Insurance Sales

- Put the *Notice Concerning Certain Issues of Regulating Life Insurance Companies' Selling Online Insurance* and the *Interim Measures on Internet Insurance Business* into law and abolish geographical limitations to online insurance sales generally.
- Allow insurance companies to enter into policy agreements online regardless of the location of the purchasing party.

### 2.3 Provide Favourable Taxation Support for Commercial Retirement Protection

- Implement a nationwide, tax-deferred retirement programme as soon as possible.
- Extend taxation incentives further to enterprises.
- Clear the stipulation of the tax-deferred policy applying to enterprise annuity (EA) and other commercial endowment insurance or pension plans.

### 2.4 Reduce Constraints on Foreign Insurance Companies' Capital

- Widen the investment scope of capital contribution to more investment categories, and clarify the way those capital funds can be used for operations.
- Release precise rules for the capital already paid in convertible currencies that regulatory bodies could release with respect to the possibility of changing those funds into renminbi (RMB), so that insurance companies have a clear view of the material and application process required by the State Administration of Foreign Exchange (SAFE) and can make plans accordingly.

 Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.



## Working Group Introduction

The Insurance Working Group represents leading European insurers, brokers and other insurance service providers engaged in life, non-life, reinsurance and specialty insurance. Its members have different operational structures, but all of them consider China as a long-term priority market. They are fully committed to contributing to the sustainable growth of the Chinese insurance market. They are aware of the crucial role commercial insurance plays in China's sustainable economic growth and social stability. To this end, they are willing and prepared to provide added value to the industry by introducing best practices and technical know-how.

## Recent Developments

### Market Overview

Premium Income	Growth rate	Value (billion CNY)
Direct insurance <sup>1</sup>	17%	2,023
Direct property insurance	16%	720
Direct life insurance	16%	1,090
Direct health insurance	41%	158
Direct personal accident insurance	18%	54

### Claim and Benefit Payments

In 2014, claim and benefit payments grew 16 per cent (CNY 721 billion). Among them, claim payments in property insurance increased 10 per cent (CNY 378 billion); benefit payments in life insurance increased 21 per cent (CNY 272 billion) compared with 2013; claim and benefit payments in health insurance surged 38.9 per cent (CNY 57 billion) and claims in accident insurance rose 17 per cent (CNY 12 billion).

Insurance Assets	Growth rate	Value (billion CNY)
Total assets	23%	10,159
Property insurance	29%	1406
Life insurers	21%	8248
Reinsurance companies	67%	351
Asset management companies	26%	24
Insurance net assets	56%	1,325

Source: CIRC

<sup>1</sup> An original insurance contract between insurer and insured.

### Status Quo of Foreign Insurance Companies in China

During 2014, the market share for foreign players increased, and reached 4.5 per cent compared with 3.9 per cent in 2013. The market share for foreign life insurance companies showed a steady increase rate during the past year and reached 5.78 per cent, while foreign property insurance companies managed to gain a 2.22 per cent market share. The premium for foreign insurance companies in 2014 was CNY 734 billion in total, a jump of 22.95 per cent year-on-year. The China Insurance Regulatory Commission (CIRC) admits that foreign insurers' business scale remains limited in China.<sup>2</sup>

### Life insurance in China 2014

Unit: CNY 10,000

	Original Insurance Premium	Insurance Holder's New Investment	Unit-linked Insurance Independent Account Increase
Foreign Insurance Companies	7,338,186	1,315,724	311,397
Domestic Insurance Companies	119,564,660	37,851,817	2,583,581

Source: CIRC<sup>3</sup>

### Reform Progress and Negotiations for the EU-China Comprehensive Agreement on Investment (CAI)

The Insurance Working Group acknowledges the efforts of the authorities in implementing certain aspects of the Third Plenum's *Decision*,<sup>4</sup> particularly regarding opening up and allowing markets play a more decisive role. There have also been some improvements in the development of the financial services and insurance sector. A clear example of this is the positive progress on the pricing of the motor vehicle insurance (Key Recommendation 7 of the *Insurance Position Paper 2014/2015*). The working group also acknowledges that since the *Decision*, the authorities are working towards having commercial insurance play a more important role in the economic and social development of China. For this purpose, they are welcoming investment in areas such as catastrophe insurance, agriculture insurance,

<sup>2</sup> 2014 Insurance Industry Overview, CIRC website, 26<sup>th</sup> January, 2015, viewed 22<sup>nd</sup> April, 2015, <<http://www.circ.gov.cn/web/site0/tab5179/info3948914.htm>>

<sup>3</sup> Ibid

<sup>4</sup> The Third Plenum of the 18<sup>th</sup> Chinese Communist Party Congress was held in November 2013, and concluded with a decision laying out new economic and policy initiatives – the *Decision*.



Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Establishing a unified, open, competitive and orderly market system is the basis for the market to play a decisive role in the allocation of resources.	Market forces should play a more important role in the insurance industry. However, in the meantime, market players are facing different limitations preventing them from receiving effective national treatment	
Relaxing control over investment access. We will have the same laws and regulations on Chinese and foreign investment, and keep foreign investment policies stable, transparent and predictable.	The industry remains over-regulated when it comes to investments, especially regarding limitations for setting up operations or obtaining licences, i.e. restrictions on ownership or establishing JVs.	
... improve the government organisational structure, function composition and work procedures so that we will have a good administrative system with decision-making.	A lack of coordination between the various authorities results in laws and regulations being applied and interpreted differently. This creates difficulties and prevents companies from having a clear understanding on how to fully comply.	
... enact preferential policies, such as tax exemption and deferral, and encourage the development of enterprise annuity, occupational annuity and commercial insurance, so as to bring into shape a multi-level social security system.	A favourable and efficient taxation policy needs to be developed in order for the Enterprise Annuity and the Commercial Pension to play an active and sustainable role in the social welfare system.	

commercial insurance, pushing for the reform of the old-age and medical insurance and encouraging the development of the enterprise annuity (EA), in order to develop a multi-level social security system.

Foreign insurance players can contribute and are eager to play an active role in reaching these goals, however, there are currently many hurdles that are preventing them from fully contributing. In this sense, effective national treatment would be a big step forward. Limitations of ownership or restrictions when setting up JVs may have had been understandable when China had just joined the World Trade Organisation (WTO), as the insurance sector was in its infancy; however, the insurance sector in China has now reached a more mature stage of development making these restrictions unnecessary. In this paper, the working group also presents other issues that affect the successful development of the Chinese insurance sector like transparency, regulatory coordination and tax support

schemes for the insurance sector.

The working group also welcomes the efforts of the authorities to implement a stronger rule of law in China. The discretionary application and implementation of rules and penalties has been traditionally one of the concerns raised in the European Chamber's *European Business in China Position Paper* and *Business Confidence Survey*. The working group hopes that these efforts will be translated into an increase in the clarity and transparency of the making, application and publication of all rules. It also hopes that a stronger rule of law will mean the application of principles like proportionality of decisions and the ability to resort to appeal when it is perceived that a decision has not followed this principle.

▶ Parallel to China's reform process are the negotiations for an EU-China Comprehensive Agreement on Investment (CAI). The Insurance Working Group believes these negotiations offer a unique opportunity for China to push the reform agenda and contribute to the development of the insurance sector. The working

<sup>5</sup> See introduction to the Financial Services section of the *European Business in China Position Paper 2015/2016*.



group considers that during these negotiations effective national treatment, fair and sustainable development of the sector through a greater role of market forces and transparency should be priorities for both parties.

### Policy and Market Developments

In the past year, the working group has seen a number of developments that have had a significant impact on the development of the insurance sector in China. The most notable of these are listed below:

- The CIRC issued the *Administrative Measures for Mergers and Acquisitions of Insurance Companies*, April 2014.
- The CIRC granted full export credit licences to Ping An, China Continent Property & Casualty Insurance Company (CCOC) and China Pacific Insurance Company (CPIC) in mid-2014. The working group understands that the Ministry of Finance (MOF) could fully open the export market and that commercial property and casualty insurance companies could have the chance to do business with a tenor over two years if the experience with the above three companies shows positive progress.
- Establishment of the Beijing Insurance Research Institute (BIRI), July 2014. The BIRI is a think tank devoted to deepening the insurance sector's reform under the Chair of the CIRC.
- The State Council's *Several Opinions on Accelerating Development of Modern Insurance Service Industry* or also known as the Ten Clauses, were issued, August 2014.
- The CIRC released the *Insurance Investment Rules*, December 2014.
- The first Sino-foreign health insurance JV is registered in the China (Shanghai) Free Trade Zone (CSPFTZ), December 2014.
- The People's Bank of China (PBOC) and the CIRC jointly issued a notice allowing insurance companies to issue bonds for capital supplement in the national interbank bond market, January 2015.
- The CIRC approved the regulations of the China Risk Oriented Solvency System (C-ROSS), February 2015.
- The CIRC implemented the reforms on commercial vehicle insurance clauses and the premium rate regulatory system, February 2015.

## Key Recommendations

### 1. Market Access and Fair Development of the Market

#### ▶ 1.1 Increase Flexibility on Ownership for Foreign Investment in Insurance Services

##### Concern

Despite the *Decision* calling for the market to play a more decisive role, insurance industry players are facing a number of restrictions that preclude them from receiving national treatment and prevents the full power of market forces from being unleashed.

##### Assessment

It has been 17 years since the basic structure of the current regime regarding the ownership of insurance companies was set up. There have been several adjustments and changes over this period of time, during which all market players have seen shareholder caps gradually being released.

In line with further opening-up, China now has a clear direction of relying more on market mechanisms. As witnessed during the 'two sessions',<sup>6</sup> allowing the market to play a more decisive role was emphasised several times during the government's working report.

In early 2015, the Ministry of Commerce (MOFCOM) released the draft Foreign Investment Law for public consultation. This proposed revision of the regulatory regime for foreign investment aims to cater for the newly developed market environment, loosening the entry criteria for foreign investment as well as guaranteeing national treatment.

The working group is encouraged by these signals, and feels confident it will eventually get to see a mature commercial environment with healthy market discipline and equal treatment for every player. The working group commends the efforts of the current administration in adjusting the present regulatory environment in an attempt to unleash the full power of competition that will drive the development and innovation of the insurance sector.

The working group believes that such healthy industrial

<sup>6</sup> The 'two sessions' or '*lianghui*' refers to the annual plenary meetings of China's main deliberative bodies: the National People's Congress and the People's Political Consultative Conference. In 2015, they took place from 2<sup>nd</sup>-15<sup>th</sup> March.





growth will benefit the Chinese people, especially in the areas of healthcare and retirement protection.

#### Recommendations

- Remove the obligation for life insurers' shareholder structure.
- Create a pilot programme in China's free trade zones allowing wholly foreign life insurance investment.
- Liberalise the option of taking more than one domestic investor into JVs to share part of the Chinese investment.
- Offer a level playing field to foreign insurers that allows them more than one equity engagement in the insurance sector in China, including concurrent operation of a wholly foreign-owned institution and participation in another licensed insurer, in line with the new *Regulation Guidelines for Mergers & Acquisition of Insurance Companies*.

### 1.2 Treat Health Insurance as a Distinct Category of Insurance

#### Concern

Foreign specialist health insurers have been unable to enter the market on a wholly-owned basis – they are prohibited by both the existing categorisation of health insurance as a type of life insurance and its related foreign-ownership restrictions.

#### Assessment

The working group supports China's push to develop a specialist health insurance market that will cater to customers' growing demand for quality healthcare funding, while ensuring that their interests are protected through appropriate regulation. The nature of health insurance differs markedly from that of life insurance and therefore requires a tailored set of regulations. Health insurance requires special operational expertise and risk management, particularly with respect to the management of medical risks and medical costs. Its single product nature also means its operating scale and asset scale are not comparable with life insurance. In fact, given the short-term nature of traditional medical indemnity products, the risk profile of health insurance more closely resembles property insurance than it does life insurance. In most jurisdictions in Europe, health insurance is actually regulated as a form of general insurance (referred to as property insurance in China). In China, the similarity of health and property insurance is already somewhat reflected in the regulations, in that

property insurers are permitted to sell short-term health insurance products.

In contrast with property insurance, where foreign insurers may apply for a wholly foreign-owned enterprise (WFOE) licence, foreign ownership of health insurers is restricted to 50 per cent. European specialist health insurers are keen to share their expertise with China but suffer delays entering the market due to foreign-ownership restrictions and the difficulty of finding a partner similarly committed to the sector, while life insurers, property and casualty insurer—who have no particular expertise in health insurance—are already offering health products.

#### Recommendations

- Issue mono line Property and Casualty (P&C) licences enabling health insurance operators to do short-term business.
- Amend the law so that health insurance is treated as a stand-alone category of insurance: specific regulations might also be developed to address the specific needs of the health insurance sector, such as a lower minimum capital requirement.
- Provide a platform to support the development of the health industry chain to help health insurance companies' work with medical institutions to provide affordable and quality medical services and reduce over treatment.
- Use the CSPFTZ and other free trade zones to pilot new regulations that allow foreign specialised health insurance providers to set up a WFOE or monoline P&C insurer.
- Continue to investigate the possibility of setting up tax incentives for the development of health insurance.

### 1.3 Treat Onshore and Offshore Reinsurers Equally Under the China Risk Oriented Solvency System (C-ROSS) and Simplify the Process for Establishing Reinsurance Branches

#### Concern

Although C-ROSS seems to encourage foreign reinsurance companies to invest in China by establishing local reinsurance branches, foreign reinsurers applying to establish in China must go through an extremely long approval process.

#### Assessment

The Insurance Working Group considers that one



of the purposes of C-ROSS is to further encourage foreign reinsurance companies to invest in China by establishing local reinsurance branches. However, foreign reinsurers applying to establish in China must go through a very long approval process, with the current regulations requiring them to first establish a RO in China, and only after completing two years with a RO presence can they apply for branch establishment, which will take another one or two years to complete. This means that in the best case scenario it will take at least a four-year term for foreign reinsurers to set up a branch in China. Such a long period of time can significantly impact their business in China while disrupting market competition. This is also in conflict, somehow, with the purpose of C-ROSS.

The C-ROSS regime penalises reinsurance companies with no local presence in China, since their Chinese clients must face more stringent capital requirements when ceding premiums to offshore reinsurers. This, besides damaging the interests of a great number of offshore reinsurers who have been supporting the Chinese market for a great number of years, can also disrupt market competition and limit reinsurance capacity.

#### Recommendations

- Eliminate the requirement of having to complete two years with a RO presence prior to the application for establishing a reinsurance branch.
- Treat offshore reinsurers and onshore reinsurers equally, provided they comply with the regulatory requirements in their respective countries of origin and have an adequate rating.

### ▶ 1.4 Allow Foreign Insurers to Operate Pension Companies in Order to Provide Enterprise Annuity

#### Concern

Foreign insurers are not permitted to obtain licences to set up specialised pension companies even when their experience and expertise in overseas markets are taken into consideration. Besides this, there is a lack of communication among all relevant government bodies involved in granting enterprise annuity licenses.

#### Assessment

In the interest of allowing China's insurance market to develop more rapidly, it is recommended that any decisions by life insurance companies to expand into

related businesses, such as corporate pension and asset management, be business-based and reside with its respective boards. It should not be restricted by regulation. Many European life insurers have experience in supporting the development of enterprise annuity schemes and wish to bring this expertise to assist developments in China.

#### Recommendation

- Allow foreign insurers to set up specialised pension companies providing enterprise annuity services, including trustee and investment services.

### ▶ 1.5 Facilitate Geographical Network Expansion

#### Concern

Despite some recent progress, the market share of foreign insurers remains low and this can be linked to a large extent to the fact that their geographical networks are limited compared with those of domestic players, who were historically allowed to open a lot of branches in quick succession.

#### Assessment

In 2013, the CIRC released a set of rules regarding the opening of branch offices by insurance companies with the aim of standardising approval processes. These measures reflected efforts to open up the insurance industry market, and bring approval processes for foreign-invested insurers in line with those for domestic insurers.

Since then, the number of branches opened by domestic players has been reduced significantly, but the advantage they still retain over foreign-invested insurers can be clearly seen in the number of branches opened in 2014.

Although there is no formal regulation that actually restricts the number of new branches that can be opened by insurers, and foreign-invested insurers can apply for several new branch approvals at the same time, in practice additional provincial branches are only ever approved consecutively, with relatively long processing times between two approvals.

At such a pace, it will take decades for foreign companies to establish a large presence on the Chinese market, even for major global players that have already been established in China for a long time.



It is therefore difficult for foreign insurers meet consumers' insurance demands in different geographical areas, which seriously hinders their competitiveness and their ability to contribute to the healthy development of the insurance industry in China.

#### Recommendations

- Continue to simplify the time-consuming licence application process for insurance companies and ensure equal treatment for all market players.
- Enforce a maximum delay of a few months (e.g. three months) for the CIRC to accept or refuse the preparation of a new branch, and provide objective reasons in case of refusal.
- Streamline the approval process for foreign insurers so that multiple provincial expansions may be approved in parallel.
- Lower the threshold to write large consumer businesses without a provincial license from CNY 400 thousand to CNY 200 thousand, and allow insurers to write employer's liability for such customers.

## 2. Sustainable Development of the Market

### 2.1 Enlarge Access of Bancassurance Business

#### Concern

A 2010 CIRC regulation effectively restricted each branch of commercial banks to cooperating with no more than three insurance companies (i.e. each branch of the same commercial bank can have different cooperating insurance companies), which has led to banks demanding very high commissions.

#### Assessment

Many of the foreign insurers that have established subsidiaries in China have more than a century of industry experience overseas. This means that they have generated a great deal of professional, technological and operational expertise. The working group understands that the Chinese Government wishes to absorb advanced know-how from overseas and that this has been a factor in its desire to open China's insurance market to foreign players.

However, the restriction on bancassurance presents particular difficulties for foreign-invested insurers: China's large, state-owned banks have the most extensive resources and distribution networks and so competition between insurers to cooperate with them is very severe. Many banks will elect to cooperate only

with domestic insurers with whom they are already familiar. Foreign-invested insurers currently have only a small market share in China and this limitation in their ability to cooperate with banks is a factor in the slow growth of their market share.

In addition, this restriction limits foreign players' access to resources and distribution channels, which renders them less competitive and prevents them from actively sharing their technology and business skills across the industry in China.

The Chinese insurance industry is currently dealing with the challenge of mis-selling through bancassurance channels which has led to substantial demands for refunds. Many overseas markets historically experienced similar difficulties, but were able to overcome them and build mature and healthy bancassurance systems. Allowing foreign players to more actively use the bancassurance channel will allow them to share experience in this respect and to assist with building market discipline.

#### Recommendations

- Relax the restrictions on bancassurance cooperation to allow banks to cooperate with a greater number of insurers.
- Allow more access for foreign players, and make it possible for them to use their overseas experience to take a positive, leading role in setting the direction of the bancassurance market channel.

### 2.2 Abolish the Geographical Restriction on Online Insurance Sales

#### Concern

Current regulations prohibit insurance businesses from carrying out business outside the province where they are registered or have a branch. This geographical restriction limits the enormous potential of online insurance sales and reduces consumers' options. It also disproportionately affects foreign-invested insurance businesses that have relatively few branches in China while their domestic counterparts tend to have a presence in all provinces.

#### Assessment

The huge increase in online sales of all types in China over the past few years indicates the growing popularity of the Internet as a sales channel. It will be an increasingly important channel for insurance sales



– particularly since the growth of insurance premiums generated by more conventional distribution channels (individual agents and bancassurance) has slowed.

One of the great advantages of online sales is that it involves no physical obstacles: theoretically anyone in the world can log on the Internet and make a purchase online without the need to attend the seller's premises. Another is reduced costs: online selling requires fewer business premises and staff.

Restricting online sales of insurance to the province(s) in which an entity has a physical presence restricts the impact of these potentially enormous benefits on the market and consumers.

In particular, it limits competition in the industry and therefore consumer choice. Members of the Insurance Working Group are committed to the Chinese insurance market. They aim to introduce to China increasingly sophisticated insurance products tested in other markets and tailored for China. The *de facto* restriction on the expansion of foreign-invested insurance companies' presence in China, together with the restriction of online sales, means that a large proportion of Chinese consumers have no access to such products. Abolishing the geographical restriction on online sales would increase that access and would go some way towards levelling the playing field for foreign-invested insurers.

Perhaps the main reason for the current geographical restriction on online sales is a concern that insurance companies may not be able to provide adequate services to consumers in provinces where the insurer has no physical presence. In this respect, the working group proposes two measures for consideration. First, insurance companies could be required to engage local insurance institutions (insurance agents and/or loss adjusters) to provide services and oversee those services. Second, they could be required to state clearly on their websites the provinces in which they are registered and how customers outside those provinces will be serviced. Customers could then make their own informed purchasing decisions.

The working group is encouraged by the two drafts for comments, the *Notice Concerning Certain Issues of Regulating Life Insurance Companies Selling Online*

*Insurance*<sup>7</sup> and the *Interim Measures on Internet Insurance Business*.<sup>8</sup> They respectively state that, provided insurers have "corresponding internal control capability, and are able to satisfy customer needs", they can expand their geographical sales area to places where they have not yet established a branch, provided they are:

- 1) life insurers selling certain types of life insurance online;
- 2) non-life insurers selling certain non-life insurance products to individual policy holders or insureds; or
- 3) non-life insurers which can independently and completely underwrite and distribute non-life insurance products online and provide the relevant claim services.

If these become law, it will allow foreign investors greater access to China's insurance market.

#### Recommendations

- Put the *Notice Concerning Certain Issues of Regulating Life Insurance Companies' Selling Online Insurance* and the *Interim Measures on Internet Insurance Business* into law and abolish geographical limitations to online insurance sales generally.
- Allow insurance companies to enter into policy agreements online regardless of the location of the purchasing party.

### 2.3 Provide Favourable Taxation Support for Commercial Retirement Protection

#### Concern

Although the State Council has issued guidelines for speeding-up the development of the insurance sector and its contribution to China's social and economic development, a favourable tax policy environment, as addressed both by the State Council and by the CIRC Chairman, is needed in order to promote and support commercial retirement protection.

#### Assessment

From 2013–2014, enterprises participating in EA increased by 10.8 per cent, and employees covered by EA increased by 11.5 per cent. Even though by the end of 2014, a total of 23 million people were under EA

<sup>7</sup> *Notice Concerning Certain Issues of Regulating Life Insurance Companies Selling Online Insurance*, CIRC, 15<sup>th</sup> April, 2014, viewed 24<sup>th</sup> June, 2015, <<http://www.circ.gov.cn/web/site0/tab5168/info3913089.htm>>

<sup>8</sup> *Interim Measures on Internet Insurance Business*, CIRC, 10<sup>th</sup> December, 2014, viewed 24<sup>th</sup> June, 2015, <<http://www.circ.gov.cn/web/site0/tab5168/info3943802.htm>>



coverage, this represents only 6.7 per cent of the total labour force.<sup>9</sup>

The issue of introducing a tax-deferred, retirement-insurance pilot programme has been under discussion for a few years, but it was only in early 2015 that the CIRC Chairman, Xiang Junbo, confirmed that such a pilot programme will be carried out in 2015.<sup>10</sup> Clear support is needed to speed up the participation in commercial retirement protection in order to meaningfully impact people's lives.

The CIRC defines retirement protection as consisting of both commercial endowment insurance and the annuity. It is recommended that, once implemented, the pilot programme and the overall tax-deferred benefit will be practically covered by both commercial endowment insurance as well as EA.

A favourable tax policy should be extended to individuals, as well as enterprises that grant additional endowment insurance coverage or raise pension funds for their employees. Currently, only an EA premium can legally compensate five per cent of total enterprise income tax. But group endowment insurance or pension funds could greatly help to supplement retirement protection. A favourable tax policy is needed in order to achieve a larger participation in EA schemes.

#### Recommendations

- Implement a nationwide, tax-deferred retirement programme as soon as possible.
- Extend taxation incentives further to enterprises.
- Clear the stipulation of the tax-deferred policy applying to EA and other commercial endowment insurance or pension plans.

## 2.4 Reduce Constraints on Foreign Insurance Companies' Capital

### Concern

Capital contributions paid by foreign shareholders in RMB are still subject to capital account limitations.

### Assessment

A regulation published by the PBOC in 2013, (document

number 225),<sup>11</sup> clarified and eased capital contributions by foreign companies in RMB.

However, capital contributions paid by foreign shareholders in RMB are still subject to capital account limitations. For instance, these funds can only be used for short-term investments in bank deposits. Considering the current investment environment in China, and the high minimum capital requirements for insurance companies, these limitations impact foreign-funded insurance companies' business in comparison to their Chinese peers.

#### Recommendation

- Widen the investment scope of capital contribution to more investment categories, and clarify the way those capital funds can be used for operations.
- Release precise rules for the capital already paid in convertible currencies that regulatory bodies could release with respect to the possibility of changing those funds into RMB, so that insurance companies have a clear view of the material and application process required by the SAFE and can make plans accordingly.

## Abbreviation

BIRI	Beijing Insurance Research Institute
CAI	Comprehensive Agreement on Investment
CCOC	China Continent Property & Casualty Insurance Company
CIRC	China Insurance Regulatory Commission
CNY	Chinese Yuan (currency)
CPIC	China Pacific Insurance Company
C-ROSS	China Risk Oriented Solvency System
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
EA	Enterprise Annuity
JV	Joint Venture
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
P&C	Property and Casualty
PBOC	People's Bank of China
RO	Representative Office
RMB	Renminbi
SAFE	State Administration of Foreign Exchange
WFOE	Wholly foreign-owned enterprise
WTO	World Trade Organisation

<sup>9</sup> *Enterprise Annuity Rockets*, *Sinoins*, 28<sup>th</sup> May, 2015, viewed 24<sup>th</sup> June, 2015, <[http://xw.sinoins.com/2015-05/28/content\\_156461.htm](http://xw.sinoins.com/2015-05/28/content_156461.htm)>

<sup>10</sup> *China Expected to Promote Pension Insurance Through Tax Cuts*, *Caijing*, 17<sup>th</sup> January, 2015, viewed 27<sup>th</sup> April, 2015, <<http://english.caijing.com.cn/2012-01-17/111626657.html>>

<sup>11</sup> *Notice of the People's Bank of China on Issues Concerning RMB Settlement for Investments in Financial Institutions in China by Foreign Investors*, *Circular No. 225 [2013]*, People's Bank of China, 10<sup>th</sup> October, 2013, viewed 24<sup>th</sup> June, 2015, <<http://www.pbc.gov.cn/publish/huobizhengceer/si/3131/2013/20131010151740582936277/20131010151740582936277.html>>





# Private Equity and Strategic Mergers & Acquisitions Working Group

## Key Recommendations

- ▶ **1. Redraft the Foreign Investment Law (FIL) so it Fully Aligns Foreign and Domestic Investors**
  - Unify the new FIL provisions with the Company Law, where applicable to domestic enterprises.
  - Ensure that all approval requirements for equity purchase price payment deadlines, price adjustment or earn-out approvals are removed.
  - Remove any reference to a threshold.
  - Clarify the requirements and terms of the review for investments that require an approval and remove conditional approvals.
  - Ensure a consistent approach by all authorities (the National Development and Reform Commission (NDRC), the State Administration for Industry and Commerce (SAIC) and the State Administration of Foreign Exchange (SAFE)) to make the FIL workable.
  - Define a workable and practical solution for existing, non-Chinese-controlled, variable-interest entities (VIEs) to comply with new FIL provisions.
  - Clarify the scope of the national security review and ensure that it will not constitute a form of economic protectionism.
  - Clarify other issues such as (without limitation) the concept of control for listed companies and the procedure by which a foreign investor can acquire control of a famous trademark or time-honoured brand.
  
- 2. Streamline Equity Transfer Provisions Involving Chinese State-Owned Enterprises (SOEs)**
  - Clarify the minimum threshold percentage of state-owned shareholding triggering mandatory valuation and listing requirements, particularly when there are multiple levels of shareholding: mandatory valuation and listing requirements should not apply where the state does not have a controlling stake.
  - Remove the requirement for a mandatory state-owned asset listing procedure (provided that the price to be paid will be at least 90 per cent of the value determined by a qualified People's Republic of China (PRC) audit company) for transfer clauses where a foreign investor will purchase equity in a foreign-invested joint venture (JV) company from a state-owned partner.
  
- 3. Accelerate and Deepen Reform of the State-Owned Sector to Establish a Level Playing Field between SOEs and Private Enterprises**
  - Accelerate and deepen reform of the state-owned sector to truly level the playing field between SOEs and private enterprises, including foreign-controlled enterprises, to the widest extent consistent with China's national security.
  
- ▶ **4. Further Open China's Capital Market to Foreign-invested Enterprises (FIEs)**
  - Simplify rules for foreign investors regarding the selling of shares of listed JVs in line with the principle of national treatment.

▶ Blue flags indicate issues that the working group recommends should be addressed in the EU-China CAI negotiations.





- Remove the proposal in the draft FIL for additional disclosure requirements on investments by foreign investors in listed companies.
- Allow foreign investors, including Qualified Foreign Institutional Investors (QFIIs) and *Renminbi* Qualified Foreign Institutional Investors (RQFIIs), equal opportunities to purchase and sell shares freely on the National Equities and Exchange Quotations (NEEQ).

## Introduction to the Working Group

The Private Equity and Strategic Mergers & Acquisitions (M&A) Working Group includes private equity (PE) and venture capital (VC) professionals; mergers & acquisitions (M&A) heads employed in large European corporations; Chinese and European fund managers from funds of European origin; and European professionals working for or with international PE funds. The working group also engages professionals operating in an advisory capacity on PE and M&A-related matters.

The working group seeks first to achieve a level playing field for all market participants, both Chinese and foreign, and second to provide a credible platform for exchange and expertise-sharing among active players in the PE and M&A sector.

The working group appreciates the open dialogue that it has with the various Chinese regulatory bodies covering PE and M&A in China. Regular communication with the Ministry of Commerce (MOFCOM), the State Administration of Foreign Exchange (SAFE), the National Development and Reform Commission (NDRC) and the China Securities Regulatory Commission (CSRC), as well as regional authorities in Shanghai and other cities, have proved beneficial for mutual understanding between these bodies and European companies operating in these sectors under the supervision of these agencies. The working group hopes that its contributions through this position paper are received as a positive contribution towards the development of the market for all players.

## Recent Developments

### Draft Foreign Investment Law

On 19<sup>th</sup> January, 2015, the MOFCOM published the draft Foreign Investment Law (FIL) for public comment. The new law intends to enable the legal system to

treat foreign-invested companies equally to Chinese companies and contains several fundamental changes to the foreign investment regime.





The draft law removes the previous investment catalogue and creates a negative list—the *Special Administration Catalogue*—which will identify industries where foreign investment is restricted or not permitted. Sectors that are not included on this negative list will be permitted. Special approval requirements that were only applicable to foreign-invested enterprises (FIEs) will be abolished. Agreements for the acquisition of equity or assets, or joint venture (JV) agreements, will no longer require government approval to take effect. This important change gives the parties much more control over the structure and the timing of their transactions.

However, the draft law tightens the control over Variable-Interest Entities (VIEs), which will be treated as foreign investments if a foreign party has *de facto* control. This may give rise to considerable uncertainties for some current VIE arrangements, especially in the Information, Communication and Technology (ICT) sector. Due to the far reaching consequences of the draft law for the current legal system, it is likely that the MOFCOM will need a longer time period to consult with relevant agencies before the law is formally adopted. It should be noted that even after the draft law has been adopted, FIEs will still remain at a disadvantage in freedom of financing due to the foreign exchange control regulations.

### Reforms of the Outbound Investment Approval System

The approval system for outbound investments by Chinese companies was liberalised during 2014. In the past, many outbound transactions required approvals from both the NDRC and the MOFCOM. The approval thresholds have now been lifted significantly so that the vast majority of outbound investments are no longer subject to approval and only require filings, which speeds up the process considerably. This reform is of substantial benefit to Chinese companies acquiring



Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Vigorously develop a mixed economy.	No real systematic change has been seen. Market dominance of SOEs has not been reduced.	
Enact market rules that are fair, open and transparent. All kinds of market players may enter areas not on the negative list on an equal basis.	The draft foreign investment law (FIL) has significant issues that go against this sentiment and FIEs are still treated differently to domestic companies.	
Streamline the government structure.	Little improvement. It is the intent of the FIL to have a unified body for approving investments but this has yet to materialise.	
Relax control over investment access.	Although the FIL does provide some relaxation in the law there has fundamentally been no progress.	

assets abroad as the uncertainty regarding whether a transaction would receive an approval had sometimes caused counter-parties to avoid Chinese investors and sometimes prevented Chinese investors from participating in bidding processes.

### China (Shanghai) Pilot Free Trade Zone Relaxation and Expansion

A series of positive developments occurred during 2014, in relation to the China (Shanghai) Pilot Free Trade Zone (CSPFTZ). After Premier Li Keqiang's visit to the CSPFTZ in September 2014, the State Council issued a decision that opened up a further 27 sectors to foreign investors in the zone.

- In February 2015, the People's Bank of China (PBOC) announced that companies in the CSPFTZ were permitted to borrow outside China without the approval of the authorities.
- In March 2015, it was announced that the CSPFTZ would be expanded to include the commercial districts of Lujiazui, Zhangjiang and Jinqiao.
- As of March 2015, the Shanghai Stock Exchange is preparing to launch an international trading platform in the CSPFTZ.

- In April 2015, three new free trade zones were launched in Guangdong, Fujian and Tianjin.

### Market Overview

Despite a slowing down of the gross domestic product (GDP) growth rate to 7.4 per cent in 2014, China continues to be an attractive destination for PE firms due to its sustainable growth model, increasingly open capital markets and a population of 1.3 billion with a rising middle class. Fundraising activity increased in China over the course of 2014, with United States Dollars (USD) 30.4 billion raised by funds focused on the country.<sup>1</sup> This represents an increase of 15.7 per cent over 2013. Investment activity increased versus 2013, in spite of the challenging macro environment. Private Equity firms announced investments valued at USD 14.2 billion in 2014, a 31 per cent increase over 2013.

After the initial public offering (IPO) moratorium was repealed, exit activity picked up and prompted a new wave of PE-backed deals. Observers expect an increased focus by PE firms on liquidating positions in companies acquired over the last five years.

<sup>1</sup> *Private Equity Roundup China*, 10<sup>th</sup> January 2015, viewed 5<sup>th</sup> May, 2015, <<http://www.ey.com/GL/en/Industries/Private-Equity/ey-private-equity-roundup-china>>





With regards to strategic M&A deals, China M&A surged 52 per cent by volume and 63 per cent by value to reach record highs during 2014. Deal sizes were also much bigger in nearly all sub-sectors – 2014 China M&A, at USD 407 billion, was more than half as much gains as the previous high set in 2013, although the majority of these deals took place between domestic Chinese companies.<sup>2</sup> Foreign, inbound strategic M&A also hit a record in value terms with some sizable deals in banking and financial services in particular. However, the IPO activity remains below the levels seen in 2010 and 2011.

In 2015, the healthy trends in China M&A will continue. The working group looks forward to more serious state-owned enterprise (SOE) reforms, a more open financial market and a more investor-friendly regulatory environment to stimulate growth.

## Key Recommendations

### 1. Redraft the Foreign Investment Law (FIL) so it Fully Aligns Foreign and Domestic Investors

#### Concern

The proposed draft FIL creates many new uncertainties and may actually result in a regression for foreign investment in many economic sectors.

#### Assessment

The forthcoming FIL, which will define how future foreign investments in China will take place, is generally perceived as good news by European investors. The working group in particular welcomes the expected replacement of the *Foreign Investment Catalogue* with a nationwide negative list, as recommended in the European Chamber's *European Business in China Position Paper 2014/2015*.

If the FIL achieves its goals, it will address some of the key recommendations formulated by the working group in previous versions of this position paper and make equity acquisitions of domestic companies by foreign investors easier.

Yet, there is a clear paradox between advocating national treatment for all companies and drafting more

than 170 articles for the FIL. In its current state, the FIL does not actually result in an alignment of the legal regime for foreign-invested entities with that of domestic companies; instead, it creates a new autonomous legal framework for foreign investment in China. China falls short of establishing full national treatment for foreign investors, who will still occasionally receive negative treatment compared to domestic enterprises. In this respect, the working group wishes to raise the following main issues.

#### Negative list – Scope of control

Under the FIL, foreign investments will be subject to prior approval if they fall in one of the sectors on an exhaustive list called the *Catalogue for the Guidance of Industries for Foreign Investment (Negative List)*. Because the content of the *Negative List* is still unknown, the working group is not in a position to assess it. However, there is hope that such a list will be limited and in line with regulations applying to Chinese investments in China's important commercial partners, such as Europe. Items on the list should strictly be determined by factors such as national security, energy resources, employment and other matters of public interest. The list should not be used as a means of economic protectionism.

Moreover, the draft law brings 'indirect' transactions within the scope of foreign investment regulations and classifies them as 'foreign investment'. This approach creates significant uncertainty when trying to determine whether an offshore transaction, which may involve multiple layers of entities down to the underlying PRC enterprise, requires authority approval.

In this respect, any transaction taking place outside China but indirectly involving a PRC enterprise in a restricted sector would end up requiring approval in China. It is rare for countries to regulate overseas transactions directly under domestic foreign investment laws, and in practice authorities generally lack the regulatory and executive capacity to properly and consistently enforce such regulations.

Finally, the FIL states that investments above a given threshold should be subject to approval. This clearly goes against the rationale of the FIL, which is to treat domestic and foreign investors equally, and there is no justifiable reason for doing so as the sectors concerned with these transactions do not

<sup>2</sup> PwC M&A 2014 Review and 2015 Outlook, PwC, 27<sup>th</sup> January, 2015, viewed 5<sup>th</sup> May, 2015, <[http://www.pwchk.com/webmedia/doc/635579478792786949\\_ma\\_press\\_briefing\\_jan2015.pdf](http://www.pwchk.com/webmedia/doc/635579478792786949_ma_press_briefing_jan2015.pdf)>





belong to any of the sensitive fields on the *Negative List*. In addition, any large-scale, offshore transaction involving just one PRC entity may require an approval in China, because the global value of the transaction would reach the threshold, even though the size of the Chinese entity may be absolutely insignificant. This is obviously not workable. Therefore, any reference to a threshold should be removed and foreign investments outside the *Negative List* should not require any approval, regardless of their amount; likewise, offshore transactions indirectly involving a PRC company outside the *Negative List* should not be subject to any approval.

### Procedure for approval

Under the FIL, the authorities will scrutinise foreign investments using several factors: the impact on energy resources, technological innovation, employment, environmental protection, production safety, regional development, capital account management, competition, social and public interests, industry development, profile of the foreign investor and its actual controller, and any other factors prescribed by the State Council.

As a result, foreign investments will not be governed by clear criteria provided by law, but by local authorities' varying and discretionary interpretation of matters as diverse and vague as 'technological innovation', 'competition' and 'public interests'. Moreover, transactions that raise potential competition issues are already assessed under the Anti-Monopoly Law (AML), so the FIL would clearly create an unnecessary overlap in this respect.

The profiles of the foreign investor should not be of any relevance (excluding any sanctions applied by China, be it United Nations (UN) sanctions or other domestic sanctions).

In addition, the competent foreign investment department may attach one or more condition such as divestments or limitations of percentages. The situations where such conditions can be requested are absolutely unclear and seem to be exclusively based only on the discretionary view of the officials in charge of reviewing the proposed transaction.

Finally, the FIL fails to organise transparent and efficient recourses against negative decisions of approval authorities.

Considering the above, the proposed review procedure is clearly a regression of foreign investment regulations in China.

### Requirement for a global and consistent administrative approach

Under the current system, the MOFCOM is not the only authority overseeing foreign investments. The NDRC, the State Administration for Industry and Commerce (SAIC), the State Administration of Foreign Exchange (SAFE), and various other departments also have crosscutting functions in this area. Coordination is required to ensure that the final FIL reconciles with the various other regulations impacting foreign investment, and that such regulations are also amended to guarantee equal treatment between foreign and domestic players.

In particular it is difficult to understand how the FIL will reconcile with the NDRC review and with foreign exchange regulations, for example, will the concept of total amount of investment be maintained?

Finally, in certain industries the authorities enforce constraints on foreign investments besides the *Negative List* and with no legal grounds. For example, foreign investment in some industries is ostensibly permitted, but once foreign investors attempt to engage in the industries the competent authority would be reluctant to issue the required licences or permits. These practices should be banned.

### Status of existing VIEs

The draft FIL seriously jeopardises variable interest entities (VIEs) that are not 'controlled' by Chinese investors.

Yet, the fact is that a vast number of these structures have already been in place for more than a decade. Foreign entrepreneurs have leveraged them in various sectors with the implicit tolerance of Chinese authorities. In addition, all VIEs do not aim to circumvent restrictions on foreign investment.

Banning existing, foreign-controlled VIEs does not appear to be a fair or realistic option. Existing VIE structures should continue to be permitted regardless of who controls them.





### Scope of national security review

The national security review is an extraordinary procedure that exists in addition to the general approval procedure set out by the FIL. Accordingly, its scope should be very narrow and focus on interests eventually affecting national security, such as military or national defence matters.

The working group is concerned to see the expansion of the scope of the national security review and the increase in subjected entities. Currently, the review is required for M&A transactions that affect military or national defence interests or that involve key domestic enterprises in areas such as agriculture, energy and resources, infrastructure and transport.

However, the current draft expands the scope of the national security review by including new activities, like greenfield investment and long-term financing, and factors like the “impact on public interests and the public order” and “all other factors deemed necessary to be considered”.<sup>3</sup> The expanded scope actually makes the review process more vague and opaque, which results in increased uncertainty in the investment environment.

The working group recognises China’s authority to put in place a process to review foreign acquisitions for legitimate national security concerns. However, the scope of the national security review, as described in the released draft FIL, far exceeds the usual scope of security matters, and the working group fears that it may be used for protectionist purposes. Furthermore, the National Security Law (NSL) is excessively broad and creates a great deal of uncertainty for business, as it implicitly leaves the Chinese Government with the option of undermining foreign market access based on unclear and broad national security considerations.

### Recommendations

- Unify the new FIL provisions with the Company Law, where applicable to domestic enterprises.
- Ensure that all approval requirements for equity purchase price payment deadlines, price adjustment or earn-out approvals are removed.
- Remove any reference to a threshold.
- Clarify the requirements and terms of the review for investments that require an approval and remove

conditional approvals.

- Ensure a consistent approach by all authorities (the NDRC, the SAIC and the SAFE) to make the FIL workable.
- Define a workable and practical solution for existing, non-Chinese-controlled VIEs to comply with new FIL provisions.
- Clarify the scope of the national security review and ensure that it will not constitute a form of economic protectionism.
- Clarify other issues such as (without limitation) the concept of control for listed companies and the procedure by which a foreign investor can acquire control of a famous trademark or time-honoured brand.

## 2. Streamline Equity Transfer Provisions Involving Chinese State-owned Enterprises

### Concern

While the Private Equity and Strategic M&A Working Group notes that on paper Chinese state-owned interests can legitimately be secured using specific regulations, experience shows that these regulations often become an obstacle to the implementation of agreed-upon and binding contractual provisions, including liquidity and exit provisions set forth in JV contracts.

### Assessment

Foreign investors are subject to burdensome administrative procedures when selling or acquiring equity in PRC-incorporated entities (domestic or foreign-invested) to or from Chinese partners: security review (where relevant), NDRC approval, MOFCOM approval, Beijing Administration of Industry and Commerce (BAIC) registration and SAFE registration.

Acquisitions of equity from SOEs require a mandatory valuation of the transferred equity and a listing procedure open to third-party bidders. The listing procedure creates a particularly inefficient constraint as in most cases the JV company will be very specific and only the JV partner will be in a position to purchase the equity from a commercial or industrial standpoint.

As a result of these numerous hurdles the binding effect of equity transfer clauses is very weak, even when the terms of the clauses and the initial intent of the parties

<sup>3</sup> Draft Foreign Investment Law of the People's Republic of China, MOFCOM, published 19<sup>th</sup> January, 2015, viewed 16<sup>th</sup> June, 2015, <<http://tfs.mofcom.gov.cn/article/as/201501/20150100871010.shtml>>





are clear. Any party acting in bad faith may effectively use the regulatory framework to escape its obligations. In this respect, PRC laws and regulations do not distinguish whether:

- the transfer of equity results from a clause that has already been through the entire approval process. This is the case, for instance, where the liquidity option (including its triggering events and pricing conditions) is set forth in a foreign-invested JV contract, which is always reviewed and approved by the MOFCOM; or
- the buyer is a foreign or Chinese investor. If the buyer is Chinese, the approval process to be followed creates a redundant workload for PRC authorities as the final situation is not affected by the nationality of the seller and excludes any foreign investment.

Ultimately, the impossibility of enforcing equity transfer clauses harms both Chinese and foreign investors. Equity transfer clauses are indeed a classic and powerful tool with respect to both governance (e.g. solving deadlocks, ironing out contract breaches) and financial matters (e.g. ensuring liquidity for an investor) in JV companies.

#### Recommendations

- Clarify the minimum threshold percentage of state-owned shareholding triggering mandatory valuation and listing requirements, particularly when there are multiple levels of shareholding: mandatory valuation and listing requirements should not apply where the State does not have a controlling stake.
- Remove the requirement for a mandatory state-owned asset listing procedure (provided that the price to be paid will be at least 90 per cent of the value determined by a qualified PRC audit company) for transfer clauses where a foreign investor will purchase equity in a foreign-invested JV company from a state-owned partner.

### 3. Accelerate and Deepen Reform of the State-owned Sector to Establish a Level Playing Field between SOEs and Private Enterprises

#### Concern

China's continued economic growth and development is hindered by the market dominance of inefficient SOEs over large swathes of the economy.

#### Assessment

Past reforms to the SOE sector were a key driver of China's rapid economic rise in recent decades. However, SOEs now lag well behind the non-state sector in terms of their productivity performance, contribution to economic growth and their role in China's broader economic development. Nevertheless, China's state sector continues to dominate many key areas of the economy, commanding a disproportionate share of the country's financial resources through a privileged position in the political system.

Further market-orientated reforms of the SOE sector will therefore be crucial if China is to achieve ongoing gains in productivity and to maintain a swift pace of economic development. The working group was therefore encouraged to see reform of the SOE sector clearly stated as a top priority after the Third Plenum of the Chinese Communist Party's 18<sup>th</sup> Congress (Third Plenum).

The SOE sector currently holds back China's economic development in two main ways:

1. SOEs have failed to comply with government stated policy that they should focus purely on the strategic sectors of the economy, such as defence, transportation, power and telecommunications, in which the government wishes to maintain a strong guiding hand. As a result many SOEs are operating in industries such as hospitality, real estate development and retail in which they are able to compete unfairly with their private-sector peers by benefiting from cheaper financing from state-owned banks, and favouritism from local governments in terms of land sales and regulation.
2. Despite these privileges, the productivity of the SOEs lags significantly behind that of the privately-owned enterprises (POEs), such that the SOEs' return on assets, for example, is currently around half of that of their POE peers.

There have been several pilot initiatives since the Third Plenum to reform the SOE sector but, to date, they have mainly involved introducing mixed ownership between the state and private sectors of previously state-owned assets, with the state maintaining majority control of those assets. Examples include CITIC Group's injection of most of its assets into CITIC Ltd, Sinopec's partial sale of its fuel retail business and Jinjiang Group's sale of 20 per cent of its hotels business to Hony Capital.





While appreciating that the government's explicit efforts to reform the state-owned sector should not be viewed in isolation, and that for instance the government's financial reform plans should have a significant impact in reducing SOEs' ability to access capital at preferential rates, the working group does not believe that the pilot initiatives described above are bold enough.

Rather, there should be greater resolve to reduce SOE involvement in non-strategic sectors of the economy by selling majority ownership of the relevant state-owned assets to the private sector. Without having control of these assets the working group believes that the private sector will have insufficient influence to be able to drive up the productivity of the assets to the level that it currently realises from its own assets.

Furthermore, in order to maximise competition for these assets their ownership should be transferred to the private sector in transparent processes designed to achieve maximum value for the state and, to the extent that it is permitted by the foreign investment regulations then in force for the assets concerned, these processes should be equally open to domestic and foreign investors.

#### Recommendation

- Accelerate and deepen reform of the state-owned sector to truly level the playing field between SOEs and private enterprises, including foreign-controlled enterprises, to the widest extent consistent with China's national security.

## 4 Further Open China's Capital Market to Foreign-invested Enterprises (FIEs)

### Concern

There are still many restrictions hampering FIEs' access to the Chinese capital markets, particularly regarding the sale and transfer of foreign investors' shares.

### Assessment

Currently it is possible for a FIE to list on China's established stock markets by incorporating itself as, or converting itself into, a Foreign Invested Company Limited by Shares (FICLS), and then applying for listing on the exchange of its choice in accordance with the relevant regulations. However, the requirements that an FICLS and its investors must satisfy to take this path are more stringent than those for a domestic company,

such as the requirements to obtain the approval of the MOFCOM to have at least one foreign promoter and to maintain a foreign shareholding of at least ten per cent post listing.

The working group suggests that these additional requirements that apply to FICLSs and their investors should be removed. This would reflect the nationwide trend of harmonising the regulatory requirements applicable to domestic entities and FIEs, as evidenced by (for example) the new draft FIL and the replacement of many approval requirements by filing requirements in the field of foreign direct investment, and is therefore consistent with overall Chinese government policy. It would also encourage foreign private equity investment in domestic companies, by facilitating their ability to subsequently exit their investments through a Chinese IPO.

However, the new draft FIL appears to do the reverse by imposing additional requirements for foreign investors to file annual investment reports if they hold ten per cent or more of the shares of a company listed on the Chinese capital markets (Article 81), in the same way as foreign investors in unlisted companies have to. Even if they hold less than ten per cent of the shares they need to file annual reports including details of the past year's dealings in the company's shares (Article 93). The working group believes that in line with the principle of national treatment for companies incorporated in China with foreign investment embodied in the draft law, and given that a separate disclosure regime is operated by the CSRC and the relevant stock exchange, these proposed additional notification requirements on foreign investors in listed companies should be removed.

Fundraising via China's over-the-counter equity exchange increased tenfold during 2014, as the platform emerged as an increasingly viable financing channel for companies that might otherwise wait years to list on the main stock exchanges. China's leadership has pledged to increase the role of capital markets in the financial system in order to reduce reliance on large state-owned banks, which often shy away from lending to smaller companies. Increasing equity finance could also help slow the worrying build-up of Chinese corporate debt since the financial crisis.<sup>4</sup> Although

<sup>4</sup> *Chinese start-ups flock to OTC equity exchange*, *Financial Times*, 10<sup>th</sup> November, 2014, viewed 15<sup>th</sup> April, 2015, <<http://www.ft.com/intl/cms/s/0/21fd2fac-6631-11e4-898f-00144feabdc0.html#axzz3XobE8f9E>>





this is a positive move, uncertainty remains as to how foreign investors can buy and sell shares on the National Equities Exchange and Quotations (NEEQ). Due to the relative youth of the NEEQ, rules regulating listing procedures and sale/transfer of shares of foreign investors after completion of the lock up period are still under formulation. This has resulted in foreign investors without any option but to exit their investments once they have listed on the NEEQ. While we understand that the current legislation and procedures are under formulation by the China Securities Depository and Clearing Corporation Ltd (CSDC), there have been cases where foreign investors are unclear of the procedures to execute a sale of their holdings.

#### Recommendations

- Simplify rules for foreign investors regarding the selling of shares of listed JVs in line with the principle of national treatment.
- Remove the proposal in the draft Foreign Investment Law for additional disclosure requirements on investments by foreign investors in listed companies.
- Allow foreign investors, including QFIIs and RQFIIs, equal opportunities to purchase and sell shares freely on the NEEQ.

## Abbreviations

AML	Anti-Monopoly Law
BAIC	Beijing Administration of Industry and Commerce
CSRC	China Securities Regulatory Commission
CSDC	China Securities Depository and Clearing Corporation Ltd
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
FICLS	Foreign Invested Company Limited by Shares
FIE	Foreign-invested Enterprise
FIL	Foreign Investment Law
ICT	Information and Communication Technology
IPO	Initial Public Offering
JV	Joint Venture
M&A	Mergers and Acquisitions
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission
NEEQ	National Equities Exchange and Quotations
PE	Private Equity
POE	Privately-owned Enterprise
PRC	People's Republic of China
QFII	Qualified Foreign Institutional Investor
RQFII	Renminbi Qualified Foreign Institutional Investor
RMB	Renminbi (currency)
SAFE	State Administration of Foreign Exchange
SAIC	State Administration of Industry and Commerce
SOE	State-owned Enterprise
VIE	Variable Interest Entity
VC	Venture Capital
UN	United Nations





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# Section Six: Forums





## Corporate Social Responsibility Forum

Established in 2005, the Corporate Social Responsibility (CSR) Forum now comprises more than 200 member companies covering a wide range of different business units including sustainability/CSR, marketing and communications, manufacturing, branding, public relations, government relations, community relations, corporate governance and compliance, human resources, environment, and health and safety.

Acting as an interactive platform, the Corporate Social Responsibility Forum aims to enhance the visibility of CSR while promoting best practices established by European companies and emphasising the importance of a strategic and innovative approach to CSR. The forum also fosters CSR communication, collaboration and co-innovation between European Chamber members and Chinese government agencies, professional organisations, local business partners and Non-Government Organisations, as well as Chinese society at large.

In line with the European Union Strategy on CSR, the forum defines CSR as the responsibility of enterprises to contribute towards creating a sustainable society, environment and economy. The forum aims to maximise the shared value of CSR for its members in China.

Sustainability and CSR are increasingly gaining attention among both European and Chinese companies as a proxy of good corporate governance. Consumers' higher demands of sustainable and safe products, compelling concerns over natural resource shortages, growing public supervision of responsible operations and supply chains, and increasing reporting requirements are the main drivers for European companies to adopt sustainability-related strategies in their business.

During its ten years of activity, the Corporate Social Responsibility Forum has effectively engaged in a constructive dialogue with the Chinese Government on concepts of sustainability and CSR, particularly in more recent years since state-owned enterprises (SOEs) have been required to produce sustainability reports.

In 2014/2015, the forum held a total of 20 activities in Beijing and Shanghai, including forum meetings/workshops, and participated in external events such as the Multi Stakeholder Forum on Corporate Social Responsibility in Brussels. Guest speakers covered a wide range of topics including young workforce, crisis management, CSR in Chinese outbound investment, social entrepreneurship, consumer rights, child rights, gender in business principles, green supply chain and the new scenario of ESG (Environmental, Social and Corporate Governance) disclosure.

In 2015/2016, leveraging the experience of European business in new societal and economic dynamics, the Corporate Social Responsibility Forum will continue fostering dialogue between European Chamber member companies and Chinese stakeholders in order to promote European CSR best practices and explore innovative ways to achieve long-term sustainability and shared values. Moreover, the forum will also explore the opportunity of establishing capacity building and career development platforms for future generations of CSR talent, practitioners and thought leaders.





## Government Affairs Forum

The Government Affairs (GA) Forum was established in 2011, and consists of government affairs professionals from member companies representing a wide range of industries, including multinationals, advertising agencies and public relations consultancies. Most of the Government Affairs Forum's participants have a great deal of experience of government affairs and policy advocacy in Europe and China, both at local and central levels.

Through quarterly meetings, featuring speakers from the academic world, industry and the Chinese Government, the forum aims to be a platform to exchange best practices in GA, and a way for members to learn more about recent policies and the latest trends in GA.

Information sharing among member companies can be very helpful when navigating China's challenging regulatory landscape, which is often lacking in transparency and predictability. The overall aim of the Government Affairs Forum is to promote a fair and transparent regulatory environment in China, and to help members gain a better understanding of China's regulatory process. The forum is open to all members of the European Chamber.

As a platform that connects members with government, the Government Affairs Forum keeps abreast of key policy changes in China. Over the past year, it analysed and translated a series of key documents available to all members, including State Council documents on clearing up and standardising preferential tax policies, the Functional Change Coordination Group and the *Negative List* and National Security Review Measures for Foreign Investments in China's Pilot Free Trade Zones.

In 2014, the forum kicked off a roundtable series themed *Finger on the Pulse*, to keep pace with developments after the Third Plenum and key institutional, administrative and opening-up reforms with a horizontal impact. Government affairs specialists from multiple industries take part in this roundtable on a regular basis to review and respond to the top-line reform processes, supplementary to the existing advocacy carried out by the Chamber's individual working groups.

The forum also organised and coordinated several seminars on hot policy topics, which enabled members to engage in exclusive dialogues with government officials from the Ministry of Commerce (MOFCOM), the National Development and Reform Commission (NDRC) and State Council Development and Research Centre (DRC). These included presentations on the EU-China Comprehensive Agreement on Investment (CAI), China's anti-trust investigations and national healthcare reform.



## Marketing and Communications Forum

Participants in the Marketing and Communications Forum are marketing and communications professionals from a wide range of industries. The forum provides a platform to exchange information, experiences and best practices among member companies in all industries on the best use of marketing and communications to achieve business objectives in China. Through regular meetings and events the forum aims to identify opportunities to improve the marketing and communications industry in China.

Social media is continuing to reshape the Chinese marketing landscape and exerts a huge influence on consumers' behaviour. The growing popularity of Wechat in China has seen an increase in the number of companies and organisations creating public Wechat accounts. How companies can utilise their public Wechat account and communicate with their audience effectively has become a new hot topic for marketing and communications practitioners, Wechat payment and the Wechat store has opened up new opportunities for e-commerce.

Despite the strong momentum of Wechat, companies still consider Weibo as part of their marketing mix. Compared to Wechat, a closed-loop communication network, Weibo is an outward and open network. Due to their different functionalities and usage patterns, a strategic and thoughtful combination of Wechat and Weibo can help companies achieve their marketing goals more effectively. For foreign companies in China, a frequent presence on LinkedIn is considered another useful tool in their social media mix.

Content marketing continues to be a hot topic among members. Regardless of what marketing tactics are used, content marketing is part of the process.

In the past year, the Marketing Forum has met to discuss a number of topics including the changing nature of public relations, the rise of employee branding, how companies leverage Wechat, event management and the mystery of marketing measurement.



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## Manufacturing Forum

Due to the importance of South China as a manufacturing base for European companies the Manufacturing Forum was established in November 2012. The aim of the group is to build a common platform for its 170 member companies to share experiences, challenges, ideas and opinions on current issues in the manufacturing industry. A key factor in the success of this forum is that it is attended only by senior members of the manufacturing community.

Once common areas of concern have been highlighted representatives of the group regularly meet to discuss them with the relevant government agencies at municipal and district levels. These meetings are frequently held with other European Chamber working groups to add strength and focus.

In 2014/2015 the forum held over 40 activities including workshops, factory tours, meetings and seminars. Guest speakers at these events spoke on specific topics dedicated to manufacturing management which included: logistics and customs; the environment; energy; intellectual property; accountancy; cost control strategies; and lean manufacturing, among others.

In 2015/2016, by leveraging the experience of European manufacturing businesses in South China, the Manufacturing Forum will continue to foster and develop the dialogue between European Chamber member companies and Chinese stakeholders in order to promote a better and more sustainable manufacturing environment.





## Retail Forum

The Retail Forum was created in 2008, succeeding the Trade and Distribution Working Group. Based in Shanghai, the forum currently consists of 176 member companies involved in manufacturing, retailing and distribution. Its membership continues to expand, and represents major international stakeholders from a range of industry sectors, such as cosmetics, clothing, luxury goods, consumer electronics, chemicals, medical devices and logistics.

A number of member-only meetings, as well as public events, are organised throughout the year. The main objective of these activities is to provide a platform to exchange information, experiences and best practices, while providing business opportunities for attending companies. In 2014, we hosted seven events, focusing respectively on distribution network, mobile payments, value chain convergence, food safety management, small and medium-sized enterprises' (SMEs') online business, store operations and solutions insights, and high-end market diagnosis, which attracted great participation from both European and Chinese enterprises. In 2015, the forum will turn its attention towards digital technologies, crisis communication, attraction of talent and e-commerce.

The forum also serves as a platform to exchange best practices and experiences, developing topics of significance for its member companies and providing frequent updates on the Chinese market and relevant Chinese laws and regulations. It enables member companies to network and connect with Chinese enterprises and organisations.

## Sourcing Forum

The Sourcing Forum was established in Nanjing in 2008, and became active in the South China Chapter in May 2009. The forum comprises over 200 purchasing professionals from various industries. It responds to the interests of European enterprises that source a wide range of products in China, including consumer goods, equipment and tools, production materials, office materials and others. It also attracts experts from legal and financial services.

The Sourcing Forum is an event-driven platform that regularly invites expert speakers to give presentations, and provides opportunities for roundtable discussions. Its aim is to facilitate the exchange of information, experiences, best practices and business opportunities among member companies. The forum generally addresses issues related to challenges and solutions for sustainable supplier relations as well as price trends and quality control of materials and goods. Since its establishment, the Sourcing Forum has covered a significant number of topics, including supplier development, project planning for purchasing operations, supplier negotiations, purchasing logistics and supply chain management.

In 2015/2016, the Sourcing Forum will focus on providing information about new challenges and emerging issues over a series of conferences themed *Profitable Sourcing in China*. These conferences will focus on best practices for managing suppliers, the cost of ensuring quality and strategies for operating in a more expensive China, with experts from the industry sharing their insights and expertise.



## Small and Medium-sized Enterprise Forum

The Small and Medium-sized Enterprise (SME) Forum was established in 2005, in order to provide a platform for European SMEs<sup>1</sup> to share experiences and gain practical information to support their business success in China. The forum comprises more than 300 SME members of the European Chamber across a wide range of industries. Relevant stakeholders include European and Chinese government officials and SME support service organisations, such as the European Union (EU) SME Centre and China Intellectual Property Rights (IPR) SME Helpdesk.

European SMEs play an important role in the European economy, being “99 out of every 100 businesses, two in every three employees and 58 cents in every euro of value added.”<sup>2</sup> China remains an attractive market for European SMEs that are considering internationalisation.<sup>3</sup>

Small and Medium-sized Enterprises face many challenges in today’s increasingly competitive market. To help overcome these challenges, the forum provides a strong network for companies conducting business in China to share resources and gather and disseminate information on the regulatory environment. The forum cooperates with relevant European Chamber working groups to ensure that specific requirements and concerns of SMEs are voiced through the Chamber’s advocacy activities. Additionally, the forum organises regular workshops on SME-specific issues such as financing, brand-building, talent attraction and retention, and IPR.

The European Chamber continues to host the annual Small and Medium-sized Enterprise Forum event, *Marketing and Branding your SME Throughout China*, attracting hundreds of participants from across China. This event helps to equip SMEs with the tools needed to adapt to China’s rapidly changing environment and provides tips on how SMEs should adapt marketing and brand protection strategies before launching their products in China. The forum also introduces the free resources available to EU SMEs in China through the EU SME Centre and the China IPR SME Helpdesk.

In 2014/2015, the Small and Medium-sized Enterprise Forum held 21 activities in Beijing, Shanghai and the South China Chapters. Meeting themes included employee retention, marketing and branding, IP protection and business solutions. Legal experts provided clarity on how new legislation and topics such as the Comprehensive Agreement on Investment, visa updates and anti-tax avoidance rules can affect EU SMEs in China.

In 2015/2016, the forum will continue to offer information tailored to SMEs in order to help them develop. It also aims to strengthen the platform of European enterprises and create more networking opportunities for European and Chinese enterprises.

<sup>1</sup> SMEs are defined by the EU as having no more than 250 employees and less than EUR 50 million annual turnover, viewed 12<sup>th</sup> June, 2015, <[http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm)>

<sup>2</sup> *A Partial and Fragile Recovery, Annual Report on European SMEs 2013–2014*, European Commission, July 2014, viewed 12<sup>th</sup> June, 2015, <[http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2014/annual-report-smes-2014\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2014/annual-report-smes-2014_en.pdf)>

<sup>3</sup> *EC helps SMEs Land Safely in China, Enterprise & Industry Magazine*, European Commission, 30<sup>th</sup> January, 2013, viewed 12<sup>th</sup> June, 2015, <[http://ec.europa.eu/enterprise/magazine/articles/mission-growth-international-issues/article\\_11062\\_en.htm](http://ec.europa.eu/enterprise/magazine/articles/mission-growth-international-issues/article_11062_en.htm)>





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# **Section Seven: Third Plenum Reality Check**











## Third Plenum Reality Check

### Environment


Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Reinforce environment-related market access standards.	<p>Foreign professional companies are unable to invest in developing proper infrastructure due to the limited number of licences available, most of which are allocated to Chinese companies.</p> <p>Recent tenders that opened in some cities in China for municipal solid waste incineration plants have set prequalification criteria, which limit access to the Chinese market for foreign waste treatment companies with a global track record.</p>	
<p>Accelerate pricing reform for natural resources and their products to give full expression to their market supply and demand.</p> <p>Establish a market-oriented mechanism to attract private capital to ecological and environmental protection, and implement third-party treatment of environmental pollution.</p>	<p>Under the pressure of the consumer price index, local governments tend to delay or reduce any increase of the price of drinking water. This puts pressure on water suppliers who, in response, have to manage their service quality to a lower level to off-set the additional loss.</p> <p>Hence, more related laws and regulations are required to ensure a genuine public-private partnership, in which contracts must be obeyed and both parties must carry equal responsibility.</p>	
Change the current environmental protection fee to an environment tax	The Environmental Tax Law has yet to take effect.	

### Finance and Taxation

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
We will promote the reform of value-added tax, and simplify tax rates appropriately.	Reform of VAT is in progress and should reach completion in 2015. The tax rate has been simplified.	
We will adjust the collection scope, procedures and rates of consumption tax, and impose this tax on products that consume too much energy and cause serious pollution as well as some high-end consumer goods.	Consumption tax reform has taken the first step by extending the taxable scope to paint and coating, which are energy intensive and create large volumes of pollution.	
We will establish an individual income tax system in which taxable income is defined in both comprehensive and categorised ways.	No notable developments.	
All preferential tax policies will be made clear in taxation laws and regulations.	Insufficient progress. The European Chamber recommends the overall improvement of the legislative process with regard to the tax system in order to satisfy this promise.	
We will improve the regulatory mechanism of income redistribution mainly by the means of taxation, social security and transfer payment and enhance the regulatory role of taxation.	No notable developments.	
We will accelerate resource tax reform and change the current environmental protection fee into an environment tax.	Adjustments made to the resource tax based on a newly issued tax circular came into effect from 1 <sup>st</sup> May, 2015. The revised resource tax covers rare earth, tungsten and molybdenum, including raw ore and the concentrate processed from mining ores, and is levied on the basis of value rather than volume.  The draft of the environment tax has been released for public comments.	

Third Plenum Reality Check

### Human Resources

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
XII. 42. We will quicken steps in the development of a modern vocational education system, deepen the integration of production and cooperation between schools and enterprises and train high-calibre workers and technical talents.	A number of initiatives have been implemented (see examples in Key Recommendation 1), however, they are not yet sufficient to provide the pool of skilled candidates needed by businesses by a long way.	











## Intellectual Property Rights

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
<p>13. Deepening reform of the management system for science and technology. “We will strengthen the application and protection of intellectual property rights (IPR), improve the technological innovation incentive mechanism, and explore ways to set up IPR courts.”</p>	<p>Parts of this promise are on track for implementation, namely the implementation of a separate specialised system of IPR Courts.</p>	
<p>31. Deepening reform of the administrative law-enforcement system. “We will integrate major law-enforcement bodies, relatively centralise the law-enforcement power, press ahead with comprehensive law enforcement, and do our best to resolve problems such as overlapping functions and duplicate law enforcement to establish an authoritative and efficient administrative law-enforcement system with the integration of power and responsibility. We will reduce the hierarchy of administrative law enforcement, and allocate more law-enforcement resources to the primary level in such key areas as foodstuffs and medicines, production safety, environmental protection, labour security, and coastal areas and islands. We will straighten out the urban management law enforcement system, and improve the level of law-enforcement and service quality. We will improve the procedure of administrative law enforcement, specify areas of discretion, strengthen supervision over administrative law enforcement, and comprehensively implement the responsibility system as well as government funding for administrative law enforcement, in order to promote strict, standardised, fair and civilised law enforcement. We will improve the mechanism that dovetails administrative law enforcement and criminal justice.”</p>	<p>Implementation of this promise may be reflected in the proposed/draft fourth amendment of the Patent Law as they relate to devolving enforcement powers to administrative authorities. The results/impact of this devolution will need to be assessed once the final version of the fourth amendment has been issued.</p> <p>The same applies to the Administrative Procedure Law, which came into effect on 1<sup>st</sup> May, 2015, the impact of which will likewise have to be assessed once more experience has been garnered of its operation in practice.</p>	
<p>32. Ensuring the independent exercise of the judicial and procuratorial power in accordance with the law.</p> <p>“We will reform the judicial administration system, unify the management of staffs, funds and properties of courts and procuratorates below the provincial level and explore ways to establish a judicial jurisdiction system that is appropriately separated from the administrative divisions to ensure that the state laws are enforced properly and uniformly. We will establish a judicial personnel management system fitting their professional characteristics, improve the system for unified recruitment, orderly exchange and level-by-level promotion of judges, procurators and the police, improve the classified management system of legal personnel, and guarantee the job security of judges, procurators and the police.”</p>	<p><i>Regulations of the SPC on the Jurisdictions of IP courts in Beijing, Shanghai and Guangzhou(2014) No.12</i> might constitute an opportunity to implement this promise, by experiencing new specific procedures. Its impact/effect will need to be assessed when more practical experience has been garnered with the new specialist IPR court system.</p>	



### Inter-Chamber Small and Medium-Sized Enterprises

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Support the healthy development of the non-public sector.	Access to financing is still a major challenge in carrying out businesses in China, particularly for SMEs.	
Deepen reform of the management system for science and technology.	The Central Government SME Development Fund will be used to support SME development in innovation to promote a healthy business environment and fair market competition. The Inter-Chamber SME Working Group hopes foreign SMEs will benefit from this positive development.	

### Legal & Competition

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
24. <b>Relaxing control over investment access.</b> "We will promote the orderly opening up of finance, education, culture, healthcare and other service sectors."	Legal services have been moved from the 'restricted' to the 'prohibited' category.	
	Foreign law firms cannot practice PRC law through the employment of individuals qualified in PRC law.	
9. <b>Enacting market rules that are fair, open and transparent.</b>	Many aspects of the application of the AML remain unclear, detailed reasoning in important cases remains unpublished and an increasing number of transactions approved by the MOFCOM are subject to remedies which can be far reaching.	
IX. <b>Promoting of the Rule of Law.</b>	Lack of transparency in the promulgation, elaboration and implementation of laws and regulations by legislative, judiciary and administrative bodies remains an issue.	

### Public Procurement





Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
9. "Enacting market rules that are fair, open and transparent. We will implement a unified market access system; and on the basis of making a negative list, all kinds of market players may enter areas not on the negative list on an equal basis and according to law."	Restrictions to foreign investment have been eased, but a nationwide negative list is not in place yet.	
	There is a discrepancy between restrictions to foreign investment and actual market access. Because FIEs are not considered 'local Chinese' enterprises, FIEs may be founded but they still face market access restrictions.	



## Research and Development

Third Plenum Reality Check		
What the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
<p><b>13. Deepening reform of the management system for science and technology.</b></p> <p>“We will set up and improve mechanisms and institutions that encourage original innovation, integrated innovation, and re-innovation based on introduction and absorption, improve the mechanism that encourages market-based technological innovation, and give free rein to the market's guiding role in technological research and development orientation, choice of paths, pricing of factors, and allocation of all innovation factors.”</p>	<p>The working group has not seen a great deal of progress from the perspective of FIEs. It remains difficult for us to participate in China's key projects. See the working group's recommendations for our thoughts on participation in major China projects and subsidies.</p> <p>Shanghai City's announcement of new measures to develop Shanghai as a scientific and innovative city covers quite a few of these topics. The working group looks forward to seeing these announced measures take effect.</p>	
<p><b>13. Deepening reform of the management system for science and technology.</b></p> <p>“We will strengthen the application and protection of intellectual property rights (IPR), improve the technological innovation incentive mechanism, and explore ways to set up IPR courts.”</p>	<p>Three IP Courts were set up in 2014, as promised. In Beijing on 6<sup>th</sup> November, Guangzhou on 16<sup>th</sup> December and Shanghai on 28<sup>th</sup> December.</p>	
<p><b>13. Deepening reform of the management system for science and technology.</b></p> <p>“We will develop the technology market, improve the technology-transfer mechanism, improve the financing conditions for small and medium-sized enterprises of science and technology, improve the venture capital investment mechanism, innovate business models, and promote the capitalisation and industrialisation of scientific and technological achievements.”</p>	<p>The China National Technology Transfer Eastern Centre was opened on 24<sup>th</sup> April, in Shanghai, integrating roles of technology transfer, incubation, investment and connection to the global market.</p>	

Standards and Conformity Assessment

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the Reality?	Status
We will further streamline the administration and delegate more power to lower levels, deepen the reform of the system concerning matters subject to government examination and approval, and reduce the central government's administration in micro affairs to the greatest extent. We will cancel all administrative approval procedures for economic activities under the effective regulation of the market mechanism. We will manage matters that require administrative approval according to procedures and with high efficiency.	Several administrative licensing processes have been simplified, e.g. medical devices licensing and cosmetics licensing, but more efforts are needed.	
We will set up legal person governance structure for public institutions, transform qualified public institutions into enterprises or social organizations, and establish a unified registration system for the management of public institutions of all kinds.	Guiding opinions regarding the integration of testing, inspection and certification (TIC) bodies have been released, proposing a three-step reform timetable.	
The government will strengthen the formulation and implementation of development strategies, plans, policies and standards, enhance market activity monitoring and supply of public services.	The <i>Working Plan on Deepening the Standardisation Reform</i> shows a positive intention to optimise the current standards system. However, it takes time to see the results of cleaning-up of the existing outdated, overlapping and contradictory standards. In spite of positive changes, it is still difficult for foreign stakeholders to contribute to the standards formulation process. Besides, overly short and sharp transition periods as well as insufficient commenting periods are hindering the implementation of standards.	
Social organisations should be commissioned to provide public services that they are apt to supply and tackle matters that they are able to tackle.	The Chinese Government will introduce social group standards into the current standards system and encourage competent social groups and industrial alliances to develop such standards. In line with this market-driven approach, we suggest that alliance standards/consortia standards be included in social group standards.	





Third Plenum Reality Check



## Agriculture, Food and Beverage



Third Plenum Reality Check		
What did the Third Plenum's Decision Say?	What is the Reality?	Status
Improve and unify an authoritative food and drug safety supervision organisation.	At the central level, the framework is already set up – the China Food and Drug Administration (CFDA) leads in food safety supervision in coordination with food safety units within the State Administration of Industry and Commerce (SAIC) and the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ). At the local level, however, implementation does not strictly follow the central framework. In some areas, there is no coordination among local FDA, SAIC and AQSIQ authorities.	
Establish the most stringent regulatory system covering the whole process.	The new Food Safety Law, which was passed on 25 <sup>th</sup> April, 2015, is more stringent than previous laws and regulations in terms of introducing dissuasive civil, administrative and criminal penalties for offenders. As the details of its implementation regulations have not yet been released, companies do not know clearly how to comply with the new law. In terms of a regulatory system that covers the whole process, China is far behind this target. This has been reflected particularly in agricultural product safety – from farm to processing to the table.	
Establish a food tracing system and quality labelling system.	Current problems of the tracing system include unclear requirements of food origin traceability, a lack of clear leading and responsible government departments, and government departments at all levels having their own interests in building separate tracing systems. This may add extra costs to companies in order for them to adapt their business to different tracing systems. There is also a lack of recognition and harmonisation of existing tracing systems already established by businesses.	

**Automotive**

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> Say?	What is the reality?	Status
Let the market play a decisive role in allocating resources.	A foreign investor's maximum share in the automotive industry is limited to 50 per cent and each foreign car maker is limited to establish no more than two such Sino-foreign joint ventures (JVs) for the production of passenger cars, and two for commercial vehicles ('2+2'). In addition there are requirements to invest at the minimum level and to set up component manufacturing and R&D centres.	
Improve the transparency and efficiency of the government.	Multiple government agencies regulate the automotive industry in an uncoordinated manner, resulting in different understanding, inefficient work and unnecessary costs.	
Let the market come up with innovation.	The government keeps recommending technical road maps.	
Market supervision is a key and basic prerequisite for the creation of a unified and open, competitive and orderly market system.	Today's system is still not efficient mainly because of weak enforcement on vehicles and road side safety.	

Third Plenum Reality Check

**Auto Components**

Third Plenum Reality Check		
What did by the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Enacting market rules that are fair, open and transparent.	European automotive suppliers in China are often forced to establish JVs with Chinese OEMs in order to get business. (KR4)	
Deepening reform of the administrative law-enforcement system.	The presence of counterfeit products is the strongest impediment to the development of a healthy independent aftermarket. This inhibits growth for real competition in the service and repair of vehicles. (KR1 and KR2)	



## Carbon Market

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
We will ... implement a trading system for ... carbon emission,... establish a market-oriented mechanism to attract private capital to ecological and environmental protection.	<p>The launch of the ETS pilots in 2013 represents one of the first attempts in the use of the market as a tool to allocate resources and determine the price of a commodity. But it is now time to act on this principle and develop the market in a fair, open and transparent way.</p> <p>The market mechanism should also be improved so that the emissions price is determined by the market resulting in lowest cost reductions.</p>	

## Cosmetics

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> Say?	What is the reality?	Status
I. ... 3. Economic system reform is the focus of deepening the reform comprehensively. The underlying issue is how to strike a balance between the role of the government and that of the market, and let the market play the decisive role in allocating resources and let the government play its functions better. It is a general rule of the market economy that the market decides the allocation of resources. We have to follow this rule when we improve the socialist market economy. We should work hard to address the problems of market imperfection, too much government interference and poor oversight.	The post-market supervision system needs to be further improved to make it more risk-focused.	
	It is good to see the concept of 'responsible-person system' introduced in the current draft of <i>CHMR</i> . The working group is looking forward to seeing its implementation, as it is the basis of streamlining administration and decentralising authority.	
IV. ...15. Fully and correctly performing government functions. We will further streamline the administration and delegate more power to lower levels, deepen the reform of the system concerning matters subject to government examination and approval, and reduce the central government's administration in micro affairs to the greatest extent. We will cancel all administrative approval procedures for economic activities under the effective regulation of the market mechanism. We will manage matters that require administrative approval according to procedures and with high efficiency. We will transfer large-scale and widely-participated-in social and economic projects to local and community-level management for convenience and efficiency.	The domestic, non-special cosmetics notification system has been welcomed by the industry and worked well in a lot of provinces. However, in some provinces registration requirements still apply.	
	Imported, non-special cosmetics are required to be registered with the CFDA before entering the Chinese market. Complicated review and approval procedures are inefficient, and the policy for delegating powers to lower-levels of government has not been implemented.	

Energy

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
<p>We must put in place a modern market system in which enterprises enjoy independent management and fair competition ... products and factors of production flow freely and are exchanged on an equal basis, strive to remove market barriers and raise the efficiency and fairness of resource allocation.</p>	<p>Foreign investors in China are excluded from direct bidding in shale gas licence rounds, and rules on indirect access through PSCs are unclear. In addition, technical data are not readily available to foreign and private investors to allow an independent technical evaluation of the resource potential.</p> <p>Discriminatory barriers, such as localisation for demonstration projects, prevent China from establishing an equal and transparent market to achieve China's long-term clean coal strategy.</p>	
<p>We must actively and in an orderly manner promote market-oriented reform in width and in depth, greatly reducing the government's role in the direct allocation of resources, and promote resources allocation according to market rules, market prices and market competition, so as to maximise the benefits and optimise the efficiency.</p>	<p>Although China has started with reforming national gas pricing, there is still a need for a clear scheme for this reform. Any such scheme should include a pricing structure that rewards gas for the value it offers, while simultaneously discouraging the use of coal.</p>	
<p>Both the public and non-public sectors are key components of the socialist market economy, and are important bases for the economic and social development of China [and] ... We will continue to break up all forms of administrative monopoly.</p>	<p>The power grid and the gas network are monopolised by a few state-owned grid companies that are not subject to appropriate supervision and transparency requirements. This makes China's on-grid system opaque for foreign companies and in this way adds market access barriers.</p> <p>Some local manufacturers and service suppliers can receive subsidies and preferential treatment in certain segments of the energy equipment market. Moreover, the E-drive compressor market is dominated by one Chinese SOE, whereas the main associated components are also dominated by SOEs.</p>	
<p>We will establish and improve an environmental protection system that strictly supervises the emission of all pollutants, and independently conduct environmental supervision and administrative law enforcement.</p>	<p>Enforcement of the advanced fuel standards—National IV and V—which would improve the quality of transportation fuels, is lacking.</p>	

Third Plenum Reality Check







## Healthcare Equipment

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
We will proceed with a comprehensive reform ... [of] the regulatory system.	The reform has been started, and it is underway.	
We will accelerate the reform of public hospitals, ensure the government shoulders its responsibilities in this regard, and set up a scientific medical treatment assessment mechanism and a personnel training and salary system suited to the characteristics of this sector.	Research projects are underway, realisation has not started yet.	
We will reform the methods of insurance payouts, and extend the medical insurance system to all the people. We will speed up the completion of the medical insurance and medical assistance system against fatal and serious diseases.	Research projects are underway, realisation has not started yet.	
We will make full use of information means to promote the downward flow of high-quality medical sources, and strengthen the regional integration of public medical service resources.	In the planning phase, trials ongoing, no role-out on a large scale yet.	
We will encourage private funds to flow to medical services, first supporting them to flow to not-for-profit medical institutions. We will allow private funds to invest directly in services that are short of resources or are to meet diverse demands, and to participate in the reform and restructuring of public hospitals in various forms.	In the 2015 <i>Foreign Investment Catalogue</i> , medical institutions are still classified as "restricted". <sup>1</sup>	
We will allow ... private medical institutions to be included in designated medical insurance institutions.	Realised in June 2015.	

<sup>1</sup> *Foreign Investment Catalogue (2015 Revision)*, NDRC and MOFCOM, entered into force 10<sup>th</sup> April, 2015, viewed 3<sup>rd</sup> July, 2015, <[http://www.sdpc.gov.cn/gzdt/201503/t20150313\\_667334.html](http://www.sdpc.gov.cn/gzdt/201503/t20150313_667334.html)>

Metals and Mining

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> Say?	What is the reality?	Status
<p><b>II. Adhering to and Improving the Basic Economic System</b></p> <p>"We must unswervingly consolidate and develop the public economy, persist in the dominant position of public ownership, give full play to the leading role of the state-owned sector, and continuously increase its vitality, controlling force and influence. We must unwaveringly encourage, support and guide the development of the non-public sector, and stimulate its dynamism and creativity."</p>	<p>The Metals and Mining Working Group has indeed observed China continuing the development of its economy with SOEs playing a leading role. SOEs are in the process of undergoing positive internal reforms. In terms of structural SOE reform, the working group notes positively, that this reform leaves the door open to eventual privatisation, along the lines of CITIC Bank's privatisation.</p> <p>Generally speaking, however, when it comes to metal products such as steel, SOEs tend to only bring their products up to the lowest, widely acceptable quality standard in the market. They are not known to produce their products to the highest possible quality standard, which in turn does not induce higher quality in downstream industries.</p> <p>SOEs tend to compete with private enterprises on price, not on quality, which in turn forces private enterprises to engage in price competition, at the expense of quality and often at the expense of environmental compliance. Notable exceptions from this pattern, such as Baosteel, have not spurred a sustained quality drive in peer SOE steel mills. The next stage of China's economic development will necessitate a quantum leap in quality and productivity, along the development paths that Japan, Korea and Taiwan have taken. As far as metals and mining is concerned, based on market dominance of SOEs such a quantum leap would be unprecedented.</p>	
<p><b>9. Enacting market rules that are fair, open and transparent.</b></p> <p>"We will implement a unified market access system; and on the basis of making a negative list, all kinds of market players may enter areas not on the negative list on an equal basis and according to law. We will explore a management model for foreign investors with pre-entry national treatment plus the negative list ... We will propel reform of our domestic commodity distribution structure while building a business environment under the rule of law."</p>	<p>The working group recognises this important commitment to a functioning and equitable market environment. There are concerns, resulting from the aspiration for market leadership by SOEs. Market leadership as such carries potential problems to the detriment of functioning, level markets, regardless if in China or elsewhere. The Chinese Government has shown an impressive determination to deal with market-dominating forces, however, the working group is concerned about a high potential for conflict of interests when it comes to state organs dealing with SOEs. The disproportionate number of exits of private enterprises from the SOE-dominated steel market bears witness to such concerns. Another concern is that SOEs deny private, foreign-owned enterprises access to their business, as experienced by working group members.</p>	

Third Plenum Reality Check



## Paediatric Nutrition Desk



Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
The underlying issue of the economic system reform is how to strike a balance between the role of the government and the market and let the market decide the allocation of resources.	This spirit has been well implemented. The ban on subcontracting and original equipment manufacturers (OEMs) has been removed from the newly-published Food Safety Law, indicating that the government favoured the role of the market over administrative intervention.	

## Petrochemicals, Chemicals and Refining

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
We will persist in equality of rights, opportunities and rules, abolish all forms of irrational regulations for the non-public economy, remove all hidden barriers, and adopt specific measures for non-public enterprises to enter franchising fields.	<p>Over the past two years, with the streamlining of government approvals, the scope of projects requiring government approvals has narrowed, and more project approval power is now controlled by local governments. Working group members hope that this will help to shorten the project approval time for their investments, and that the central government will strengthen 'overall balancing' to minimise the risk of overcapacity.</p> <p>The <i>National Layout Plan</i> for seven major petrochemical parks was adopted by the State Council in June 2014. Private firms have been granted more access to invest in refinery, cracker and downstream products in these parks. Working group members hope that the Chinese Government will publicise more details of this plan.</p> <p>In the revised <i>Foreign Investment Industrial Guidance Catalogue</i> promulgated in March 2015, caps on equity ratios for foreign direct investment (FDI) have been removed for sectors like cracker and refinery. Working group members see more opportunities in cracker downstream investments.</p>	
Any price that can be determined by the market must be left to the market, and the government is not to carry out improper interventions. We will push ahead with pricing reforms of water, oil, natural gas, electricity, transportation, telecommunications and some other sectors while relaxing price control in competitive areas.	The price of natural gas increased unexpectedly in 2014. This placed a severe burden on the operations of Petrochemicals, Chemicals and Refining Working Group members' facilities that use natural gas a raw material. On top of that, more factors such as the increased consumption tax on naphtha and other petrochemical feedstocks, increasing costs for hazardous waste treatment, adoption of consumption tax on chemicals like coatings, the introduction of the national emissions trading scheme (ETS) (to be launched in 2016), environmental and carbon taxes, all combine to create additional cost burdens for working group members' investments in China.	

<p>We will encourage non-public enterprises to participate in SOE reform, foster mixed enterprises with non-public capital as the controlling shareholder, and encourage qualified private enterprises to establish the modern corporate system.</p>	<p>Working group members noted positive developments in the reform of 'mixed ownership' in central SOEs, and the promotion of the public-private partnerships (PPP) model in sectors like infrastructure and environmental protection.</p>	
<p>We will have the same laws and regulations on Chinese and foreign investment, and keep foreign investment policies stable, transparent and predictable.</p>	<p>Working group members noted China's progress in adopting negative lists in pilots FTZs and the drafting of Foreign Investment Law.</p>	



**Pharmaceuticals**

<p style="text-align: center;"><b>Third Plenum Reality Check</b></p>		
<p><b>What did the Third Plenum's <i>Decision</i> say?</b></p>	<p><b>What is the reality?</b></p>	<p><b>Status</b></p>
<p>The main responsibility and role of the government is to strengthen and improve public services, safeguard fair competition, strengthen oversight of the market and maintain market order. We will further streamline the administration and delegate more power to lower levels, deepen the reform of the system concerning matters subject to government examination and approval. We will cancel all administrative approval procedures for economic activities under the effective regulation of the market mechanism.</p>	<p>Currently, there are only a few departments streamlining administration effectively, for example, the drug price reform by the central government. From 1<sup>st</sup> June, 2015, the government no longer controls the maximum retail price for drugs, but it should still be cautious about its influence on price in other forms. For example, in some provinces, local governments set a minimum percentage for price reduction, which contradicts the market-forces-orientated approach the central government has pledged to adopt.</p>	
<p>We will improve the public security system. We will improve unified, authoritative food and drug safety oversight organisations. We will integrate major law-enforcement bodies, relatively centralise the law-enforcement power, press ahead with comprehensive law enforcement, and do our best to resolve problems such as overlapping functions and duplicate law enforcement to establish an authoritative and efficient administrative law-enforcement system with the integration of power and responsibility. We will reduce the hierarchy of administrative law enforcement and allocate more law-enforcement resources to the primary level in foodstuffs and medicines.</p>	<p>The new Food Safety Law<sup>1</sup> has been published, but supplementary policies are still being devised. The working group hopes the supplementary policies will give clear guidance on administration and enforcement. The working group hopes the new supplementary policies consider the differences between domestic regulations and foreign regulations, and provide a comprehensive mechanism to implement the new law.</p>	




Third Plenum Reality Check

<sup>1</sup> Food Safety Law, National People's Congress, entered into force 1<sup>st</sup> October, 2015, viewed, 16<sup>th</sup> July, 2015, <[http://www.gov.cn/xinwen/2015-04/25/content\\_2852919.htm](http://www.gov.cn/xinwen/2015-04/25/content_2852919.htm)>



<p>We will reform the methods of insurance payouts, and extend the medical insurance system to all the people. We will speed up the completion of the medical insurance and medical assistance system against fatal and serious diseases. We will improve a financial input system for and the budgeting system of social security. We will strengthen management of and supervision over investment of social insurance funds, and encourage the funds to be invested into diversified sectors in the market. We will steadily make basic urban public services available to all permanent residents in cities, and incorporate farmers who have registered as urban residents into the urban housing and social security network, and make sure their previous subscription to old-age insurance and medical insurance in the countryside continues in the urban social security system.</p>	<p>There is little progress on the methods of insurance payouts.</p> <p>It is still difficult for patients to receive medical treatment in cities where his/her <i>hukou</i> is not located.</p> <p>There is no timeframe for combining medical insurance for urban workers, medical insurance for urban residents, and the new rural cooperative medical system (NRCMS).</p>	
<p>We will improve the mechanism whereby prices are mainly determined by the market. Relax price control in competitive areas. We will abolish the practice of raising medicine prices to make up for the shortfall in hospital funds, rationalise the prices of medical services and medicines, and establish an appropriate compensation mechanism. Promote market-oriented reform in width and in depth, greatly reducing the government's role in the direct allocation of resources, and promote resources allocation according to market rules, market prices and market competition, so as to maximise the benefits and optimise the efficiency.</p>	<p>▶ The control on maximum retail prices for drugs has been abolished. In some areas, however, hospitals are manipulating the bidding system to extract their own revenue from the process. The working group hopes the government enforces its commitment to allow market forces to form prices through competition by devising supplementary policies to support this reform.</p>	

Rail

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Let the market play a decisive role in allocating resources.	Limited market access remains a major issue for foreign players in the Chinese railway industry. No foreign entity is allowed to bid directly for a project in rolling stock or signalling segments.	
The government should encourage healthy competition on the market.	China has identified railway equipment—especially high-speed rail equipment—as a strategic emerging industry, which means that the government will continue to support the development of state-owned national champions in the field of railway equipment manufacturing.	
Create a fair and transparent regulatory environment.	Foreign players in the rail industry are often not given the opportunity to comment on drafts of standards and specifications, which may lead to entry barriers and unfair competition.	

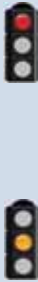
Third Plenum Reality Check

Renewable Energy







Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
We must put in place a modern market system in which enterprises enjoy independent management and fair competition ... products and factors of production flow freely and are exchanged on an equal basis, strive to remove market barriers, and raise the efficiency and fairness of resource allocation.	Although the Chinese Government has approved a series of regulations reflecting a desire to further promote the development of renewable energy, those measures primarily support the development of Chinese companies and technologies. Therefore, more transparency, particularly in the bidding system, and a level playing field are needed.	
	There is still a lot of potential in China in terms of biomass development. But to allow European companies to contribute to China's biomass development, a more open and flexible national power market is needed to help European companies overcome barriers in terms of permits, licensing and regulatory issues.	






## Smart Grid

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
We must put in place a modern market system in which enterprises enjoy independent management and fair competition ... products and factors of production flow freely and are exchanged on an equal basis, strive to remove market barriers, and raise the efficiency and fairness of resource allocation.	<p>There is a strict control of foreign participation in the standardisation process and the SGCC has a huge influence on the standard-setting process. This discriminates against European firms in China.</p> <p>Fair access to the development of the demand response (DR) service market, microgrids and integrative DER is needed.</p> <p>New market actors can only succeed if the regulatory framework ensures non-discriminatory access to power system infrastructure and information, but this is currently lacking. Therefore, the government should promote the development of a platform for the non-discriminatory management of power system information.</p>	

## Aviation and Aerospace



Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
In natural monopoly industries in which state-owned capital continues to be the controlling shareholder ... carry out reform focusing on separation of government administration from enterprise management ...	It is widely acknowledged among industry players that China's over-regulation in the aviation sector has become a bottleneck to the market and risks hampering industry growth.	
Supporting the healthy development of the non-public sector.	There has been a very positive development in the emergence of new private airlines. On the manufacturing side, however, private sector development lags behind. This is detrimental to the development of new technologies and the competitiveness of this sector in China.	
... develop a mechanism within which the market plays a key part in determining innovation programmes and allocation of funds, and assessing results.	The support for innovation from private industry is limited and the allocation of funds is not efficient.	
All enterprise investment projects ... should be decided by the enterprises independently in accordance with the law, and no longer require government approval.	Burdensome administrative approval processes are still common in certain areas, for instance aircraft purchase and registration.	
... improve the government organisational structure, function composition and work procedures.	Multiple government agencies regulate the industry, resulting in different understanding, inefficient work and unnecessary costs.	
Further opening up inland and border areas. ... will support inland cities to start more international passenger and freight air routes.	China has been very active in developing western (southwest/northwest) areas with special incentive policies for direct international air links.	

**Construction**

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
“We will stick to the path of a new-type of urbanisation with Chinese characteristics, push forward people-oriented urbanisation, promote the coordinated development of megacities, mid-sized cities, small cities and small towns, promote the integrated development of industries and cities, and advance urbanisation and the building of new rural areas in a coordinated manner.”	Although sustainable urban development is still high on the agenda, little progress has been seen the last year. In the current challenging property market, sustainability in particular has had less attention paid to it. The sustainable development of a complete living environment—not only limited to green buildings—needs more attention in providing better living conditions.	
“Deepening reform of the management system for science and technology.”	Minor improvements have been seen in terms of implementation of international best practises and standards, transparency, performance tracking and codes.	
“We will promote innovation in urban construction management.”	Little changes have been made. Smart Cities with relevant technology and material innovations should be promoted more and access for foreign global players should be granted.	

Third Plenum Reality Check

**Information and Communication Technology**

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
The <i>China Standardisation Reform Plan</i> was proposed, making reference to improving the standardisation process, membership openness as well as certification processes.	Some positive implementation of the <i>Decision</i> in the workings of the China Communications Standards Association's Technical Committee 8 (CCSA/TC8) which has been opened to foreign JVs. However, a fair and equal opening of all important standards development organisations to WFOEs is yet to be seen.  No details of the implementation of the standardisation reform plan yet.	
National Key Science & Technology R&D infrastructure should be open to the whole industry without exception, if policy allows. Build up new innovation reporting and censoring mechanism and construct open and transparent national research funding management and project evaluation system.	Small positive steps have been taken in ICT-related China National Key Projects to allow limited participation of FIEs by invitation only. The whole system is still opaque and closed to FIEs, therefore full openness and transparency needs to be implemented.	





## Information Security







Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
<p>Adherence to 'rule of law'</p> <p>Article 2: "We must ... govern the country according to the rule of law."</p>	<p>The China Banking Regulatory Committee's (CBRC's) <i>Guidelines on the Application of Secure and Controllable Information Technology to Strengthen Banking Industry Network Security and Informatisation (CBRC Guidelines)</i> were never published and stakeholders were not given the opportunity to comment, as rule of law would dictate. This is particularly significant for the industry, as the <i>CBRC Guidelines'</i> emphasis on products being "secure and controllable" could serve to severely curtail access to the Chinese market to foreign producers.</p>	
	<p>The OSCCA's <i>Year 2000 Clarification: Relevant Questions Regarding Commercial Use Encryption Management, (Year 2000 Clarification)</i><sup>1</sup> states that only products of which the <i>core function</i> is encryption are under the jurisdiction of the OSCCA's <i>CERs</i>. It is at present unclear whether the <i>Year 2000 Clarification</i> is still adhered to, yet rule of law dictates that any regulation needs to be formally repealed in order to be no longer applicable by law.</p>	

## Logistics

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Streamline administration for foreign enterprises.	Given the rising concerns over terrorism, the requirements for tighter security have placed increased administrative and operational burdens on the logistics industry.	
Improve the transparency of governmental control.	The logistics industry's involvement in the legislation and standards setting is very limited.	
Reduce the governmental control over investment access.	Domestic express companies still receive preferential treatment in certain areas related to investment.	

<sup>1</sup> In March 2000, the OSCCA released the so-called 'Year 2000 Clarification: Relevant Questions Regarding Commercial Use Encryption Management, which clarifies that the OSCCA's 1999 Commercial Encryption Codes only apply to "specialised hardware and software for which encryption and decoding operations are core functions".




### Quality and Safety Services

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the Reality?	Status
We will implement a unified market access system; and on the basis of making a negative list, all kinds of market players may enter areas not on the negative list on an equal basis and according to law.	The general negative list has not been released yet. The new rules published by the ACSIQ this year still distinguish between foreign and domestic investments. Moreover, the new rules will apply until 2020.	
We will explore a management model for foreign investors with pre-entry national treatment plus the negative list. We will make the business registration system more convenient by reducing the number of items that require qualification verification, turning certification before licensing into licensing before certification, and gradually changing the paid-in capital registration system into a subscribed capital registration system.	The new <i>Foreign Investment Catalogue</i> has removed the inspection and certification industry from the 'restricted' category, but in reality, this is not reflected in the practice of the ACSIQ, even in the CSPFTZ. The management model has not yet been made public, and the number of items that require qualification verification has not been reduced. The system of certification before licensing was turned into licensing before certification with respect to the certification industry and the registration of import and export product testing institutions.	
We will reform the market oversight system, implement uniform market oversight, tidy up and annul all sorts of regulations and methods that impede the national unified market and fair competition, strictly ban and punish all unlawful acts extending preferential policies, combat regional protection, and oppose monopoly and unfair competition.	For foreign institutions, there are no clear rules with regard to how to apply for state-promoted certification qualifications. So far, only domestic certification institutions have obtained such qualifications. The inspection and certification industry is still characterised by market interference by government-designated agencies as well as monopolies under administrative support.	
We will establish and improve a social credit system to commend honesty and punish dishonesty.	Fake reports and certificates of internationally well-known inspection and certification institutions still exist. A social credit system in the field of product safety should run as a supplement to civil dispute settlement without overly involving public powers in the prevention and settlement process.	
We will improve the market exit system in which the good eliminates the bad, and perfect the enterprise bankruptcy system.	No clear progress has been observed so far, since the function of the market requires the absence of administrative interference, including the administrative approval of qualifications.	
We will further streamline the administration and delegate more power to lower levels, deepen the reform of the system concerning matters subject to government examination and approval, and reduce the central government's administration in micro affairs to the greatest extent.	There are no substantial changes in the inspection and certification industry. Significant reduction in the number of administrative approval items and application documents has not been realised yet.	



We will cancel all administrative approval procedures for economic activities under the effective regulation of the market mechanism.	The government still has doubts with regards to the market's ability to effectively regulate economic activities.	
We will manage matters that require administrative approval according to procedures and with high efficiency.	There are no sufficient facts to indicate that the management is being regulated and the efficiency is improved.	
We will promote government purchases of public services by means of contract and entrustment, and introduce a competition mechanism into general-affairs management services.	There are some symbolic projects but with many restrictions.	
We will accelerate the reform of public institutions based on the classification of their functions, increase government purchases of public services, straighten up the relationship between public institutions and their competent administrative departments, and promote de-administration of public institutions.	Though there has been ample public discourse on this matter, little has been done to put it into practice.	
We will improve the government's organisational structure, function composition, and work procedures so that we will have a good administrative system with decision-making, executive, and oversight powers checking each other and operating in concert with one another.	The tasks are heavy and will take time.	
We will have strict management on performance, fulfil government responsibilities, and ensure the integration of power and responsibility.	No clear progress has been observed so far.	
We will introduce a list of the powers of local governments and their working departments at all levels, and publicise the power-exercise process in accordance with the law.	It is uncommon that such information is made public.	
We will improve information disclosure in the Party, government and other fields, so as to promote transparency in decision-making, management, services and results.	No clear progress has been observed so far.	
We will speed up institutional reform to fight formalism, bureaucracy, hedonism and extravagance.	Formalism and bureaucracy still exist, but in a form less obvious than previously.	
We will improve the system under which officials take the lead to improve work style and stay close to the community to conduct research, and perfect the system of keeping in close contact with and serving the people.	Staying close to the community to conduct research does not always lead to satisfactory results.	

**Banking and Securities**

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Establishing a unified, open, competitive and orderly market system is the basis for the market to play a decisive role in the allocation of resources.	Foreign banks face restrictions to their organic and non-organic growth which considerably limits their market share and contribution to the Chinese economy. Foreign entities also find it more difficult to access funding for their operations compared to domestic entities.	
Relaxing control over investment access. We will have the same laws and regulations on Chinese and foreign investment, and keep foreign investment policies stable, transparent and predictable.	The industry remains over-regulated when it comes to investments, especially regarding limitations on investment in domestic players, setting up operations or obtaining licences (i.e. restrictions on ownership, setting joint-ventures).	
... improve the government organisational structure, function composition and work procedures so that we will have a good administrative system with decision-making.	A lack of coordination among the various authorities results in laws and regulations being applied and interpreted differently. This leads to difficulties in understanding how to fully comply.	





Third Plenum Reality Check



## Consumer Finance and Non-Banking Financial Institutions

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
<p>Financial reform and market opening reform among the main priorities.</p> <p>Rebalancing the economy towards consumption and the service sector as the overarching policy goal.</p>	<p>There has been an expansion of the CFC pilot programme to 12 cities, encouraging private capital to enter. The licensing process for new CFC companies is almost complete. A number of European players (although with minority share) now have a presence in the market. All the points above represent a positive development.</p>	
<p>'Inclusive finance' – a shift towards a more equitable and high quality growth.</p>	<p>Consumer finance companies and other NBFIs have a special role to play in the drive towards 'inclusive finance', since they often serve clients who are underserved by traditional bank providers. The expansion of the consumer finance pilot programme and the rapid development of alternative credit providers, leveraging notably online channels (with the ongoing efforts of Chinese regulators to design appropriate Internet banking regulations, which for the moment seem to be going in the right direction) are all encouraging developments.</p>	
<p>Fair competition and a better business environment in China.</p>	<p>While the CFC industry is still a state-owned enterprise- (SOE)-dominated sector (hence privileged access to information and funding), the working group also sees a number of private companies (including European players) taking their stake. There is whole range of innovative companies operating via online channels, where there is free competition – at least so far. The working group will monitor what the new regulations on Internet banking will bring.</p>	
<p>Equal market access.</p>	<p>Given that the development of consumer finance is still in the pilot phase, there are limits to the total number of players in the market as well as strict geographical restrictions for foreign companies.</p>	
<p>Equal access to funding.</p>	<p>Foreign entities still find it more difficult to access funding for their operations compared to domestic entities.</p>	

Insurance

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Establishing a unified, open, competitive and orderly market system is the basis for the market to play a decisive role in the allocation of resources.	Market forces should play a more important role in the insurance industry. However, in the meantime, market players are facing different limitations preventing them from receiving effective national treatment	
Relaxing control over investment access. We will have the same laws and regulations on Chinese and foreign investment, and keep foreign investment policies stable, transparent and predictable.	The industry remains over-regulated when it comes to investments, especially regarding limitations for setting up operations or obtaining licences, i.e. restrictions on ownership or establishing JVs.	
... improve the government organisational structure, function composition and work procedures so that we will have a good administrative system with decision-making.	A lack of coordination between the various authorities results in laws and regulations being applied and interpreted differently. This creates difficulties and prevents companies from having a clear understanding on how to fully comply.	
... enact preferential policies, such as tax exemption and deferral, and encourage the development of enterprise annuity, occupational annuity and commercial insurance, so as to bring into shape a multi-level social security system.	A favourable and efficient taxation policy needs to be developed in order for the Enterprise Annuity and the Commercial Pension to play an active and sustainable role in the social welfare system.	

Third Plenum Reality Check

<sup>1</sup> See introduction to the Financial Services section of the *European Business in China Position Paper 2015/2016*.



## Private Equity and Strategic Mergers & Acquisitions

Third Plenum Reality Check		
What did the Third Plenum's <i>Decision</i> say?	What is the reality?	Status
Vigorously develop a mixed economy.	No real systematic change has been seen. Market dominance of SOEs has not been reduced.	
Enact market rules that are fair, open and transparent. All kinds of market players may enter areas not on the negative list on an equal basis.	The draft foreign investment law (FIL) has significant issues that go against this sentiment and FIEs are still treated differently to domestic companies.	
Streamline the government structure.	Little improvement. It is the intent of the FIL to have a unified body for approving investments but this has yet to materialise.	
Relax control over investment access.	Although the FIL does provide some relaxation in the law there has fundamentally been no progress.	

## Abbreviations

3-DES	Triple Data Encryption Standard
3GPP	Third Generation Partnership Project
3R Regulations	Three Guarantees Regulations
4G	Fourth Generation
4S	Sales, Service, Spare Parts and Survey
5G	Fifth Generation
ABC	Agricultural Bank of China
ACEA	European Automobile Manufacturers' Association
AEO	Authorised Economic Operator
AFC	Auto Finance Company
AIC	Administration of Industry and Commerce
AISI	American Iron and Steel Institute
AMEA	Anti-Monopoly Enforcement Authority
AML	Anti-Monopoly Law
AOAC	Association of Analytical Communities
AOG	Aircraft on the ground
AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
ATC	Air Traffic Control
ATM	Air Traffic Management
AUCL	Anti-unfair Competition Law
AWB	Air Waybill
B2V	Business Tax to VAT
BAIC	Beijing Administration of Industry and Commerce
BAT	Best Available Technologies
BCM	Billion Cubic Metres
BCMA	Billion Cubic Metres per Annum
BCS	Business Confidence Survey
BCTC	China Bank Card Testing Centre
BEV	Battery Electric Vehicle
Biopharma	Biological Pharmaceutical
BIRI	Beijing Insurance Research Institute
BL	Bidding and Tendering Law
BOC	Bank of China
BoCom	Bank of Communications
BQT	Bureau of Quality and Technology Supervision
CAAC	Civil Aviation Administration of China
CAC	Cyberspace Administration of China
CAEFI	China Association of Enterprises with Foreign Investment
CAI	EU-China Comprehensive Agreement on Investment
CAL	China Accredited Laboratory
CAME	China Association of Medical Equipment
CAPEX	Capital Expenditure
CATR	China Academy of Telecommunication Research
CB	Certification Bodies
CBRC	China Banking Regulatory Commission





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CCAA	Central Cryptography Administration Authority
CCB	China Construction Bank
CCC	China Compulsory Certification
CCCAP	China Certification Centre for Automotive Products
CCER	Chinese Certified Emission Reduction
CCGT	Combined-Cycle Gas Turbine
CCHP	Combined Cooling, Heat and Power
CC-IS	China Compulsory Certification for Information Security Products
CCOC	China Continent Property & Casualty Insurance Company
CCRA	Common Criteria Recognition Agreement
CCSA	China Communications Standards Association
CCTV	Closed-Circuit Television
CCUS	Carbon Capture Utilisation and Sequestration
CD	Certificates of Deposits
CDB	China Development Bank
CDE	Centre for Drug Evaluation
CDMD	Consumable and Disposable Medical Devices
CDS	Customs Declaration Sheet
CEC	Commercial Encryption Codes
CEEIA	China Electrical Equipment Industrial Association
CEPA	Closer Economic Partnership Arrangement
CERs	Commercial Encryption Regulations
CFC	Consumer Finance Company
CFDA	China Food and Drug Administration
CFETS	China Foreign Exchange Trade System
CGB	Chinese Government Bonds
CHIRA	China Health Insurance Research Association
CHMR	Cosmetics Hygienic Management Rules
CHP	Combined Heat and Power
CIQ	China Inspection and Quarantine Bureau
CIRC	China Insurance Regulatory Commission
CITIC	China International Trust Investment Company
CLP	Classification, Labelling and Packaging
CLT	Cross-Laminated Timber
CMA	China Metrology Approval
CMDE	Centre for Medical Device Evaluation
CMIF	China Machinery Industry Federation
CNAS	China National Accreditation Service for Conformity Assessment
CNCA	Certification and Accreditation Administration of the People's Republic of China
CNG	Compressed Natural Gas
CNR	China Northern Railway
CNY	Chinese Yuan (Currency)
CO <sub>2</sub>	Carbon Dioxide
COCIR	European Coordination Committee of the Radiological, Electromedical and Healthcare IT Industry
COP	Conference of the Parties
CPC	Communist Party of China
CPCCC	Communist Party of China Central Committee
CPFTZ	China Pilot Free Trade Zone
CPIC	China Pacific Insurance Company
CPP	Certification of Production Permission

CQC	China Quality Certification Centre
CQM	China Quality Mark Certification Group
CR	China Railway Corporation
CRn	Concentration Ratio
C-ROSS	China Risk Oriented Solvency System
CRRC	China Rail Rolling Stock Co Ltd
CSDC	China Securities Depository and Clearing Corporation Ltd
CSG	China Southern Power Grid Company
CSL	Cyber Security Law
CSP	Construction Service Provider
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
CSR	China Southern Railway
CSRC	China Securities Regulatory Commission
CT	X-ray Computed Tomography
CTA	Clinical Trial Authorisation
CTL	Counter-Terrorism Law
CTMO	China Trademark Office
CTX	Coal Transformation
CUP	China Union Pay
DE	Distributed Energy
DER	Distributed Energy Resources
DG	Directorate General
DG	Distributed Generation
DOE	Designated Operational Entity
DR	Demand Response
DRG	Diagnostic-Related Groups
DSM	Demand Side Management
DTA	Double Taxation Agreement
EA	Enterprise Annuity
EASA	European Aviation Safety Agency
EC	European Commission
ECC/RSA	Elliptic Curve Cryptography/ Rivest, Shamir and Adleman algorithm
ECP	Energy Conservation Product
EDI	Electronic Data Interchange
EDS	Express Delivery Service
EGM	Enterprise Grading Management
EHI	Association of the European Heating Industry
EIA	Environmental Impact Assessment
ELP	Environment Label Products
EMV	Europay, MasterCard, Visa
EMVCo	Global standardisation body for credit and debit payment cards based on chip card technology
EOR	Enhanced Oil Recovery
EPL	Environmental Protection Law
EPO	European Patent Office
ERP	Enterprise Resource Planning
ES	Energy Storage
ETS	Emissions Trading System
ETSI	European Telecommunications Standardisation Institute
EU	European Union
EUCCAP	EU-China Civil Aviation Project



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EUR	Euro (Currency)
FCPA	Foreign Corrupt Practices Act
FDA	Food and Drug Administration
FDI	Foreign Direct Investment
FICLS	Foreign Invested Company Limited by Shares
FIE	Foreign-Invested Enterprise
FIL	Foreign Investment Law
FIP	Foreign-Invested Partnership
FIT	Feed-in-Tariff
FRAND	Fair, reasonable and non-discriminatory
FSC	Forest Stewardship Council
FSMP	Food for Special Medical Purposes
FTZ	Free Trade Zone
FYP	Five-Year Plan
GA	Government Affairs
GAC	General Administration of Customs
GB	Guobiao or Chinese national standard
GCP	Good Clinical Practice
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GHS	Globally Harmonised System
GHTF	Global Harmonisation Task Force
GLP	Good Laboratory Practice
GM/T	<i>Guo Mi Tuijian</i> or <i>Guojia Mima Tuijian</i>
GMP	Good Manufacturing Practice
GPA	Government Procurement Agreement
GPL	Government Procurement Law
GPP	Green Public Procurement
GRP	Good Refurbishment Practice
GSMA	Groupe Spéciale Mobile Association
GSP	Good Supply Practice
GW	Gigawatt
HCs	Hazardous Chemicals
Health IT	Health Information Technology
HHI	Herfindahl–Hirschman Index
HKSARG	Hong Kong Special Administrative Region Government
HNTE	High and New-Technology Enterprise
HR	Human Resources
HSM	Hardware Security Module
HSR	High-Speed Rail
HTA	Health Technology Assessment
IAM	Independent Aftermarket
IC	Integrated Circuit
ICAO	International Civil Aviation Organisation
ICBC	Industrial and Commercial Bank of China
ICL	International Competition Law
ICN	International Competition Network
ICT	Information and Communication Technology
IDC	Internet Data Centre
IEC	International Electrotechnical Commission

IECSC	Inventory of Existing Chemical Substances Produced or Imported in China
IIT	Individual Income Tax
IMDG	International Maritime Dangerous Goods
IMDRF	International Medical Device Regulators Forum
IMT	International Mobile Telecommunications
IMT-2020	International Mobile Technology- (IMT)-2020 Promotion Group
INDC	Intended Nationally Determined Contribution
IOC	International Oil Company
IoT	Internet of Things
IP	Intellectual Property
IPCC	Intergovernmental Panel on Climate Change
IPO	Initial Public Offering
IPR	Intellectual Property Rights
ISCCC	China Information Security Certification Centre
ISO	International Organisation for Standardisation
ISP	Internet Service Provider
IT	Information Technology
ITU	International Telecommunications Union
IVD	In Vitro Diagnostic
JCCT	Joint Commission for Commerce and Trade
JLV	Joint Law Venture
JPO	Japan Patent Office
JRPMM	Jint Reformation for Public Health Services, Medical Insurance, and Medical Production-Circulation
JV	Joint Venture
KIPO	Korea Intellectual Property Office
KOL	Key Opinion Leader
KPI	Key Performance Indicator
LCC	Life Cycle Cost
LDR	Loan-to-Deposit Ratio
LNG	Liquefied Natural Gas
LoI	Letter of Intent
IoT	Internet of Things
LTE	Long-Term Evolution
M&A	Mergers and Acquisitions
M2M	Machine to Machine
MEDDEV	The European Commission provides a range of guidance documents to assist stakeholders in implementing Directives, related to Medical Devices. The guidance documents are called “MEDDEVs”
MEP	Ministry of Environmental Protection
METIS	Mobile and Wireless Communications Enablers for the Twenty-Twenty Information Society
MFSCA	Multi-Functional Smart Card Alliance
MIIT	Ministry of Industry and Information Technology
MLPS	Multi-Level Protection Scheme
MLR	Ministry of Land and Resources
MNC	Multinational Corporation
MOE	Ministry of Education
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOH	Ministry of Health
MOHRSS	Ministry of Human Resources and Social Security
MOHURD	Ministry of Housing and Urban-Rural Development



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MOJ	Ministry of Justice
MOLAR	Ministry of Land and Resources
MOR	Ministry of Railways
MOST	Ministry of Science and Technology
MOT	Ministry of Transport
MPS	Ministry of Public Security
MRV	Measurement, Reporting and Verification
MSA	Marked Surveillance Authorities
MSDS	Material Safety Data Sheets
MSE	Micro and Small Enterprise
MSS	Ministry of State Security
MVBER	Motor Vehicle Block Exemption Regulation
MVNO	Mobile Virtual Network Operator
MW	Megawatt
NAFMII	National Association of Financial Market Institutional Investors
NAL	Network Access Licence
NBFI	Non-Banking Financial Institution
NCE	New Chemical Entity
NDA	New Drug Application
NDRC	National Development and Reform Commission
NEA	National Energy Administration
NEEQ	National Equities Exchange and Quotations
NEV	New-Energy Vehicle
NHFPC	National Health and Family Planning Commission
NIST	National Information Technology Standardisation
NNIs	New Nine Initiatives
NO <sub>2</sub>	Nitrogen Dioxide
NOC	National Oil company
NOx	Generic term for the various nitrogen oxides produced during combustion
NPC	National People's Congress
NRCMS	New Rural Cooperative Medical System
NRDL	National Reimbursement Drug List
NSL	National Security Law
O&M	Operation and Maintenance
O <sub>2</sub>	Oxygen
OE	Original Equipment
OECD	Organisation for Economic Cooperation
OEM	Original Equipment Manufacturer
OPS	Original Part Supplier
OSCCA	Office of the State for Commercial Cypher Administration
OTC	Over the Counter
P2P	Peer-to-Peer
P&C	Property and Casualty
PARC	number of vehicles available in certain area
PBOC	People's Bank of China
PBOC3.0	People's Bank of China Banking Integrated Circuit Card Specifications 3.0
PCR	Petrochemicals, Chemicals and Refining
PD	Primary Dealer
PE	Permanent Establishment
PE	Private Equity

PEFC	Programme for the Endorsement of Forest Certification
PHEV	Plug-in Hybrid Electric Vehicle
PMA	Pre-Market Approval
PMS	Post Marketing Surveillance
PN	Paediatric Nutrition
POE	Privately-Owned Enterprise
POS	Point of Sales
PPP	Public-Private Partnership
PRB	Patent Re-examination Board
PRC	People's Republic of China
PSB	Public Security Bureau
PSC	Production Sharing Contract
PV	Photovoltaic
PVC	Polyvinyl Chloride
QFII	Qualified Foreign Institutional Investor
QSIQ	General Administration of Quality Supervision, Inspection and Quarantine
QSS	Quality and Safety Services
R&D	Research and Development
RA	Regulatory Affairs
RASFF	Rapid Alert System for Feed and Food
RDPAC	R&D-Based Pharmaceutical Association Committee
RE	Renewable Energy
REACH	Registration, Evaluation, Authorisation and Restriction of Chemicals
RFP	Request for Proposal
RMB	Renminbi (Chinese Currency)
RMI	Repair and Maintenance Information
RO	Representative Office
RPS	Regulated Product Submission
RQFII	Renminbi Qualified Foreign Institutional Investor
RTA	Radio Type Approval
S&T	Science and Technology
SAC	Standardisation Administration of China
SAFE	State Administration of Foreign Exchange
SAIC	State Administration for Industry and Commerce
SAP	Standard Assessment Procedure
SAPPRFT	State Administration of Press, Publication, Radio, Film and Television
SASAC	State-owned Assets Supervision and Administration Commission
SAT	State Administration for Taxation
SB/T	<i>Shangbiao/Tuijian</i> (Industry standards set and recommended by the MOFCOM)
SBWGC	Shenyang Blower Works Group Corporation
SC	South China
SCA	Standards and Conformity Assessment
SCGO	State Council General Office
SCIO	State Council Internet Information Office
SCIO	State Council Information Office
SCLAO	State Council Legislative Affairs Office
SCO	State Commission Office
SCOPSR	State Commission Office of Public Sectors Reform
SDO	Standards Development Organisation
SDoC	Self-Declaration of Conformity



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SDO	Standards Developing Organisation
SDS	Safety Data Sheet
SECAM	Security Assurance Methodology
SEMB	State Encryption Management Bureau
SFA	State Forestry Administration
SFDA	State Food and Drug Administration It was officially renamed the China Food and Drug Administration (CFDA) on 22nd March, 2013
GCC	State Grid Corporation of China
SG-CG	Smart Grid Coordination Group
SHA1/DES	Secure Hash Algorithm 1/Data Encryption Standard
SHBOJ	Shanghai Municipal Bureau of Justice
SIL	Social Insurance Law
SIPO	State Intellectual Property Office
SJV	Securities Joint Venture
SME	Small and Medium-sized Enterprise
SMx	<i>Shangyong Mima</i> series of algorithms
SOE	State-Owned Enterprise
SOx	Sulphur Oxide
SPC	Supreme People's Court
SRA	State Railway Administration
SSE	Shanghai Shipping Exchange
SSLNG	Small-Scale Liquefied Natural Gas
SSM	Standard Solar Model
SUSTECH	Sustainable Technology Initiative
TC	Technical Committee
tC/hm <sup>2</sup>	Tonne of carbon per square hectometre
TCAL	Taxation Collection Administration Law
TCAs	Tax Compliance Agreement
TCMS	Train Control and Monitoring System
TD	Time Division
TD-LTE	Time Division Long Term Evolution
TIC	Testing, Inspection and Certification
TMP	Testing at Manufacturers Premises
ToC	Table of Contents
TPA	Third-Party Access
TRAB	Trademark Review and Adjudication Board
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TSO	Transmission System Operator
TTC	Threshold of Toxicological Concern
UHF	Ultra High Frequency
UK	United Kingdom
UN	United Nations
UNFCCC	United Nations Framework Convention on Climate Change
US	United States
USB	Universal Serial Bus
USD	United States Dollars (Currency)
USFDA	US Food and Drug Administration
USPTO	United States Patent and Trademark Office
UVA	Ultra Violet A (short-wave ultra violet radiation)
VAS	Value-Added Service

VAT	Value-Added Tax
VC	Venture Capital
VD	Voluntary Disclosure
VIE	Variable Interest Entity
VPN	Virtual Private Network
WEEE	Waste Electrical and Electronic Equipment
WFOCE	Wholly Foreign-Owned Construction Enterprises
WFOE	Wholly Foreign-Owned Enterprise
WHO	World Health Organisation
Wi-Fi Aps	Wireless Access Points
WLAN	Wireless Local Area Network
WMP	Witnessed Manufacturers Testing
WPP	Wind Power Plant
WTO	World Trade Organisation
WTO/GPA	World Trade Organisation Government Procurement Agreement
WTO/TBT	Agreement on Technical Barriers to Trade of the World Trade Organisation
WWF	World Wide Fund for Nature
ZUC	<i>Zuchongzhi</i>





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