This Position Paper represents the views of the European Union Chamber of Commerce in China. Our Working Groups, Forums and more than 1,600 member companies have together compiled the latest assessments, concerns and recommendations of European businesses operating in China.

We hope that the Position Paper will promote constructive dialogue and co-operation between Europe and China, at both the political and business levels. We look forward to continued improvement in business co-operation, to the benefit of both Europe and China.
European Union Chamber of Commerce in China

www.europeanchamber.com.cn

The information contained herein is based on input and analysis from July 2010 to July 2011.

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The draft translation of the Chinese text was provided by thebigword, a language services company.

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Message from the President


China’s double-digit GDP growth in 2010 not only contributed to the recovery of the global economy but also propelled the country to the front of the international stage. In the meantime, the country faces inflation challenges and the need to transform its economy. The 12th Five-Year Plan prioritises a number of areas for further development, such as: price stability, a more balanced and sustainable growth model, an increase in domestic consumption, greater energy efficiency, carbon emissions reduction, and a more open market especially in finance, taxation, and industries that are currently experiencing inadequate competition. Further restructuring and opening up of the economy is needed as export markets seem more and more unreliable, the scarcity of human resources and raw materials puts pressure on costs as the population ages. Urbanisation, the next big growth driver, is a complex process and implications on the environment are of global importance. European Businesses, both manufacturing and service-related, are willing to continue to offer and use their experience and know-how in building an innovative economic system to the benefit of China’s development.

In this Position Paper 2011/2012 the European Chamber has compiled examples of the progress made in addressing business concerns and has also clarified cases where obstacles still need to be overcome to level the playing field not only for foreign invested companies but for private Chinese-invested ones as well.

Containing 46 individual papers, the Position Paper 2011/2012 aggregates the expertise of European Chamber Working Groups and Forums across 27 industries, in nine cities (Beijing, Chengdu and Chongqing, Nanjing, Guangzhou and Shenzhen, Shanghai, Shenyang, and Tianjin) and deals with 11 specific horizontal topics, it offers detailed recommendations on how to improve the operational business environment in China based on the views of our members.

Although the Position Paper primarily addresses Chinese policy makers, it also analyses the challenges and the opportunities faced by foreign companies in China, thereby offering valuable insight to those doing business or planning to do business in China, and also to offer guidance to European legislators in guiding their China policy.

On behalf of the European Chamber, I would like to express my sincere thanks to all the departments of Chinese central and local governments, especially China’s Ministry of Commerce (MOFCOM), the China Council for the Promotion of International Trade (CCPIT), and that are open to engage in constructive dialogues with the European Chamber and its members.

I would also like to acknowledge the dedication and the endeavors of all the members of the European Chamber, and especially of the Chairs and Vice Chairs of the Working Groups, which form the cornerstone of the Chamber’s work.

Davide Cucino
President
European Union Chamber of Commerce in China
About the European Chamber

Purpose
· As the independent voice of European business in China, we seek greater market access and improved operating conditions for European companies

Services
· We provide European business with an effective communication and lobbying channel to the European and Chinese authorities, business associations and media
· We ensure our key recommendations and lobbying strategies are shaped by business through our members’ Working Groups
· We monitor China’s compliance with the World Trade Organization and other international commitments which impact on doing business in China
· We support companies by providing a platform for the exchange of information on business and market conditions in China
· We help companies expand their networks of European and Chinese business contacts
· We promote sharing of knowledge and experience between European and Chinese business

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 law and regulations
· We treat all our members, business partners and employees with fairness and integrity

General Background
The European Union Chamber of Commerce in China was originally founded by 51 member companies based in China on 19th October 2000. The rationale for the establishment of the Chamber was based on the need of the European Union and local European businesses to find a common voice for the various business sectors. Nine years after its foundation, the European Chamber now has a total of more than 1600 members in seven chapters: Beijing, Chengdu and Chongqing, Nanjing, Pearl River Delta (Guangzhou and Shenzhen), Shanghai, Shenyang, and Tianjin. The Chamber is recognised by the European Commission and the Chinese authorities as the official voice of European business in China.

The European Chamber is an independent member-driven, non-profit, fee-based organisation with a core structure of 29 Working Groups and 7 Forums representing European business in China. The Chamber is directed by a President and an Executive Committee elected each year by and from its members.

Dirk Moens
Secretary General
European Union Chamber of Commerce in China
Section One:
Executive Summary
Executive Summary

As China looks to rebalance its economy, new drivers of growth are needed to replace older ones, and in this regard further market opening and the development of the private sector present a formidable opportunity. The stated goals in the 12th Five-Year Plan include industrial upgrading, developing services, encouraging innovation and green development. These targets match the strengths and practical experiences of European companies in management know-how, service provision and green and advanced technology. As long as there is a level playing field for enterprises both domestic and foreign, state-owned and private alike, European companies can and would want to continue to play an important role in China’s development plans.

However, despite some encouraging statements and developments, European companies continue to face challenges to both enter and operate in China’s market due to unequal implementation of the law and the laws themselves. As China becomes increasingly globally integrated, the European Union Chamber of Commerce in China strongly encourages both Europe and China to resist any forms of race-to-the-bottom protectionism and to contribute to open markets in the spirit of mutual benefit.

China emerged...

...from the last decade as the world’s second largest economy. However, a combination of an over-reliance upon fixed-asset investment and exports, failing to move up the value chain and the slow development of the service industry risk stifling economic development as both the labour supply starts to decline and marginal decreasing returns from technological improvements begin to appear. Although the stimulus package of late 2008 helped China stave off the international economic recession, the share of Gross Domestic Product coming from fixed asset investment has consistently grown over the last 4 years reaching nearly 50% in both 2010 and the first half of 2011.¹

The 12th Five-Year Plan...

...aims to address these issues through shifting its strategic focus on industrial upgrading, the development of the services sector, and fostering innovation. China is also moving to reduce income disparities and increase health, education and social welfare coverage. Although these measures will encourage domestic consumption, they will also place significant strain on fiscal spending.

New drivers of growth...

...are required to sustain long-term development. Increased productivity through urbanisation and adapting to new technology will continue to drive growth forward, but this former is expected to peak, at which time innovation and creativity, combined with efficiency and market competition, will be necessary to avoid a potential middle-income trap. Waste in fixed-asset investment, with massive loans and subsidies directed mostly to State-Owned Enterprises (SOEs), not only raises the prospect of significant bad debt, but also

negates the incentive for SOEs to raise their level of efficiency and to become more innovative and creative.\(^2\)

**Going forward…**

...China needs to continue to look for new drivers of growth. Much like the first five years of China’s accession to the World Trade Organization (WTO), a second round of internal domestic reforms could once again serve as a sustainable force to drive China in the coming five, ten, and fifteen years. SOE reform and further opening of the market to both domestic private industry and foreign-invested enterprises is necessary to give play to sustainable driving forces.

Sustaining growth requires a move up the value chain and the production of technologically advanced goods. Reforms that encourage healthy competition and facilitate transparency and predictability in the legal system are required to cultivate the forces of innovation and efficiency that underpin such growth. Removing barriers for all players will foster such competition, bringing benefits to the economy as a whole and encouraging the development of private industry and small and medium-sized enterprises (SMEs) that can provide a solid support structure to add momentum and strength to China’s longer-term economic development.

This *Position Paper* is the product of six months’ consultation, involving hundreds of companies and individuals from European businesses operating all over China, and brings together over 600 recommendations to various levels of the People’s Republic of China (PRC) Government administration. It is intended to serve as a source of constructive and valuable input for China’s future development.

**1) Modest Progress, Barriers Remain**

**1. 1 Progress Made**

*European companies have reported improving business performance during the last year in terms of revenue and profit growth.*\(^3\) *As a result, China’s strategic importance for global companies is becoming more pronounced. Although competition for both domestic and foreign-invested companies is rapidly intensifying and the cost of raw materials as well human resources is rising, European companies are confident that they possess the competitive strengths to compete in this environment as long as the playing field is level.*

This *Position Paper* aims to highlight issues and progress made, and to formulate recommendations on remaining issues and concerns. The following table provides examples of progress made in areas such as transparency, intellectual property rights, taxation, environment, legislation, standards and industry specific market access. The European Chamber welcomes these steps in the right direction.

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\(^2\) A study by China’s Tianze Economic Research Institute showed that from 2001 to 2009 the average return on equity of SOEs was 8.16%, while that of industrial enterprises above a designated size was 12.9%. The same report also stated that when Chinese land, loan, and other subsidies are included, the average return for state-owned and holding enterprises for the same period was -1.47%. Unirule Institute of Economics, April 2011, *The Nature, Performance, and Reform of the State-owned Enterprises*, http://www.unirule.org.cn/xiazai/2011/20110412.pdf (viewed 17th August, 2011).

\(^3\) European Union Chamber of Commerce in China, May 2011, *European Business in China Confidence Survey 2011*
# Examples of Improvements – 2010/2011

<table>
<thead>
<tr>
<th>Working Group Paper</th>
<th>Recommendation</th>
<th>Years in PP</th>
<th>Progress Made</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Auto-Components</td>
<td>Improve Safety Standards for Passenger Vehicles</td>
<td>1</td>
<td>National legislation has been revised to be stricter and closer to international safety and environmental standards.</td>
</tr>
<tr>
<td>2 Banking &amp; Securities</td>
<td>Allow China National Advanced Payment System membership</td>
<td>1</td>
<td>A more transparent approval process has been put into place by the People’s Bank of China.</td>
</tr>
<tr>
<td>3 Environment</td>
<td>Strive Towards a Green Economy by Implementing Targets for Environmental Protection and Energy Efficiency</td>
<td>2</td>
<td>For the first time, green GDP and climate change are mentioned in the 12th Five-Year Plan, which includes a focus on energy efficiency and ameliorating environmental degradation. Targets have been placed on energy intensity reduction, pollution control and forest stock volume (some of which are binding).</td>
</tr>
<tr>
<td>4 Finance &amp; Taxation</td>
<td>Replace Business Tax with a Service Value Added Tax</td>
<td>2</td>
<td>It was announced as part of the 12th Five-Year Plan that Business Tax would be replaced with Value Added Tax by 2013.</td>
</tr>
<tr>
<td>5 Intellectual Property Rights</td>
<td>Close Procedural Loopholes to Allow Trademark Owners to Register or Recover Trademarks Filed in Bad Faith</td>
<td>2</td>
<td>The Trademark Adjudication Board agreed to align its procedures with the China Trademark Office on trademark cancellation actions, provided there is an application for suspension of the decision.</td>
</tr>
<tr>
<td>6 Intellectual Property Rights</td>
<td>De-couple Indigenous Innovation from Government Procurement Policy</td>
<td>1</td>
<td>Three key implementation measures underpinning the link between government procurement policies and indigenous innovation have been repealed by the Ministry of Finance.</td>
</tr>
<tr>
<td>7 Legal</td>
<td>Clarify Various Aspects with regards to the Anti-Monopoly Law (AML)</td>
<td>2</td>
<td>The State Administration of Industry &amp; Commerce and the National Development &amp; Reform Commission released several implementation rules to provide for greater clarity and predictability relating to the AML.</td>
</tr>
<tr>
<td>8 Renewable Energy</td>
<td>Allow Equal Access to Government Funds</td>
<td>2</td>
<td>A subsidy only available for domestic wind turbine generator manufacturers or Chinese controlled Joint-Ventures (JV) expired in February 2011. The end of this special subsidy (as well as the cancellation in January 2010 of a 70% localisation requirement) for wind turbine generators sold in China reflects positive changes toward fairer industrial policies in the wind industry.</td>
</tr>
<tr>
<td>9 Travel</td>
<td>Allow European Union Tour Operators to Operate Outbound Travel Services</td>
<td>8</td>
<td>The China National Tourism Administration issued licences to three foreign JV tour operators to establish pilot projects to operate outbound travel services from China.</td>
</tr>
<tr>
<td>10 Public Procurement</td>
<td>Improve the China’s WTO Government Procurement Agreement (GPA) Offer</td>
<td>5</td>
<td>China’s second revised GPA offer was announced in mid 2010 with slight improvements including lower thresholds and expanded (though still too restricted) coverage.</td>
</tr>
</tbody>
</table>

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4 These improvements are listed in alphabetical order according to the name of the Working Group paper.
5 Position Paper (PP)
1.2. Barriers Remain

In early 2011, the European Chamber’s members gave their opinions on the current business environment for Foreign-Invested Enterprises (FIEs) in China. The results showed that 43% of members felt that over the past two years government policies have become more discriminatory and 46% feel that this trend will continue over the next two years. These figures are actually an increase from 2010.6

On 13th September, 2010, Premier Wen Jiabao stated “I wish to reiterate here that all enterprises registered in China according to Chinese laws are Chinese enterprises.” There have also been a number of other high profile statements indicating that foreign enterprises are to be treated the same as domestic enterprises in China.7

Despite these welcome and promising words, they do not reflect daily operations where foreign businesses are still not treated equally in China in 2011 both in terms of written laws and regulations, and in terms of implementation. There remains a prevalence of long-standing market access barriers, laws and regulations that unambiguously discriminate against foreign companies, as well as the biased and subjective implementation of laws and regulations.

The European Chamber does not seek preferential treatment, but simply the opportunity for European business to compete on a level playing field with domestic enterprises under the principle of national treatment. There are many examples in this Position Paper covering different sectors and issues which unequivocally demonstrate that there remains enormous opportunity for the further inclusion of foreign companies in China’s markets.

The table below lists 10 concrete examples of discriminatory measures which are included within this Position Paper:

<table>
<thead>
<tr>
<th>Working Group Paper</th>
<th>Concern</th>
<th>Years in PP</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership Restrictions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Automotive</td>
<td>Automobile Manufacture</td>
<td>8</td>
<td>For foreign automobile manufacturers, the only permissible business structure is a JV with a Chinese partner, where the maximum share is limited to 50%. In addition, a foreign investor is limited to setting up no more than two such JVs for the production of passenger cars, and two for commercial vehicles.</td>
</tr>
<tr>
<td>2 Auto-Components</td>
<td>New Energy Vehicle component production</td>
<td>New</td>
<td>The draft Foreign Investment Catalogue indicates that foreign investors will now be limited to a maximum 50% stake in JVs producing components for new-energy vehicles.</td>
</tr>
</tbody>
</table>

8 These examples are listed in alphabetical order of the Working Group under the respective categories
9 Position Paper (PP)
## Examples of Discriminatory Concerns

<table>
<thead>
<tr>
<th>Working Group Paper</th>
<th>Concern</th>
<th>Years in PP</th>
<th>Details</th>
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<tr>
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<td>Provision of Financial Services</td>
<td>6</td>
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<tr>
<td>4</td>
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<td>Provision of Basic Telecom Services</td>
<td>6</td>
</tr>
<tr>
<td>5</td>
<td>Aviation</td>
<td>Foreign Computer Reservation Systems (CRS)</td>
<td>5</td>
</tr>
<tr>
<td>6</td>
<td>Construction</td>
<td>Design/ Engineering</td>
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</tr>
<tr>
<td>7</td>
<td>Information Security</td>
<td>Commercial Encryption</td>
<td>2</td>
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<tr>
<td>8</td>
<td>Renewable Energy</td>
<td>Offshore Wind Project Development</td>
<td>2</td>
</tr>
<tr>
<td>9</td>
<td>Various industrial sectors</td>
<td>Unfair Utilisation of Subsidies</td>
<td>2</td>
</tr>
<tr>
<td>10</td>
<td>Standards and Conformity Assessment</td>
<td>Foreign Participation in Standardisation Technical Committees and Working Groups</td>
<td>3</td>
</tr>
</tbody>
</table>
2) Recommendations to Chinese Policy Makers

*The recommendations in this Position Paper are offered with the intention to assist China in continuing its reform and opening up of the economy for both foreign and domestic enterprises. Many of the recommendations outlined in the Position Paper can be categorised into the following broad themes:*

1. Increase Market Access
2. Enhance Transparency & Predictability in Legislation
3. Improve Regulatory Efficiency
4. Encourage Innovation through Intellectual Property Rights Protection

**1. Increase Market Access**

*Long-standing market access barriers persist for foreign companies wishing to operate in China. Such barriers can come in many forms, such as licensing, standardisation, claims of national security, unequal access to subsidies, straightforward ownership restrictions and wholly protected sectors (see examples in the table above)*.

More worryingly, additional barriers have been included in the recently released revised draft ‘Catalogue of Industries for Guiding Foreign Investment’. For example, the Catalogue indicates that foreign investors will now be limited to a maximum 50% stake in JVs producing components for new-energy vehicles.

Given that Chinese companies are increasingly acquiring foreign companies abroad, it seems anachronistic that foreign companies can still not even operate in some sectors in China let alone acquire another company. For example, foreign firms are *de facto* obstructed from operating in the basic telecoms service sector; and in many financial services sectors foreign companies can only enter the Chinese market by being part of a JV with a domestic partner.

In April 2011, the European Chamber released its *Public Procurement in China* Study, which examined how a market which can be estimated to represent as much as 20% of China’s economy is *de facto* out of bounds for foreign companies. In contrast, Chinese companies are generally free to bid in EU procurement markets — which are globally the most open — and are increasingly doing so. Furthermore, the European Chamber believes that the EU markets should remain open.

**2. Enhance Transparency & Predictability in Legislation**

*Transparency and predictability in rule-making is essential for a stable business environment in a modern economy. Consultations with affected players and reasonable grace periods to adjust ahead of significant changes enable companies to plan their business development. However, mentioned throughout this Position Paper are examples of changes in legislation that were brought into effect at short notice and without prior consultation. ‘Discretionary enforcement of broadly drafted laws and regulations’ was also named as the most significant regulatory obstacle for European business in China in 2011.’*

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10 European Union Chamber of Commerce in China, April 2011, *Public Procurement in China*
Of the 67 Chinese government calls for comment on draft legislation that the European Chamber responded to in 2010 and the first half of 2011 (46 in 2010 and 21 in the first half of 2011), the average length of time given for comment was just 21 days, with the longest being 91 days and the shortest just 8 days.\textsuperscript{12} In contrast, within the European Commission, the best practice is to allow 8 weeks for the collection of responses to written public consultations.\textsuperscript{13} Whilst the number of consultations has improved in the past 5 years the length of time allowed seemingly has not.

**Example cases:**

1. **National Security Review**  
   
   **Grace Period:** 0 Days; **Consultation Time:** 38 days (but enforced immediately)

   On 5\textsuperscript{th} March, 2011, China’s Ministry of Commerce (MOFCOM) introduced new interim procedures requiring foreign investors to obtain approval before acquiring control of domestic Chinese companies in certain sectors. This development caused concern to the European Chamber’s members because:
   a) A lack of definition of key terms such as “national security concern” and “vital industries” coupled with such a wide scope left many companies simply not knowing where they stand. Likewise, such vagueness also makes the approval process very subjective.
   b) The capacity to apply the review retroactively to transactions completed before the new procedure came into effect also risks undermining some businesses that have been operating in China for some time already.
   c) It was released for public comment (to which the European Chamber responded), yet was enforced from the start date anyway.

2. **Urban Maintenance and Construction Tax and Local Education Surcharge**  
   
   **Grace Period:** 44 days; **Consultation Period:** 0 days

   The State Council’s Circular [2010] No.35, was released on 18\textsuperscript{th} October, 2010, entitled ‘Notice Issued by the State Council to Unify the Collection of Urban Construction and Maintenance Tax and Education Surcharge on Domestic and Foreign-Invested Enterprises and individuals’. It announced the resumption of the collection of the surtaxes from foreign enterprises, foreign-invested enterprises and foreign individuals, effective from 1\textsuperscript{st} December, 2010. Whilst the European Chamber supports the leveling of all aspects of the business environment for foreign and domestic enterprises, this change caused significant planning and operational duties for the European Chamber’s members because:
   a) The short time period between the announcement and the implementation of the Circular.
   b) The lack of any grandfathering period in order to adjust to the changes.
   c) The lack of any public consultation prior to the release of the Circular.

3. **Social Insurance Law**  
   
   **Consultation Period:** 8 days

   The PRC Social Insurance Law (SIL) became effective on 1\textsuperscript{st} July, 2011. The European Chamber submitted two sets of

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\textsuperscript{12} The European Chamber actually responded to 76 calls for comments in this period (53 in 2010 and 23 in 1H2011) but the online links of nine of them could not be tracked as of July 2011.

\textsuperscript{13} European Commission, 11\textsuperscript{th} December 2002, General principles and minimum standards for consultation of interested parties by the Commission (COM(2002)704).

Concerns were raised by European companies because of prevailing uncertainties regarding the participation of foreigners in China’s social insurance scheme. The consultation on relevant guidelines was initiated only 2 weeks before the effective date of the SIL and only 8 days were allowed for comments. At the time of writing, more than one month after the SIL came into effect, there still exists a lack of clarity about the treatment of foreigners employed in China within China’s social insurance scheme.

3. Improve Regulatory Efficiency

The European Chamber’s members state that the lack of coordination between different regulators is a significant obstacle to doing business in China. This is an issue that impacts the operations of both foreign and domestic enterprises in China alike.

Cases have been reported where companies have had licence applications to engage in a certain area of business rejected without receiving any indication as to what the criteria are on which they have been judged (see example 2 below). There are also instances of significant changes in regulation being communicated only verbally with nothing in writing ever produced.

Example cases:

1. The People’s Bank of China (PBOC) and the China Banking Regulatory Commission (CBRC)

In the first half of 2010, banks suffered substantial operational problems due to two regulatory instructions: PBOC relating to loan-growth quotas, and the CBRC on Entrustment Payments requirements. Both bodies were operating with the same goal (curbing inflation) but problems arose merely because of a lack of coordination on the timing of the releases.

2. Information Security – commercial encryption technology

A spate of regulations released by the Office of the State Commercial Cypher Administration (OSCCA) in 2006 and 2007, which are collectively referred to as the ‘Commercial Encryption Regulations’, set out licensing and certification requirements for information security products with encryption as the core commercial function. These licences and certifications are required for various government projects and are increasingly becoming required within SOE requests for proposals for commercial projects. However, OSCCA continues to require licences for products for which, in the opinion of the European Chamber, encryption is not the core function. Furthermore, OSCCA also refuses to communicate in writing to FIEs crucial technical requirements necessary to successfully apply for these licences and to accept licence applications submitted by FIEs. As a result, all of the 150-plus certified companies on OSCCA’s website are Chinese-controlled enterprises.
3. The Regulation of the Automotive Sector

Four ministries (NDRC, MIIT, MEP, MOT) have the remit to reduce the average fuel consumption and emissions level of automotive products, and before a motorised vehicle is allowed on the road, it also has to pass approval by four separate bodies (MIIT, AQSIQ, MEP, MPS).

4. Encourage Innovation through Intellectual Property Rights (IPR) Protection

A defined target of the 12th Five-Year Plan is to reach 3.3 patents for every 10,000 people. According to the National Patent Development Strategy (2011-2020) issued by the State Intellectual Property Office in November 2010, the annual number of patent registrations should reach two million by 2015. This would make China the most innovative country in the world.

In order to support this goal, the government has taken a number of measures including subsidies and tax breaks for companies, and benefits for individuals, for the filing of patents.

However, this innovation-by-numbers approach has led to a race for quantity of registered rights rather than an improvement of the quality of inventions. This issue has been recognised by the Government and will be further examined by the ‘Patent Quality Task Force’. 14

IPR protection in China remains an ongoing concern of European Chamber member companies. Innovation cannot thrive without the protection of the IP created in the process. Innovation is a lengthy process bearing risks for those who invest time and effort. If IP is not sufficiently protected, enterprises both foreign and domestic will be deterred from investing in innovation.

The State Council’s anti-counterfeiting campaign launched in collaboration with MOFCOM and dubbed the ‘special action’ was designed to counter the widespread and continuous violations of IPR throughout China and in particular the sale of fake and counterfeited goods. This ‘special action’ was warmly welcomed by European Chamber members, yet it points out that anti-counterfeiting is a continuous struggle and is therefore not suitable for a short-term campaign. IP protection should be incorporated into a long-term strategy.

3) Recommendations to European Policy Makers

Whilst the recommendations in this paper are primarily aimed at PRC governmental authorities, the European Union Chamber of Commerce in China also offers the below recommendations to European Union authorities and individual European member state authorities.

1. Pursue an EU-China Investment Treaty

In the spring of 2010, a Joint Investment Task Force was created to explore options for enhancing the bilateral investment relationship between the European Union and China. Accordingly, the Directorate General for Trade at the European Commission initiated a ‘Public Consultation on the future investment...’
relationship between the EU and China’ over June-July 2011.

While the EU tackles many internal issues in Europe including the sovereign debt crisis and significant changes brought forth by the Lisbon Treaty, the European Chamber believes it is critical not to lose sight of the importance of its commercial relations with China and the opportunities it represents for future growth, be it bilateral trade or bilateral investment. In this regard, the European Chamber supports the development of a bilateral investment agreement between the EU and China.

Such an agreement must take into account investment realities and must therefore cover market access barriers within a wide range of industry sectors. The European Commission should pursue a comprehensive yet realistic agreement covering both post-establishment and pre-establishment national treatment, which would in the long term be beneficial to the economies of both China and Europe.

2. Develop a Coordinated European Policy towards China

The effectiveness of EU trade policy with China has in the past been undermined by an approach which has been fragmented and uncoordinated both within the EU and between its member states.

The European Commission has in recent years endeavoured to develop a harmonised policy towards China from the EU and its member states. This will improve the effectiveness of European interaction with China and reduce the potential for Europe’s position to be weakened by internal division. The recent creation of Market Access Teams (MATs) 15 in China by the European Commission’s Directorate-General for Trade is an example of a positive step forward towards aligning policy between the European Commission, member state authorities and business. It is important that such MATs develop priority issues and outline common lines of approach for all involved. Its success however will also require that member states make use of its results for their own bilateral high-level visits and policy work, and feedback accordingly.

The European Chamber welcomes these efforts towards strengthening European-level trade policy with China. It hopes that the Directorates General for Trade and for Enterprise and Industry in the European Commission also continue to foster even greater internal levels of coordination and information-sharing on approaches to China with regulatory Directorates General of the European Commission, as well as with Members of the European Parliament.

The European Chamber also believes increased consolidated and public communication on the visits, dialogues and outcomes of high-level meetings between European authorities and Chinese authorities on business issues would help ensure a better understanding of EU efforts and activities with regards to China.

4) Looking Forward

As China embarks upon its 12th Five-Year Plan, European companies will be eagerly watching and wondering to what extent China’s structural reforms will include new opportunities for them.

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15 The Market Access Teams are organised by the EU delegation to China and bring together local expertise (including EU member state Embassy and Consulate officials) to identify and tackle trade barriers.
While increased transparency, consultation and predictability are all longstanding issues that have once again been highlighted within the 12th Five-Year Plan and this year’s Position Paper, what European companies really want is increased market access. At the same time, as China looks for new drivers for its evolving growth model, the European Chamber and its members truly believe that further opening and private sector development can once again, like in times past, be a source of growth.

The 1st April, 2011 release of the revised draft ‘Catalogue of Industries for Guiding Foreign Investment’ came as a disappointment insofar as there was little progress from the previous version. However, the Government’s statements on China ensuring a “level playing field” are deeply regarded by European business as an important signal of the Government’s attention to the concerns expressed by foreign businesses.

As a strong supporter of China’s development, opening and reform, the European Chamber looks forward to seeing these statements being translated into more actions and more concrete positive examples such as those outlined in Table 1 of this Executive Summary.

Given the many sectoral, regional, and horizontal action plans that are being developed and implemented as a part of the 12th Five-Year Plan, the European Chamber hopes that the Chinese Government will consider developing a similar action plan for increased market opening that could serve as a basis for continuing dialogue. As such, the below additional recommendations are made to the Chinese policy makers:

**Recommendation**
- Develop an overall action plan, in coordination with relevant ministries, that outlines the steps for increased market opening
- Consider forming an inter-ministerial task force to meet with and address key issues from foreign businesses
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 offer constructive advice and recommendations aimed at improving clarity and transparency in regulations, increasing market access, and encouraging equal treatment for foreign players in the Chinese market. Prominent examples of these can be seen in numerous industries, such as in Environment, Finance & Taxation, Human Resources, Legal & Competition, Marketing Communications, Public Procurement, and Standards & Conformity Assessment.

The ambiguous nature of Chinese laws and regulations create concern for European firms as they have a horizontal effect on a variety of industries. For example, the Anti-Monopoly Law (AML) took effect over three years ago, and in a number of areas, detailed guidance remains absent. The Chinese government should issue comprehensive rules and guidelines on all remaining key aspects of the AML in order to promote fuller understanding and compliance by businesses, and to offer them greater legal certainty. Where such rules or guidelines are unavailable, the Anti-Monopoly Enforcement Authority bodies should take this lack of clarity into account in their enforcement of the AML.

In addition, certain provisions of the Labour Contract Law such as term of contracts, overtime, labour discipline, and termination of employment need clarification. At present, they remain open to the interpretations of local authorities, leaving uneven standards of employee protection. Please refer to the following papers for specific examples.

The European Chamber is delighted to see the announcement that Business Tax will be replaced by a Service Valued-Added Tax by 2013, as has been previously recommended in this Position Paper. Nonetheless, the legislative process in general could still benefit from improvements by increasing the notification period and consultation process with affected parties, as well as allowing longer grandfathering periods to adjust to major changes.

Foreign Invested Enterprises (FIEs) still face discriminatory measures against them in several industries. For example, public procurement and bidding laws continue to discriminate against FIEs. Moreover, developing national, sectoral, or provincial standards in Standard Development Organisations are often known to bar FIEs from participation in standardisation processes. The European Union’s (EU) latest trade policy paper, Trade, Growth and World Affairs (2010), aims to bring reciprocity to bilateral relations with other countries, especially in the public procurement area. The European Chamber hopes that the EU and its respective firms, can enter into a constructive bilateral dialogue with the Chinese government in order to strengthen evolving trade relations.

The Position Papers in this section include: Corporate Social Responsibility, Environment, Finance & Taxation, Human Resources, Legal & Competition, Marketing Communications, Public Procurement, Standards & Conformity Assessment, Small and Medium-Sized Enterprises, and Sourcing.
Introduction to the Forum

The Corporate Social Responsibility (CSR) Forum is an event-driven platform that regularly organises meetings, trainings and events that are of interest to all European Chamber members. The aim is to develop mechanisms and tools that our members can use to successfully implement CSR strategies into their business operations in China.

The CSR Forum was established in 2005. The European Chamber, via the CSR Forum, has built relationships with local governments and non-governmental organisations in China such as the Shanghai Pudong New Area, China Europe International Business School (CEIBS) and the Global Reporting Initiative (GRI).

Together with these and other stakeholders, the CSR Forum not only wants to improve the CSR performances of its own members, but also aims to build bridges with the Chinese government by providing feedback on the development of its CSR guidelines. For example, the CSR forum has commenced a series of round table discussions about Corporate Governance and Compliance. By exchanging best practices, members are improving their business conduct with Chinese governments and counterparts.

CSR in China

On 1st January 2008, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) published its ‘Notification on issuance of guidelines on fulfilling social responsibility by state-owned enterprises’. This was the first concrete guidance from the Chinese government on how it expected state-owned enterprises to implement CSR. An increasing number of Chinese companies, both state-owned and private have been developing CSR-related activities in the past years, partly because the law requires it, partly because of the internationalisation of Chinese business.

Laws and regulations in China contain compulsory provisions on several CSR issues that incorporate standards for environmental protection, product quality, a minimum wage and workplace safety. As a recent report from the Organisation for Economic Co-operation and Development (OECD) corporate governance committee points out, the Code of Corporate Governance of Listed Companies requires that while ensuring sustained growth and maximising shareholders’ interests, listed companies should also be committed to community welfare, environmental protection and social responsibilities. But, as with a wide range of laws and regulations, the monitoring and enforcement standards are lacking and there is much confusion about what is legally required and what is not. CSR is not a mainstream issue for Chinese consumers and therefore CSR compliance is regarded by management as a contractual cost of meeting procurement requirements and audit regimes rather than as a means for creating value. Improved business transparency is much needed in China. Apart from financial reporting, domestic and foreign investors are keen on knowing clearly how businesses perform on labour-related, environmental and economic indicators. Chinese companies who want to invest overseas are increasingly questioned about their CSR performance by investors and stakeholders.

The context for CSR is also changing and should now be understood within the wider agendas of corporate sustainability and governance: agendas that offer a source of economic return, reputation and risk management. One of the issues that the Forum is currently discussing is the potential implications of the U.S. Foreign Corrupt Practices Act (FCPA) and the new U.K. Bribery Act.

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CSR Challenges

The scope of Chinese regulations in relation to CSR will keep expanding. Many developments are taking place in policy areas such as labour law, environmental law and anti-corruption. For example, new social insurance regulations have been adopted in 2010\(^4\). Also, following scandals\(^5\) that have created uncertainty with investors, the Chinese government seeks to improve the corporate governance of listed companies through various laws, measures and codes. These result in compliance questions for companies: e.g. what are the legal liabilities resulting from insufficient corporate governance and compliance systems?

The adoption of CSR principles has improved in recent years, but more has to be done by governments and businesses to further strengthen CSR principles in China. Improved conduct by Chinese businesses can help to address the important challenges that the country is facing. It is therefore also essential that the Chinese government actively participates in the international CSR community, to align Chinese CSR-related regulations and reporting guidelines with international standards. The European Chamber encourages China and the EU to look together at common future CSR definitions, standards and approaches.

These are all issues that the European Chamber, in cooperation with the CEIBS Centre for Leadership and Responsibility and other stakeholders is exploring. The main test now in China is to build a critical mass that is able to transform business practices in China. The level of CSR awareness in small and medium-sized enterprises (SMEs) remains minimal. Strong involvement of stakeholder and public consultation in the development of new CSR guidelines is essential. The European Chamber, together with other parties, will keep supporting these developments.

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(viewed on 21 June 2011)

5 For example, the melamine tainted milk scandal, Alibaba’s online fraud scandal
Environment Working Group

Key Recommendations

1. Enforce Existing Environmental Laws and Regulations
   - Enforce existing environmental laws and regulations. In order to improve enforcement, better cooperation is needed between MEP, SEPB, municipal government agencies and the judiciary.

2. Increase Incentives for the Use of Environmentally-Friendly Technology
   - Install incentives and better communicate those incentives, such as favourable taxation and lower import barriers for systems and technologies that ameliorate environmental degradation and support energy efficiency projects.

3. Strengthen the Focus on the Circular Economy through the Entire Supply Chain
   - Reinforce the obligations and liabilities of waste generators who should select and audit more strictly their waste management partners and remain liable for their waste disposal.

4. Include Soil and Groundwater Clean-Up in the Land Development Process
   - Implement and enforce the Environmental Impact Assessment (EIA) process to address soil and groundwater quality as part of any feasibility study prior to redevelopment and hold experienced expert panels to review these projects to ensure soil and groundwater cleanup is addressed properly.

Introduction to the Working Group

The Environment Working Group’s goal is to engage with relevant government departments to improve environmental policies in China. It also wishes to enhance cooperation with local governments to share best practices on the enforcement of policies, environmental standards and environmental protection.

The Working Group, established in 2006, consists of companies active in the fields of waste management, manufacturing and construction, but also environmental service providers take part.

Recently, the Working Group has engaged with a wide range of stakeholders. Representatives met with the Shanghai Development and Reform Commission (SDRC) and Shanghai Environmental Protection Bureau (SEPB) to discuss future Shanghai energy and environment policies. SWITCH-Asia “Train the Trainers” project, now in its third year, has expanded its scope and is now also providing training sessions for policy-makers to enhance the enforcement of energy-efficient policies in the construction sector. A high-level green building workshop was held in Shanghai with fifty officials participating. The European Chamber is setting up energy-efficient initiatives that will provide Chinese municipalities and companies that help build their low-carbon cities.

Recent Developments

China’s Minister of Environmental Protection (MEP), Zhou Shengxian recently said, “If our homeland is destroyed and we lose our health, then what good does development do?” referring to the pursuit of economic development and its consequences on the environment.1

Indeed, estimates about the impact of environmental degradation on the Chinese economy and society range between 4-5% of GDP every year, which would have accounted in 2010 for CNY1.79 trillion, or more than EUR 190 billion.2

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1 “China pollution ‘threat to growth’”, Financial Times, viewed 19 April 2011, http://www.ft.com/cms/s/0/36714a47-4359-11e0-8f0d-00144feabdc0.html#axzz1JvcjzgF0
2 Exchange rate 19 April, 1 Chinese Yuan = 0.10769848 Euros
The future for China’s environment, the quality of water, soil and air, looks bleak. The nation’s dependency on coal and oil for power generation will be dominant and neither renewable energy sources nor large-scale energy efficiency initiatives can replace China’s rapidly rising demand for power and electricity.

But the 12th Five-Year Plan gives strong policy direction for future laws that help ameliorate the degradation. Three pillars in the plan stand out:

1. Developing energy-efficient technology.
2. Increasing environmental quality.
3. Support the shift to new energies and reliable energy supplies.

Seven “Strategic Emerging Industries” (SEI) will be supported with preferential measures, financial support, better industrial standards and more research. At least three of these directly relate to environmental protection:

1. Energy-saving and environmental protection (advanced and eco-friendly products, cyclic utilisation, industrial equipment and services)
2. New energy (nuclear power, solar power, wind power, biomass energy, geothermal, ocean energy)
3. New energy vehicles (plug-in hybrid vehicles and pure electric vehicles, fuel cells, hydrogen cars, solar cars)

The 12th Five-Year Plan has set targets, such as energy intensity reduction, targets on pollution control and increase in forest stock volume, some of which are binding. China is now genuinely pursuing green economic development.

As in previous position papers, the Environment Working Group emphasised that China needs to abandon economic growth at the cost of the environment and move towards a “greener GDP”. At a press conference following the closing of the annual session of the 11th National People’s Congress (NPC), Premier Wen said: “China must abandon the “GDP only” mentality and ensure that economic growth must no longer be achieved at the cost of resources, energy and the environment.”

During this time of significant change and paradigm shift, European business operating in China has the opportunity to both contribute to the quality of environmental regulations and to pursue business opportunities that will assist China in developing a greener GDP. European companies possess the know-how and experience for China’s required high value-adding technologies and solutions. The European Chamber wants to serve as a platform and build bridges with Chinese authorities and companies, for example by sharing best practices.

Key Recommendations

Many issues, which the Environment Working Group is concerned with, overlap with issues from other Working Groups, such as Energy, Non Ferrous Metals, Construction for example sustainable development is also a key topic for the Construction Working Group. Therefore, the recent developments as well as the key recommendations in this section should be read in close relation to those mentioned in the other sections of this Position Paper.

1. Enforce Existing Environmental Laws and Regulations

Concern

Many regulations in China, including for the environmental sector, are of high quality, but suffer from a lack of adherence and enforcement. This is a concern in many sectors and has been for many years. In previous editions of this position paper, much attention has already been given to the problem. Please refer for more details to previous position paper editions.

Assessment

Many industries and projects fail to meet the standards as set out in the Environmental Impact Assessment (EIA) Law, such as the steel industry or construction projects. Then, violations remain uninvestigated and unpunished. Please refer for more details to previous position paper editions.

Recommendation

- Enforce existing environmental laws and regulations. In order to improve enforcement, better cooperation is needed

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Footnotes:

3 However, the government has recently suspended approval for new nuclear projects, see for example: http://www.bloomberg.com/news/2011-03-16/china-halts-approval-of-new-nuclear-projects-amid-checks-after-japan-leaks.html (viewed 26 june 2011)

4 See for example: http://news.xinhuanet.com/english2010/china/2011-03/05/c_13762236.htm (viewed 27 june 2011)

2. Increase Incentives for the Use of Environmentally Friendly Systems and Technologies

Concern
There is a real need and a genuine demand for green technologies in China. But quite often the incentives to stimulate the installment or use of these technologies is absent or the regulations are not clear.

Assessment
No concise overview exists in China about available existing or future green incentives. For example, in Shanghai, subsidies seem to exist for power generation by using combined heating and cooling power (CCHP) of about CNY 1,000 per KWh. However, it is not clear which department is responsible for this policy and a written document containing this policy is difficult to obtain. Furthermore, in Shanghai, a discount for gas consumption exists when used for clean power generation, such as CCHP of around 33% of the normal gas price. But, again, it is unclear where to obtain a written document containing the details of this policy. The Shanghai government issued policies in 2004, and again in 2008, about CCHP incentives, but it is difficult to obtain copies; it is unclear which government department is in charge.

Moreover, there is no tax differentiation for the import of environmentally-friendly technology. When environmentally-friendly technologies, such as microturbines, high performance heatpumps or filters, are imported into China, they are classified and taxed the same way as their lesser environmentally-friendly counterparts; a high performance microturbine is taxed the same way as a “normal” engine.

Sometimes, even disincentives exist. In some areas, State Grid will require a fee of around CNY 800.00 to have energy efficient power generation connected to the grid.

And Shanghai Gas asks CNY 10,000.00 per meter of new installed pipeline to connect the final user to the gas pipeline network.

Guidelines on what is deemed to be an environmentally-friendly practice are not clear and transparent. Application processes relating to adopting environmentally-friendly systems and technologies are not transparent and very complicated.

Recommendation

- Install incentives and better communicate those incentives, such as favourable taxation, and lower import barriers for systems and technologies that ameliorate environmental degradation and support energy efficiency projects.

3. Strengthen the Focus on the Circular Economy through the Entire Supply Chain

Concern
Competent Chinese authorities have been enhancing their monitoring efforts on waste disposal and recycling facilities. Rapid urbanisation will lead to a steep increase of municipal solid waste (MSW) and other types of waste. Separation of waste for power generation and recycling is still under-utilised. Furthermore, in order to yield optimal results, the circular economy should be extended upstream in the supply chain, to waste generators and waste transportation companies.

Assessment
In many public areas of large cities, refuse sorting is becoming common practice. However, household refuse sorting is lagging behind and is more difficult to be utilised by refuse power station.

Meanwhile, upstream, waste generators have uneven practices in terms of waste management. Certain industrial sites strive to reduce their environmental footprint, others tend to disregard this matter in favour of reducing the associated costs. This can translate into poor waste management on their site (risky storage and/or packaging methods), superficial compliance control and poor operation by their suppliers (for transportation and disposal/recycling).

While the Environmental Impact Assessment (EIA) law provides for an excellent process to define a proper waste management system of any new industrial project, waste generators often are at liberty to deviate from the prescribed waste management system. The EIA terms are not widely supervised and enforced, so that many operators can later choose a cheaper solution for their waste, not described in their EIA.

The aforementioned phenomenon generates an unfair competitive advantage to companies that poorly manage
their waste. Furthermore, this contributes to maintaining in operation small waste management companies, with low treatment fees and low environmental performance. This could be an obstacle to the reinforcement and consolidation of healthy waste management companies.

Recommendation
- Strengthen the focus on the circular economy through the entire supply chain. Reinforce the obligations and liabilities of waste generators, who should select/audit more strictly their waste management partners and remain liable for their waste disposal.

4. Include Soil and Groundwater Clean-Up in the Land Development Process

Concern
China’s rapid development has polluted soil and groundwater due to mining, agriculture and industry. Some are concentrated on “brownfields”, such as on abandoned factory sites. Brownfields are often located in city centers and, if redeveloped without clean-up, cause exposure risks and health concerns to future occupants.

Currently, land acquisition happens via public bidding without evaluating soil and groundwater impacts. Developers who are willing to address soil and groundwater contamination during redevelopment cannot compete with developers that do not want to address the contamination due to increased costs and risks.

Background/Assessment
Evaluating soil and groundwater clean-up costs during land auctioning will allow developers to evaluate the business model upfront and help them to leverage redevelopment of polluted land as a business opportunity, rather than as a constraint.

But experience with clean-up technologies and cost valuation is still limited in China. Due to their risk management practices, international companies have learned to cope with this challenge in multiple ways. Inviting different international experts at key (governmental) panel meetings and organising networks between international and Chinese experts to discuss specific challenges will accelerate brownfield redevelopment with “Chinese characteristics”.

Redeveloping brownfield sites helps to create economic value, by identifying profitable solutions and by creating new enterprises and jobs. Second, it creates ecological value: soil and groundwater contamination are treated towards achieving a cleaner environment. Thirdly, it creates social value, acting as catalyst for urban renewal.

Recommendation
- Include soil and groundwater clean-up in the land development process. Implement and enforce the Environmental Impact Assessment (EIA) process to address soil and groundwater quality as part of any feasibility study prior to redevelopment and hold experienced expert panels to review these projects to ensure soil and groundwater clean-up is addressed properly.

Abbreviations
- CSR      Corporate Social Responsibility
- EIA      Environmental Impact Assessment
- EU       European Union
- NPC      National People’s Congress
- SDRC     Shanghai Municipal Development and Reform Commission
- SEPB     Shanghai Environmental Protection Bureau
- MEP      Ministry of Environment Protection of People’s Republic of China
- MSW      Municipal Solid Waste
Key Recommendations

1. Improve the Legislative Process
   · Provide reasonable notice periods before implementing any substantial changes in tax laws and regulations or provide a transitional regime.
   · Provide detailed implementation guidance for local tax authorities when new rules are issued and help ensure regulations will actually be applied locally, e.g. with regard to the explicitly mentioned option for representative offices to take advantage of applicable tax treaty benefits as stipulated under Guoshuifa [2010] No.18.
   · Clarify which tax authority is competent for settlement of Business Tax on offshore service income for projects involving the provision of both offshore and onshore services, so as to avoid conflicts of jurisdiction between the tax authorities of the place of the withholding agent and of the performance of the onshore services (if different).

2. Clarify the Reporting and Tax Assessment Conditions Relating to Indirect Share Transfers (SAT Circular 698)
   a. Reporting Conditions
      · Clarify that for jurisdictions that exempt tax on gains derived from share transfer transactions due to the application of a participation exemption regime or a tax treaty would be exempted from Circular 698 reporting.
   b. Exemption from Reporting
      · Apply a de minimus rule to exempt the reporting obligation where internal restructuring or a sale of group companies, which includes PRC and non-PRC tax resident enterprises and the PRC resident enterprises only form a relatively small part of the transaction. The de minimus rule would be measured by the revenue of the PRC resident enterprises as a percentage of revenue of all entities included in the share transfer transaction.
   c. Tax Assessment Timetable
      · Specify a timeframe within which the in-charge PRC tax authority must notify the non-resident transferor of the taxability of the share transfer transaction.
      · Clarify that the non-resident transferor is exempt from any late payment surcharges and/or penalties if it has provided the required documents within the prescribed timeframe, regardless of when the in-charge PRC tax authority has completed its tax assessment.
   d. Assessment of Reasonable Commercial Purpose and Economic Substance
      · Provide objective criteria or concrete examples of what constitutes “reasonable commercial purpose” and possessing “economic substance”.

3. Allow Greater Flexibility in the M&A Tax Rules for Corporate Restructuring (SAT/MOF Circular 59)
   · Allow corporate restructurings, which involve the change of ownership of a resident enterprise in China for

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Finance & Taxation Working Group
the tax-deferred treatment, provided that the conditions as stated in Articles 5 and 6 of Circular 59 are met, or at least expand the scope of Article 7 to include more cross-border restructuring forms.

4. Review the Tax Deductibility of Advertising and Promotion (A&P) Expenses
   • Review the existing tax regulation relating to A&P expenses by extending the same tax treatment, i.e. revised tax deduction cap from 15% to 30% accorded to the manufacturers of cosmetics, pharmaceuticals and beverages (excluding alcohol) pursuant to Caishui [2009] No.72, to both the manufacturers and distributors of other consumer industries.
   • Issue clear guidelines and tax circulars on the definition of A&P expenses from a Chinese tax perspective.

5. Exempt Permanent Establishment (PE) Assessment as supplementary explanation applicable to all technologically advanced projects
   • Issue a tax circular providing the exception of PE assessment as supplementary explanation applicable to all technologically advanced projects.

6. Clarify the Taxation of Foreign-invested Partnership Income
   • Issue a tax circular providing clearer and detailed guidance on how PRC partnership income is to be taxed on foreign partners (corporate and individual) by taking into account the aforementioned issues.

Please note that the finance and taxation-related recommendations listed below can be found in other sections of this Position Paper:

   • Aerospace Working Group, Key Recommendation 4: Unify Regional Aircraft Import Tax
   • Auto-Components Working Group, Key Recommendation 2: Vehicle Taxation & CO2 Balance Taxation
   • Environment Working Group, Key Recommendation 2: Increase Incentives for the Use of Environmentally Friendly Systems and Technologies
   • Logistics Working Group, Key Recommendation 1: Taxation Issues
   • Petrochemicals, Chemicals and Refining Working Group, Key Recommendation 2: Exempt Naphtha from the Consumption Tax
   • Private Equity and Strategic M&A Working Group, Key Recommendation 2: Clarify and Confirm Several Tax Measures Affecting Foreign Private Equity Investment in Chinese Companies

The papers covering Non-Ferrous Metals, Human Resources and Small and Medium Sized Enterprises also contain details relating to the tax environment.
Introduction to the Working Group

The Finance and Taxation Working Group consists of multinational companies (MNCs) and international accounting firms operating in China. The objective of the Working Group is to engage in an effective dialogue with the authorities to work out a more flexible, 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 12th Five-Year Plan, released in February 2011, includes proposed reforms of the Chinese tax framework to help meet the broad goals of the Plan. The Finance & Taxation Working Group is pleased with the announcement that Business Tax (BT) will be replaced by a Service Valued-Added Tax (VAT) by 2013. This change has been recommended in the previous two editions (2009/2010 and 2010/2011) of this Position Paper but has been removed from this year’s version in recognition of the public statements of intent made by China’s tax policy leaders.

The 12th Five-Year Plan includes further plans to reform the system of consumption taxes and signals the intent to levy carbon and environmental taxes, as well as individual income tax reform. These measures are in support of the broad goals of the 12th Five-Year Plan such as encouraging domestic consumption, greater income equality, encouraging efficient and non-polluting industries and promoting the growth of the service sector.

The Working Group also acknowledges that, with the release of State Administration of Taxation (SAT) Circular Yinfa [2010] No. 249, last year’s issue of opening bank accounts by non-resident enterprises has been addressed. The same applies to our request for better coordination among tax bureaus, which has been addressed with SAT Circular Guoshuifa [2010] No. 119.

The tax environment was formally equalised between domestic and foreign enterprises towards the end of 2010 when the exemptions for foreign companies from paying the Urban Maintenance and Construction Tax (UMCT) and the Local Education Surcharges (LES) were abolished. The Working Group supports the harmonisation of treatment for foreign and domestic firms in China, however the process in which the change was made led the Working Group to draw attention to a number of problems:¹

1. The short time period between the announcement and the implementation of the circular.
2. The lack of any grandfathering period in order to adjust to the changes.
3. The lack of any public consultation prior to the release of the circular.

The Working Group offers constructive input in the form of recommendations in this Position Paper that member companies of the European Chamber believe will help the relevant government departments in China to continue to reform the tax system for the ultimate good of the Chinese economy as a whole.

Key Recommendations

1. Improve the Legislative Process

Concern

Over the past few years a number of regulations and guidelines – including new VAT refund rates and the UMCT and LES for Foreign-Invested Enterprises (FIEs) - have come into effect at very short notice and in some cases have even been implemented retroactively, all with dramatic consequences for the financial position of numerous companies and industries. In addition, regulations have been issued offering rights to taxpayers that in practice are not available due to the lack of implementation guidance for the local tax officials.

Assessment

The Working Group members appreciate SAT’s sincere efforts to modernise the taxation regulatory framework (and harmonise rules for foreign and domestic enterprises). This includes the release of SAT Circular Yinfa [2010] No. 249 – addressing the issue of opening bank accounts by non-resident enterprises, and SAT Circular Guoshuifa [2010] No. 119 – providing better coordination among tax bureaus.

However, the members of the Finance & Taxation Working Group

¹ The State Council’s Guofa [2010] No.35 (“Circular 35”), was released on 18th October 2010, entitled “Notice Issued by the State Council to Unify the Collection of Urban Construction and Maintenance Tax and Education Surcharges on Domestic and Foreign-Invested Enterprises and individuals”. It announced the resumption of the collection of the surtaxes from foreign enterprises, foreign-invested enterprises and foreign individuals, effective from 1st December 2010. The European Chamber wrote to the SAT and the MOF to request a one month grandfathering period to allow time to adjust, but was not permitted this.
Group have expressed their concerns about the tight deadlines given to companies to comply with the important changes in tax regulations implemented over the last two years. Furthermore, there is concern about inconsistencies in the regulations. Some examples are highlighted below:

a. Issues Relating to the New Measures on the Taxation of Representative Offices

On 20th February 2010, the SAT issued Guoshuifa [2010] No. 18 (Circular No. 18), which sets out a new framework governing the taxation of representative offices established by Non-Resident Enterprises (NRE) in China. Indeed, Circular No. 18 introduced significant changes to the tax regime applicable to representative offices, in particular on the computation of the tax base for both Enterprise Income Tax (EIT) and BT purposes. The Working Group praises the changes brought about by Circular No. 18: the new principle that representative offices shall pay EIT and BT on an actual basis is in line with both international practice and the rules applicable to other types of NREs.

However, the Working Group has two concerns regarding the legislative process in relation to Circular No.18:

(i) Insufficient implementation time for taxpayers
Circular No. 18 took effect retroactively on 1st January 2010, e.g., the beginning of the current tax year. This means that Circular No. 18 applied during the first quarterly filing of EIT and BT that took place before 15th April. However, many local tax bureaus did not have time to prepare for the implementation of Circular No. 18 and, in fact, such filings were in many cases completed under the former rules, even though they have expressly been repealed by Circular No. 18. This created considerable confusion.

(ii) Lack of guidance
Circular No. 18 explicitly provides that representative offices may claim tax treaty benefits based on the relevant provisions in the applicable Double Tax Treaty in accordance with the measures for the administration of tax treaty benefits for non-residents, namely Guoshuifa [2009] No.124. This option is in line with global tax practices.

In reality, however, the Working Group has experienced that local tax officials deny the application for this tax treaty benefit with reference to the lack of further internal guidance on the implementation of this option, specifically on how the representative office should substantiate that it only performs activities of a preparatory or auxiliary nature.

Furthermore, it has been one year since the implementation of the new rules. However, practice shows that local tax officials have a tendency to continuously apply the secondary taxation methods, e.g. deemed income methods. We are rarely seeing cases where the actual profit method is applied.

In this regard, the Working Group believes that further implementation guidance, e.g. more detailed requirements on how the activities of a representative office should be documented, would help local tax officials to improve the implementation of provisions stipulated in the relevant tax circular and allow the taxpayer to make use of an option granted by the relevant tax regulations.

b. The Provisional Measures for Tax Administration on Contracting Engineering Operation and Providing Labour Services of Non-residents promulgated by the SAT on 20th January 2009 (Decree No. 19) set out a new framework for tax registration and payment by NREs.

Under the previous system, an NRE carrying out a project or rendering services in China had to perform a tax registration within 30 days from the conclusion of the related contract. When the NRE was liable to EIT or BT in China, these taxes were in most cases withheld at the source and settled on behalf of the NRE by its Chinese client before completion of Foreign Exchange (FX) formalities for payment of the related income in foreign currency.

Decree No. 19 maintains the tax registration requirement and indicates that such registrations shall be performed with the tax authorities where “the project is located.” More importantly, it brought about major changes in the way tax registration and settlement shall be performed.

The main change is that an NRE shall directly settle EIT and BT if it has a permanent or business establishment in China. When the NRE does not have any establishment in China, taxes remain payable through a withholding agent, which in practice will often be the Chinese client.

c. Complications when a project is carried out from several locations in China

As far as EIT settlement is concerned, an NRE with
establishments in different locations may, according to the EIT Law, apply for approval by tax officials to make a consolidated tax settlement at the location of its main establishment. However, prior to making such an application, the NRE should have completed tax registration formalities in all places where it has an establishment. This considerably increases the administrative burden on foreign taxpayers. For instance, an NRE rendering services in different districts of the same municipality would in principle need to complete tax registrations in each district.

A simplification of tax formalities could be achieved by authorising NREs to carry out tax registration only where their main establishment is located and settle BT on a consolidated basis at their main establishment.

In addition, service projects contracted by NREs often include two phases: an initial phase where only offshore services, e.g. services rendered from outside China, are provided, and a second phase where both offshore and onshore services, e.g., services rendered through an establishment in China, are provided. In this case, it is unclear where BT related to offshore services has to be paid in the first phase, if the place of the withholding agent (generally the Chinese client) and the performance of the onshore services in the second phase are different. This creates a risk that tax bureaus of both places claim BT payment on offshore service income.

Recommendation
- Provide reasonable notice periods before implementing any substantial changes in tax laws and regulations, or provide a transitional regime.
- Provide detailed implementation guidance for local tax authorities when new rules are issued and help ensure regulations will actually be applied locally, e.g. with regard to the explicitly mentioned option for representative offices to take advantage of applicable tax treaty benefits.
- Clarify which tax authority is competent for settlement of Business Tax on offshore service income for projects involving the provision of both offshore and onshore services, so as to avoid conflicts of jurisdiction between the tax authorities of the place of the withholding agent and of the performance of the onshore services (if different).

2. Clarify the Reporting and Tax Assessment Conditions Relating to Indirect Share Transfers (SAT Circular 698)

a. Reporting Conditions

Concern
Although the SAT issued Announcement [2011] No. 24 (“the Announcement”) on 28th March, 2011 to clarify certain provisions of Circular 698, the SAT’s definitions of certain parameters such as “effective tax burden” and “not taxing foreign-sourced income” do not clarify situations whereby the capital gains are tax exempted at the intermediate holding company level via application of the participation exemption regime and/or a tax treaty.

Assessment
According to Article 5 of Circular 698 and the Announcement, all non-resident investors are required to report an indirect transfer of the shares of a Chinese entity if either of the following two conditions is met:

(a) The effective tax burden in the jurisdiction of the offshore intermediate holding company being transferred is less than 12.5%; or
(b) The jurisdiction in which the offshore intermediate holding company resides does not tax foreign-sourced income.

The Announcement has now clarified that the “effective tax burden” refers to the effective tax imposed on the gains derived from the share transfer transaction, and “not taxing foreign-sourced income” refers to the intermediate holding jurisdiction does not tax on foreign-sourced gains derived from the share transfer transaction.

Under the participation exemption regime, most European Union countries will exempt tax on capital gains derived from share transfer transactions at their overseas subsidiaries level. The key objectives are to encourage investments and free flow of capital across nations. Under certain tax treaties, some jurisdictions also give the right to tax on share transfers to the other contracting state, of which the alienator of shares is a resident. Based on the literal interpretation of the condition stated above, it seems that these jurisdictions do not fall within the Circular 698 reporting condition.
Recommendation

- Clarify that for jurisdictions that exempt tax on gains derived from share transfer transactions due to the application of a participation exemption regime or a tax treaty would be exempted from Circular 698 reporting.

b. Exemption from Reporting

Concern
The reporting requirements under Article 5 of Circular 698 are quite comprehensive and have already created a lot of administrative burden to the non-resident transferors of shares. Furthermore, Article 8 of Circular 698 requires that where an offshore entity transfers multiple intermediate holding companies in one transaction, the main contract for the entire transfer and the subcontract for the transfer involving a Chinese subsidiary should be presented. In addition, Article 8 provides where there is no subcontract for each transfer of the Chinese subsidiary, the detailed information about the intermediate holding company owning the Chinese subsidiary must be disclosed and a price allocation must be made for the transfer of the Chinese subsidiaries.

Assessment
Circular 698 increases the compliance burden of MNCs doing business in China. This reporting requirement subjects many group restructurings, such as internal restructuring or the sale of group companies, which includes PRC and non-PRC tax resident enterprises, to the reporting obligation. Internal restructurings are often made without the intention of avoiding PRC tax on capital gains that would otherwise be imposed if there were a direct transfer of the shares of a Chinese entity because the gain continues to be retained within the group company. The sale of group companies is often made with bona fide commercial purposes and is not intended to avoid Chinese capital gains tax.

Recommendation
- Apply a de minimus rule to exempt the reporting obligation where internal restructuring or a sale of group companies, which includes PRC and non-PRC tax resident enterprises and the PRC resident enterprises only form a relatively small part of the transaction. The de minimus rule would be measured by the revenue of the PRC resident enterprises as a percentage of revenue of all entities included in the share transfer transaction.

c. Tax Assessment Timetable

Concern
Circular 698 does not impose any timeframe within which the in-charge PRC tax authority must notify the non-resident transferor the taxability of a share transfer transaction. Late payment surcharges and/or penalties may apply if the transaction is eventually assessed as taxable in China.

Assessment
Circular 698 does not impose any timeframe within which the in-charge PRC tax authority must notify the non-resident transferor the taxability of a share transfer transaction. Under such circumstances, it would be unfair to impose any late payment surcharge and/or penalties if the share transfer is being assessed as a taxable transaction and the non-resident transferor has submitted the required documents within the prescribed timeframe under Circular 698.

Recommendation
- Specify a timeframe within which the in-charge PRC tax authority must notify the non-resident transferor of the taxability of the share transfer transaction.
- Clarify that the non-resident transferor is exempt from any late payment surcharges and/or penalties if it has provided the required documents within the prescribed timeframe, regardless of when the in-charge PRC tax authority has completed its tax assessment.

d. Assessment of Reasonable Commercial Purpose and Economic Substance

Concern
Circular 698 does not define “reasonable commercial purpose” for purposes of assessing whether the offshore intermediate holding company should be disregarded and “economic substance” for purposes of re-characterising the share transfer transaction.

Assessment
While Article 6 of Circular 698 permits the tax authorities to disregard the existence of an intermediate holding company and to use economic substance principles to re-characterise the transfer of its shares as a direct transfer of the shares of the underlying Chinese entity where the non-resident transferor has avoided PRC tax through the abuse of organisational structure and without a reasonable commercial purpose, it neither defines “reasonable commercial purpose” nor “economic substance”.

Recommendation
  · Provide objective criteria or concrete examples of what constitutes “reasonable commercial purpose” and possessing “economic substance”.

3. Allow Greater Flexibility in the Tax Rules for Corporate Restructuring (SAT/MOF Circular 59)

Concern
Caishui [2009] No. 59 (“Circular 59”) sets the rules for tax-deferred treatments of corporate restructurings. Articles 5 and 6 of Circular 59 provide a set of preconditions for tax-deferred restructurings. Under Article 7, tax-deferred treatment for cross-border restructurings is further restricted to four narrow scenarios that can only enjoy the special restructuring relief if they satisfy additional preconditions.

Assessment
Circular 59 shall allow enterprises to perform business driven corporate restructurings under deferral of income tax obligations and by this avoid tax obstacles for economically necessary and desirable developments. In this respect, the preconditions outlined in Articles 5 and 6 of Circular 59 are capable of allowing a wide range of corporate restructurings for proper business reasons. However, for share transfers with involvement of NREs, Article 7 only allows tax-deferred treatment in case of transfers between a parent company and its 100% directly-owned subsidiary.

In this regard, reasonable corporate restructurings in multinational enterprise groups may not be covered by Article 7. For example, the business-driven merger or split of a non-resident parent company into another non-resident company that results in a transfer of shares in a resident company, the shortening of the shareholder chain by means of liquidation, or the contribution of shares into another group company for proper business reasons which is not a 100% directly-owned subsidiary of the contributor.

Recommendation
  · Allow corporate restructurings, which involve the change of ownership of a resident enterprise in China for tax-deferred treatment, provided that the conditions as stated in Articles 5 and 6 are met, or at least expand the scope of Article 7 to include more cross-border restructuring forms.

4. Review the Tax Deductibility of Advertising and Promotion (A&P) Expenses

Concern
Following the changes introduced in the Enterprise Income Tax Law and its Detailed Implementation Rules (“the EIT Law”) that became effective on 1st January, 2008, foreign companies in certain industries have not been able to utilise any carry-over A&P expenses brought forward from previous tax years for Chinese tax deduction purposes due to the 15% cap. As a result, these companies are not allowed by their external auditors to recognise any deferred tax assets, leading to a high effective tax rate at the group level.

Assessment
It is positive that a specific tax circular Caishui [2009] No. 72 (“Circular 72”) was issued to increase the deduction limit for manufacturing enterprises from 15% to 30% for some selected industries between 2008 and 2010. The circular confirms the higher needs for A&P investment by these industries and contributes to their healthy development. However, there are still different industries or even different types of business models in the selected industries not covered by the scope of Circular 72. Since 1st January, 2011, Circular 72 has expired and all companies are subject to the 15% cap.

Annually, many companies have been incurring significant amounts of A&P expenses, for example in the form of TV and media expenses and have been undertaking various forms of promotional activities and campaigns in order to boost sales in the domestic Chinese markets. The amounts of A&P expenses incurred have been increasing in tandem with annual sales growth rate over the years. Consequently, the overall annual A&P expenses incurred are in excess of the statutory 15% cap over annual gross sales allowable by the EIT Law.

Businesses have therefore not been able to utilise the carry-over A&P expenses where the annual A&P expenses exceeding the 15% cap are allowed to be carried forward to subsequent years under the Chinese domestic tax laws for future utilisation due to the significant amount of A&P expenses incurred annually. This has resulted in the permanent loss / difference of the carry-over A&P expenses due to the reasons outlined above.
Recommendation

- Review the existing tax regulation relating to A&P expenses by extending the same tax treatment, i.e. revised tax deduction cap from 15% to 30% accorded to the manufacturers of cosmetics, pharmaceuticals and beverages (excluding alcohol) pursuant to Caishui [2009] No.72, to both the manufacturers and distributors of other consumer industries.

- Issue clear guidelines and tax circulars on the definition of A&P expenses from a Chinese tax perspective.

5. Exempt Permanent Establishment ("PE")

Assessment as supplementary explanation applicable to all technologically advanced projects

Concern

In the event of project investment and corporation set-up in China, foreign companies often need to import high-technology and industry-specific machinery or equipment by means of purchase or lease, and in the meantime provide consultancy services in relation to the installation and use of the machinery or equipment within China through technically skilled employees or other personnel. Pursuant to the New Corporate Income Tax Law (CIT) in China, the income obtained by foreign companies resulting from services rendered in China will be subject to CIT. Even though tax relief could be applied under the relevant tax treaty, there is still the possibility that the foreign companies may face additional tax liability due to the constitution of PE in China.

Assessment

Under Article 5, paragraph 3, sub-paragraph (b) of the Tax Treaty concluded between China and Switzerland, dated 6th July, 1990, the term "permanent establishment" encompasses the furnishing of services, including consultancy services, by an enterprise of a Contracting State through employees or other personnel in the other Contracting State, provided that such activities continue for the same project or a connected project for a period or periods aggregating more than 6 months within any 12-month period.

According to the Protocol effective on the 27th September, 1991, an exception clause regulates that, notwithstanding the provision of Article 5, paragraph 3, sub-paragraph (b), an enterprise of a Contracting State shall not be deemed to have a PE in the other Contracting State if it furnishes in that other Contracting State consultancy services in connection with the sale or lease of machinery or equipment through employees or other personnel; such consultancy services include instructions for the installation of the machinery or equipment and consultations on technical materials, training of personnel as well as providing design services related to the installation and use of the machinery or equipment.

This exception clause avoids the possibility for the constitution of PE resulting from the aforementioned consulted services rendered through assigned employees and personnel of foreign companies. This effectively eliminates additional Chinese tax burden of the foreign company (e.g. non-resident).

Nevertheless, this exception clause is not included in every tax treaty entered into by China, for example, the China-Germany and China-US treaties. Due to the discrepancy between all these tax treaties, different tax treatments and potential tax burdens arise when the same project is carried out by foreign investors from different countries.

More importantly, lack of this exception clause increases to some extent the tax costs of importing manufacturing machinery or equipment. This then creates an obstacle in terms of introducing advanced technology associated with the machinery or equipment. Higher investment costs will impact the investment strategy of foreign investors in a negative sense, which is not in line with the government's policy of encouraging and attracting foreign investment and technology for domestic development.

In recent years, relevant new circulars from both the CIT and Turnover Tax perspective have shown that significant tax benefits have been offered for the introduction and transfer of advanced technology from overseas, e.g., the CIT exemption/reduction and BT exemption on transfer of technology. Additionally, the section regarding accelerating the strategic adjustment of the economic structure mentioned in the 12th Five-Year Plan of the PRC, clearly indicates that enterprises need to optimise their structures in order to promote the upgrading of industries and strengthen technological reform, as the government looks to focus more on introducing advanced technology and expertise from overseas.

This exception clause is considered to be consistent with China's strategic principle of attracting foreign investment and technology that will not only facilitate the investment
condition for an injection of foreign funds, but also establishes a fair and reasonable investment environment for foreign investors.

Recommendation
- Issue a tax circular providing the exception of PE assessment as supplementary explanation applicable to all technologically advanced projects.

6. Clarify the Taxation of Foreign-invested Partnership Income

Concern
The Chinese State Council released the “Administrative Measures for Foreign Corporations and Individuals to Establish Partnership in China” (“the Measures”) on the 25th November, 2009. The Measures set forth the administrative rules and procedures for foreign investors to establish partnerships in China, effective from the 1st March, 2010. However, 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, but no circulars or guidelines clarifying any uncertain issues have been issued in the interim period. This has created a great deal of uncertainty for foreign investors.

Assessment
The partnership model is widely adopted overseas due to its flexibility in management, legal and capital structure. The Measures will avail a new form for foreign investors to make their investments in China. Taxation is the most unclear part surrounding the Foreign-invested Partnership (FIP) model as the Measures have not addressed any tax matters, and China’s current tax rules on partnership do not address the various concerns on this subject.

A tax circular, Caishui [2008] No.159 was issued jointly by the Ministry of Finance (MOF) and SAT in December 2008 to address income tax matters for partnerships. According to that circular, the income of a partnership should be taxed in the following way:

- A partnership is not a taxable entity itself. This follows the CIT Law which clearly stipulates that it is not applicable to partnerships.
- The taxable income is computed at the partnership level, allocated to each separate partner, and then taxed at the partner’s level. The corporate partners and individual partners are subject to CIT and Individual Income Tax (IIT), respectively, on the taxable income so allocated. In other words, the taxpayers are the corporate partners and individual partners, instead of the partnership.
- Circular 159 provides that the computation of the partnership’s taxable income should be based on another two tax circulars, Caishui [2008] No.65 and Caishui [2000] No. 91. They were old circulars merely addressing the levying of IIT in relation to sole proprietorship businesses and individual partners of a partnership. It does not appear helpful with regard to how to compute the taxable income of a partnership that would involve corporate partners.

In addition, more questions arise when it comes to a partnership involving foreign corporate partners such as:

a) Whether the foreign corporate partner, especially the limited partner in an FIP model, is subject to 10% withholding tax in respect of the allocated taxable income, instead of CIT rate of 25%?

b) Would there be another layer of tax upon repatriation of the allocated taxable income after tax at the foreign partner’s level?

c) Would the nature of income (e.g. dividend, interest and royalty) derived by the FIP pass through to the foreign partner? This is relevant where the foreign partner may be eligible to claim treaty benefit on such income if the nature of the income is retained.

d) Would the taxable loss allocated to the foreign partner be allowed to be carried forward to offset against the allocated taxable income from that partnership in future years? If so, for how long?

e) If the foreign partner disposes of the partnership interest, how should the gain be computed?

Recommendation
- Issue a tax circular providing clearer and detailed guidance on how PRC partnership income is to be taxed on foreign partners (corporate and individual) by taking the aforementioned issues into account.
Abbreviations

A&P  Advertising and Promotion
BT  Business Tax
CIT  Corporate Income Tax
CNY  Chinese Yuan
EIT  Enterprise Income Tax
FIP  Foreign-Invested Partnership
IIT  Individual Income Tax
LES  Local Education Surcharge
MOF  Ministry of Finance
MNC  Multinational Company
NRE  Non-Resident Enterprise
PE  Permanent Establishment
PRC  People's Republic of China
RMB  Renminbi
SAT  State Administration of Taxation
UMCT  Urban Maintenance and Construction Tax
VAT  Value-Added Tax
Introduction to the Forum

The Human Resources (HR) Forum was established in 2008 to represent HR professionals from European companies and specialised HR service providers across five European Chamber chapters (Beijing, Chengdu, Nanjing, Pearl River Delta and Shanghai). Currently there are over 600 member companies all over China active in the Forum.

The objective of the HR Forum is to provide a platform to exchange information, experiences and best practices among member companies, as well as to raise awareness of HR and labour-related issues across industries. It is an event-driven platform, regularly delivering seminars and training sessions of interest to HR professionals and since 2010, several European Chamber chapters engaged with provincial Human Resources and Social Security Bureaus to discuss labour-related issues.

Recent Developments

China’s rise to become “the factory of the world” along with its ambitions to up-grade its service sector economy has resulted in severe shortages of skills across all levels and disciplines. Although the number of available people is large – the number of skilled and experienced personnel has not kept pace with twenty years of economic growth and industrial development. The key challenges for the HR management span from shortage of skilled labourers, professionals and managers to rising salaries and wages. This has resulted in companies outbidding each other to attract the best talent, to safeguard their existence and growth in China.

The so called “War for Talent” is one of the greatest challenges for all foreign companies in China. In the European Chamber’s Business Confidence Survey, members stated – the lack of talent (57%) and the retention of talent (58%) being one of the top HR challenges. In addition, the ‘Hukou’ system which partly restricts the workforce mobility among Chinese employees has also had an impact on talent acquisition and retention.

Foreign companies have also reported a perceived increase in regulatory obstacles and have expressed concern with the discrepancies in law enforcement, particularly in the implementation of regulations such as the Labour Law, between foreign and Chinese companies.

As a result, the HR Forum believes that three below stated issues ought to be addressed by the Chinese government to allow for European companies to adapt and better integrate into the Chinese market.

1. Workforce Issues

Concern

There is a significant shortfall of skilled and qualified job-seekers and employees in China – at various levels - leadership, professionals, technical engineers and white- and blue-collar labour – to satisfy demand from European companies. In addition, European companies are increasingly concerned about investing in long-term graduate training schemes due to the risk of losing trainees to competitors following completion of the training scheme.

Assessment

The HR Forum observes that at the entry-level only few graduates in China are ‘fit for purpose’ to work in a foreign company, mainly due to a shortfall in soft skills. Short-term solutions for these companies include relying on internship programmes. However, the root of the problem is the imbalance between the educational system and the market requirement of modern China.

Figure 1: Talent Acquisition is One of the Top Five Challenges in Human Resources Management

<table>
<thead>
<tr>
<th>Top 5 challenges</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of appropriately-skilled local talent</td>
<td>57%</td>
</tr>
<tr>
<td>High expectations on salary and bonus</td>
<td>21%</td>
</tr>
<tr>
<td>Unknown brand name</td>
<td>7%</td>
</tr>
<tr>
<td>Perception of career opportunities</td>
<td>9%</td>
</tr>
<tr>
<td>Lack of willingness of existing employees to be assigned to China</td>
<td>3%</td>
</tr>
</tbody>
</table>


2 Ibid

Given the overall talent shortage, investment in education and training is needed at all levels. The private sector – and in this case European companies in China are prepared to contribute to training and education of their staff. However, as all these contributions are not mandatory and thereby not undertaken by all companies, those who invest in training should get incentives to do so or continue to do so. Otherwise such investments will be limited to only a certain number of larger European Multinational Companies (MNCs), despite the fact, that all European Small and Medium Enterprises (SMEs) combined are the biggest European employer.

The HR Forum furthermore observes that there is also need to improve soft skills such as critical thinking, problem solving, innovation, and communication, in order to overcome today’s overly technical rote learning system. Professional and vocational training schemes would also help develop more soft skills as well as hard skills, as already demonstrated in Shanghai with the first vocational training centre successfully having been set up in cooperation by one of the European Chambers. The Forum welcomes more vocational training centres to be opened across China, as it has proven to be an excellent tool to reduce the skill shortfall.

Recommendation
· Create incentives (e.g. tax benefits) for companies that would like to invest in education and training for their staff
· Form a cross-government, industry, and educational advisory body to focus on improving the quality of fresh Chinese graduates entering to the workforce

2. Laws and Regulations

2.1 Labour Contract Law (LCL)

Concern
There is a lack of clarity and uniform implementation of the Labour Contract Law and its implementation guidelines on a local level, especially with regard to substantial matters, such as contract term and contract renewal.

Assessment
The LCL which was promulgated on 1 January 2008 has been welcomed by European companies as providing a legal requirement for fair treatment of employees and also as basis for improving competitiveness between employers who all are required to provide minimum standards.

It is understood that certain provisions of the law have to be open to interpretation according to local and regional requirements. However, on substantial matters, such as, contract term and renewal of labour contracts, handling and proof of overtime, deviating working time schedules, implementation of labour disciplines, and termination of employment uniform guidelines on interpretation are still lacking. Different interpretations and possibilities of actual enforcement of the LCL across provinces and local authorities make a uniform HR management difficult for companies operating China-wide.

In addition, the application of the LCL to foreigners is still not fully implemented and protection of their rights is not sufficient, especially as local regulations (e.g. in Shanghai) allow deviating agreements. Further, with the expiration of the fixed term work permit the status as employee is lost and courts do not grant labour protection, although a valid labour contract exists.

Recommendation
· Implement interpretation guidelines on a national level regarding substantial matters, such as term of employment contract and renewal of contract, working time schedules, labour disciplines and termination
· Clarify the application of the LCL to foreigners and grant labour protection as long as valid labour contracts exist

2.2 Social Insurance Law (SIL)

Concern
The social security systems between China and many European countries are not comparable and also not compatible. There is concern that the application of the new social insurance law will bring increased costs to both employers and employees with limited or difficulty to access real benefits.

Assessment
The Forum welcomes the new SIL, which was approved on 28th October 2010 and came into effect on 1st July 2011. The Law stipulates a general right for all citizens to access and enjoy five categories of insurance: pension, medical, work-related injury, unemployment and maternity insurance. The Forum hopes provisions such as transferability of employees’ pension insurance accounts from one place of residence to another, and basic pension coverage for rural residents

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for example. The Forum also hopes this development will bring more flexibility to the Chinese work force despite the restrictions resulting from the ‘Hukou’ system.

However, as these new regulations will bring higher costs for employers, clear definitions on a national level, on fundamental aspects, in particular regarding definition of salary and schemes for migrant workers, caps for social insurance contributions, etc. should be provided for predictable and legal implementation.

With China’s economy and society becoming more open, the inclusion of foreigners to the statutory social insurance system can be regarded as following international practice and providing equal treatment. However, as the social security systems between China and many European countries are not comparable and also not compatible, increased costs without real benefit for the employees are a major concern of European companies. Although further clarification on contribution requirements, range of coverage, possibility of exception, exit from China etc. are still expected, European companies are afraid that an unified implementation within the local funds will take time and bring risks to the companies. Also, the negotiation of social security agreements with further countries will be a time consuming issue and should be initiated to meet the specific needs and provide fair treatment.

**Recommendation**

- **Specific issues for Chinese employees:**
  - Implement clear definitions on a national level, on fundamental aspects, in particular regarding definition of salary and schemes for migrant workers, caps for social insurance contributions, etc. should be provided for predictable and legal implementation

- **Specific issues for foreign employees:**
  - Allow expatriates to be exempt from mandatory social security participation if they can prove adequate private or other statutory social insurance in the respective insurance area
  - Conduct negotiations on bi-lateral agreements on social security with further countries
  - Grant an adequate interims until the effectiveness of mandatory insurance in order to enable companies and foreigners to prepare and countries to negotiate bi-lateral agreements

### 2.3 Visa Rules and Regulations for Foreigners Working in China

**Concern**

There is an inconsistent implementation of visa rules and regulations for foreigners working in China, which creates uncertainty for companies to relocate their employees and their intermediate families to China smoothly.

**Assessment**

29% of the companies participating in the 2011 Business Confidence Survey described ‘visa and work permits practices’ to be one of the top regulatory obstacles when doing business in China.⁵

Immigration procedures are overly burdensome and create unnecessary workload for both employee and HR departments. The requirement for two years work experience for young graduates before obtaining a work permit in China for example makes it difficult for companies to move young talents into the country and give them early exposure to a market of growing global importance.

Work permits and visa are generally granted for only one year. Even after having worked in China for a number of years employees have to go through the extension procedure every year. In most cases the procedure takes up to one week during which identification documents are kept at the immigration office posing limitation to domestic and international travel for the employee during this period.

**Recommendation**

- Improve the immigration system for foreign employees working in China and ensure consistent implementation of rules and regulations on visa, work and residence permit for working foreign employees

### 3. Benefit Costs

**Concern**

The trend of rapidly rising employee benefit costs for employers constitute a major challenge for European companies in China.

**Assessment**

The Forum welcomes the increased focus on employee conditions. However, in China employers are required to contribute to a Chinese employee’s social benefit package.

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The mandatory costs related to social benefits for local employees already can be as high as 40% of base salary.

With the addition of the new SIL, this will likely increase the social insurance and welfare cost payments for employers, in particular contributions for non-Chinese employees for the first time.

The increase of City Average Wages (CAW) plays an important role in determining the maximum contributions for social benefits. The maximum contribution is based on three times the average city wages. Such the mandatory benefits costs have increased at 8%-18% annually in last five years.\(^6\)

**Abbreviations**

- ACFTU: All-China Federation of Trade Union
- CAW: City Average Wages
- HR: Human Resources
- SIL: Social Insurance Law
- LCL: Labour Contract Law
- MNCs: Multinational Companies
- MOHRSS: Ministry of Human Resources and Social Security
- SME: Small and Medium-sized Enterprise

**Recommendation**

- Introduce and promote tax-free employee benefits such as supplementary pensions or meal and education subsidiaries
- Carefully consider the real benefits for employees, and the actual costs on employers with regard to changes in benefit schemes

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\(^6\) Aon Hewitt Study on Mandatory Benefits
**Key Recommendations**

1. **Trademarks**
   - Ensure that the applicant of a trademark cancellation action for non-use shall be notified of the submission of evidence of use by the trademark registrant in the Trademark Office procedure, and shall have full access to that evidence and shall have the right to submit to the Trademark Office any comment and counter-evidence that he deems fit.
   - Consider issuing a joint regulation by the Supreme People’s Court (SPC) and the State Administration for Industry and Commerce (SAIC) in order to ensure that when a final judgment that orders the modification of a company name is notified to an Administration for Industry & Commerce (AIC) bureau, the AIC bureau shall notify the company directors to proceed in accordance with the judgment within 15 days. In case of non-compliance, the name of the company will be deleted and replaced by its registration number.

2. **Patent Quality**
   - Develop a system whereby, in the case of a granted utility model that is subsequently invalidated, the patentee: (a) reimburses the State any subsidies that have been received for filing and obtaining the granting of that utility model and (b) for particularly egregious situations, e.g., situations where the patentee wilfully filed an invalid patent, may be fined an additional sum up to the subsidy received for each invalidated utility model.

3. **Remuneration of Service Inventions**
   - Develop an interpretation of the relevant IP courts at the highest level (preferably Supreme People's Court) or of SIPO to give clear guidance to companies on how certain general questions of inventor remuneration issues will be handled in case of disputes. Especially clarify that (a) only the direct employer of the employed inventor under a Chinese labour law contract is liable for inventor remuneration and (b) that labour contracts and/or company regulations should only be challengeable in exceptional cases of wilful neglect of inventors’ rights.

4. **Trade Secrets**
   4.1 **Plaintiff’s Burden to Prove Trade Secret Misappropriation**
      - Clarify trade secret laws, e.g., issue a Supreme People's Court judicial interpretation, so that it is clear to Chinese courts that the third element of proving trade secret misappropriation e.g., the defendant used improper means to obtain the trade secret, can be inferred from other facts such as access to and possession of the trade secret by the defendant.

   4.2. **Online Document Sharing Websites**
      - Extend/clarify the scope of the Tort Law so that it expressly provides that a document sharing website operator will be jointly liable when it has either subjective or objective knowledge, i.e. “knows or ought to know”, that the documents that it makes available infringe.

5. **IP Enforcement at Trade Fairs**
   - Ensure consistency of local trade fair regulations with state trade fair regulations so as to ensure that provisions restricting enforcement against repeat infringers do not unduly limit the possibility of repeat enforcement at a trade fair to situations where the rights holder has an effective judicial decision or administrative ruling against the (alleged) infringer.
Introduction to the Working Group

The Intellectual Property Rights (IPR) Working Group consists of over 100 European companies engaged in investment, research and development, and the production and distribution of high-end and consumer products. Over the last 10 years, the Working Group has witnessed China’s efforts to curb the dramatic increase of IPR violations that affect its economic order, its innovative capacity and the rights of its consumers. The Working Group serves as a bridge between Chinese government agencies, and judicial authorities and European businesses. It offers its assistance and support to China and makes suggestions and recommendations aimed at improving the efficiency of its IPR protection efforts.

Recent Developments

In its White Paper of 2010 the State Intellectual Property Office (SIPO) presents statistics on litigation and law enforcement with regards to IP protection.

Trademark Revision and Adjudication Board (TRAB) to Suspend its Decision Regarding Cancellation Action

Following a Position Paper presentation meeting to SAIC in February 2011, the IPR Working Group met again with representatives of the CTMO and TRAB to discuss key recommendation 5.1 of the 2010/2011 Position Paper (suspension of the procedure by the TRAB when the issue is to be first decided by the CTMO). During this meeting, the TRAB agreed to proceed with a policy of suspension, provided that:

- A specific application for suspension is made;
- Such application is made at the same time as the application for review or within three months thereafter during the period for the submission of additional arguments and evidence.

Anti-Counterfeiting Campaign

In October 2010 the State Council launched an anti-counterfeiting campaign in collaboration with the Ministry of Commerce (MOFCOM). Dubbed the ‘special action’, the operation was designed to counter the widespread and continuous violations of IPR throughout China and in particular the sale of fake and counterfeited goods. As a result, municipalities and provinces widely reported destroying millions of these goods and bringing violators to justice. Having been a successful initiative, the State Council decided to extend the campaign until June 2011, ordering all government bodies to report to MOFCOM before 15th July.

The Working Group wholeheartedly welcomed this “special operation”, yet it points out that anti-counterfeiting is a continuous struggle and is therefore not suitable for a short-term campaign. The Working Group recommends that the issue be incorporated into a long-term strategy.
Patent Ownership

The 12th Five-Year Plan calls for the ownership of valid invention patents per 10,000 capita to increase from 1.7 to 3.3. The Working Group members support this worthy goal and wise public policy. Working Group members were particularly pleased to see that the goal focused on invention patents, and excluded utility models, therefore avoiding the potential waste in resources caused by people pursuing empty and superficial goals as associated with increasing the number of relatively-easy-to-get utility model patents.

Government Procurement & NIIP

One of the major concerns last year was the government procurement policy that was linked to National Indigenous Innovation Products (NIIP): a public procurement project would only be granted to companies that were primarily Chinese-based and owned. The purpose was to be able to use, dispose and further develop IP without any foreign restrictions. As a direct result of this policy, Foreign-Invested Enterprises (FIEs), including Wholly Foreign Owned Enterprises (WFOEs) and majority foreign joint ventures (JVs) no longer qualified for government procurement.

Following months of enquiries and lobbying from the European Chamber and other interested groups, the Ministry of Science and Technology (MOST) announced in January 2011 that government procurement will no longer be linked to the requirements of NIIP, while clarifying that the policy was never intended to be discriminatory. The MOF Notice on Abolishing 3 National Indigenous Innovation-related Policies1, mainly: Indigenous Innovation Product Government Procurement Contract Measures, Indigenous Innovation Product Government Procurement Budget Measures, and Indigenous Innovation Product Government Procurement Evaluation Measures represents a first concrete step towards releasing relevant regulations abolishing the link between Indigenous Innovation and Public Procurement. The Working Group appreciates these announcement that will help ensure fair competition.

Joint Opinion on Criminal Enforcement

On 10th January, 2011 the Supreme People’s Court, the Supreme People’s Procuratorate and the Ministry of Public Security jointly issued an Opinion on Several Issues Concerning the Application of the Law to Cases of Criminal Intellectual Property Infringement. The Opinion addressed the issue of jurisdiction, the validity of evidence collected by administrative enforcement authorities, the taking of samples, the consultation of expert opinions and the issue of evidence in private prosecution cases. The Opinion also explained how to determine what constitutes “the same type of goods” within the meaning of Article 213 of the Criminal Code (using an identical trademark on identical or the same type of goods) and what is an “identical trademark”. Furthermore, the Opinion, for the first time, addressed the issue of whether the value of products seized, and therefore, not yet sold, and the value of infringing products on which the infringing trademark has not been affixed yet should be counted in the calculation of the criminal threshold (established at CNY 150,000).

There are, still, queries about why a different threshold should be used for products sold and products seized and not sold, but as a whole, the Opinion was welcome and constituted useful guidance for the relevant authorities implementing the campaign.

Regulation of the Supreme Court on Judicial Practice

A few days before the opening of the People’s Congress session, in February 2011, the Supreme Peoples’ Court issued two regulations aimed at improving the transparency of the judicial system, which the Working Group welcomed. It provided, inter alia, that communications with the judges in charge of a case should be made through official channels only, in writing and with a copy left in the file. Furthermore it provided that whenever judges have a family link with a lawyer (spouse, parent) exercising in the same circumscription, one of the two should leave the circumscription.

Court Cases

The Pen Case

In a December 2010 ruling of a case that concerned the slavish imitation of a pen, the SPC took the opportunity to fix some rules about the possibility to obtain the protection of the shape of a product. The Court ruled that, by itself, the shape can be considered as a peculiar decoration and therefore, be protected under Article 5 of the Anti-Unfair Competition Law. The case, which addresses an issue that had long been debated, was highly welcome. However,

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1 MOF Note number 85 of 30th June 2011
one should bear in mind that the SPC added some specific conditions that might be extremely difficult to achieve. It stated that the design of the product must, not only, have distinctive characteristics that distinguish it from ordinary designs, but it must also have developed, through use, a “secondary meaning”, a trademark concept that can be quite difficult to satisfy. In this case, the plaintiff, realizing that it was unlikely to bring enough evidence to establish such “secondary meaning”, withdrew the claim and settled with the defendant. However, the SPC still made its point by issuing an opinion in December 2010.

The April 2010 SPC Explanation and Its Recent Implementation

In a new interpretation of the explanation containing practical guidance on the granting of trademark rights and related administrative litigation, the SPC indicated that, in case of two similar conflicting trademarks, when it comes to the reputation of a trademark in Article 16, both trademarks are to be taken into account. In other words, now not only the prior registered trademark’s reputation is decisive, as the infringing trademark’s reputation is looked upon as well. The SPC stated that when the latter has built up a good reputation and has been in existence “for a long time”, the Court should reconsider protecting the prior registered trademark in order to maintain “social stability”. This in effect means that a large scale infringer might have a better chance to survive than a small one.

Commentators not only criticized this decision but also identified many questions left unanswered by the Explanation including:

• The period of time an infringing trademark had to be in existence in order to qualify as “a long time”, and;
• The importance of prior registered trademark owner’s awareness of the other infringing trademark when determining this period
• The SPC did not clarify either of these issues choosing to keep the freedom of interpretation. The result was a case where, after ten years of litigation, the SPC decided to rule in favour of an infringing company, basing its decision on the fact that it had developed a large scale business and built up a good reputation.

Case Study 1:

A European clothing company, famous for its logo representing a saurian, registered in China as a trademark since 1980, initiated a legal action in 2000, before the Beijing High Court, against another foreign company who was using the almost same trademark, but in the reverse position. The defendant had started its business in 1995, on a large scale. The AIC had already raided one of the boutiques in 1998, and the defendant had argued that, since it was using another trademark (composed of letters with the logo) on the packaging, neck labels, tags and as a shop sign, there was no risk of confusion. The case had been referred to the Trademark Office which had ruled that the use of the saurian figure alone was an act of infringement.

The Beijing High Court waited for eight years before it made its judgment (a period during which the plaintiff obtained twelve judgments in its favour in different parts of China). Finally, the Court decided that since the two trademarks had been coexisting in China for a long time, and since the defendant was using another trademark in relation to the sale of the products, the risk of confusion caused by the similarity between the two trademarks was not sufficient to declare that this case an act of infringement. The SPC confirmed this decision, implementing its Interpretation of April 2010, on the “long term coexistence”, and introducing, even further than the 3 dimensional trademark case in Guangdong, the concept of “global product”, which allows anyone to use the registered trademark of another person, provided that it is done together with another name, even if not visible on the product, but on packaging or tags.

Another development worth noting is a new “global method of comparison” used by the Courts. A prior registered trademark is not always protected when the subsequent filer uses its own name or trademark together with the trademark in conflict. This is in contradiction with the principle established earlier by the SPC in the Ferrero case2, where the court had considered that even if the defendant used its own name on the goods, the act was still an act of infringement.

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Case Study 2:

A European company owned a three-dimensional trademark for the shape of a bottle of sauce. A Chinese company used the exact same shape, but affixed its own label, registered as a trademark, on the bottles. Even though the use of the registered three-dimensional trademark was not disputed, the Chinese company took the initiative of starting legal action in order to obtain a judgment of non-infringement, on account of the fact that, since it was using its own name/trademark on the products, no confusion was possible. The courts in Guangdong province sustained this reasoning, which in practice, deprived the three-dimensional trademark registration of any efficiency.

The IPR Working Group is concerned with these recent developments, which raise the fundamental issue of trademark protection under the Trademark Law. Instead of bringing clarity, these decisions create a grey zone that may further encourage counterfeiters. They send a signal to infringers that, provided they engage rapidly in a large business, are successful in dragging on proceedings for a long time, or when infringers take the precaution to use another name or mark together with the infringed trademark, their activity has a good chance to become legalized.

The IPR Working Group respectfully draws the attention of the Chinese Authorities to the negative consequences that such trends would have on the credibility of the Chinese legal system and the implementation of the National IPR Strategy.

Key Recommendations

Some of the following concerns, assessments and key recommendations submitted below are different from those that were presented by the IPR Working Group during the preceding years. This does not mean that these previous concerns have been addressed by the Chinese government. In fact, with regard to many of them, improvements are still lacking.

One of the most important key recommendations put forward by the IPR Working Group in the 2009/2010 Position Paper concerns the systemic problem of requirements for notarisation and legalisation of powers of attorney and evidence from outside China. This issue continues to be at the centre of the political dialogue between the European Union and China and remains a major concern for European right holders.

Other unaddressed areas are the misuse of confidential information during procedures of import/export of technology; the need to revise the calculation method of the criminal threshold; the need to coordinate administrative and PSB enforcement work; and the need to strengthen the fight against counterfeiting on the Internet. Currently the Supreme People’s Court (SPC) encourages the publication by the civil courts in China on all IP decisions but in practice the publishing policies of the courts vary considerably and many decisions are not published.

According to SPC statistics over 40,000 cases were decided in 2010 but only a few have so far been published. More will be published but publication often takes many months or even years. Under Art 63 of TRIPS publishing of IP decisions is a requirement.

An additional concern that has gained in importance in the last year is with regard to the area of standards and patents, particularly with regard to the Disposal Rules for the Inclusion of Patents in National Standards and the Administration of the Establishment and Revision of National Standards that involve Patents in Chinese National Standards.

To read the concerns, assessment and Key Recommendations in this regard, please refer to the Standards and Conformity Assessment Working Group section (Key Recommendation 6).

These concerns remain, and require urgent attention from the Chinese authorities to effectively enhance the IP protection system in China.

1. Trademarks

Cancellation Actions

Concern

Cancellation actions, pursuant to Article 44 (4) of the Trademark Law and Article 39.2 of the Implementing Regulations, against a registered trademark that has not been used for three consecutive years, are to be filed with the Trademark Office. In such cases, the trademark registrant is granted a period of two months to submit evidence of use. However, the applicant of the cancellation
action has no right to review the evidence submitted by the trademark registrant. The result is that cancellation actions are rejected most of the time because of the relative ease for the defendant in fabricating evidence.

**Assessment**

It is easy to fabricate evidence for the use of a trademark. If the examiner does not pay special attention, it is easy to make him/her believe that a trademark has been widely used. Only the cancellation action applicant, who has an interest in the case and is able to review in detail the seriousness of the alleged use, can bring to the attention of the examiner the information that he/she needs to make an adequate decision. This can be done when the case is referred to the TRAB, which provides for a fully transparent procedure. However, having to increase the workload of the TRAB of basically all the rejected cancellation actions seems a waste of human resources and time.

**Recommendation**

- Ensure that the applicant of a trademark cancellation action for non-use shall have full access to the evidence produced by the trademark registrant in the Trademark Office procedure and shall have the right to submit to the Trademark Office any comment and counter-evidence that he deems fit.

**Enforcement of Judgments Ordering a Company to Change its Name**

**Concern**

When a trademark owner obtains a judgment ordering a company to cease using a trade name or the plaintiff’s registered trademark in its trade name, the defendant does not always respond immediately by implementing the judgment and modifying the company name. The trademark owner needs to enforce the decision, which is notified by the Court to the relevant bureau of the AIC. However, such notification is often insufficient to achieve the desired result, since the AIC bureaus do not recognise the authority of a Court judgment in their own administration.

**Assessment**

Such situations, which occur frequently, are equivalent to a denial of justice. This problem arises because it is argued Courts have no jurisdiction over the AIC bureaus. However, an easy solution could be that a joint regulation be issued by the SPC and the SAIC.

This issue has occurred frequently in Hong Kong, where infringers take advantage of local company rules to register shell companies using the trademarks of others. The Hong Kong Registrar has solved the problem by ordering the companies to change their name and notifying them that unless they do so within a given period of time, their company will become identifiable on the Company Registry by a sole registration number.

**Recommendation**

- Consider issuing a joint regulation by the SPC and the SAIC in order to ensure that when a final judgment that orders the modification of a company name is notified to an AIC bureau, the AIC bureau shall notify the company directors to proceed in accordance with the judgment within 15 days. In case of non-compliance, the name of the company will be deleted and replaced by its registration number.

2. Patent Quality

**Concern**

In accordance with the National IPR Strategy, Chinese individuals and enterprises are encouraged to develop new technologies and protect them by filing and acquiring IP rights. Subsidies and awards are granted to those who obtain the most IP rights.

Utility model patents are easily and quickly obtainable, which explains their ever-increasing popularity. However, more than 47% of such utility models are subsequently invalidated (as opposed to 21.1% for the Invention Patents).

This ratio of invalidation means that a significant number of the utility models are filed by applicants who have little consideration for the quality of the patent right.

**Assessment**

A patent brings value to the patentee, but it also brings cost to society. A market participant in today’s knowledge economy increasingly has to conduct active patent searches to find patents that are relevant to his potential

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new products, and conduct in-depth validity analysis if he finds a patent that is potentially dangerous to his product and his company. The exponential growth in utility model patents in China, and with it, the rapid growth in low-quality patents, increases the cost of monitoring, analysis and litigation for all, including local and multinational companies. Although the cost of monitoring, analysis and litigation is an inevitable and necessary by-product of the patent system, monitoring, analysis and litigation associated with low-quality, unexamined utility model patents is an unnecessary waste of resources for the entire society.

Recommendation

- Develop a system whereby, in the case of a granted utility model that is subsequently invalidated, the patentee: (a) reimburses the State any subsidies that have been received for filing and obtaining the granting of that utility model and (b) for particularly egregious situations e.g., situations where the patentee wilfully filed an invalid patent, may be fined an additional sum up to the subsidy received for each invalidated utility model.

3. Remuneration of Service Inventions

Concern

The Patent Law provides for the “reasonable” remuneration of an employee who has made a “service invention” in the course of his employment. The revised Implementing Rules provide that, in the absence of any individual agreement or in the absence of established company policies stipulating the level and manner of such remuneration, the entity to which the patent is granted should pay a minimum remuneration determined in the Rules. Such minimum remuneration is so high that it is unanimously considered by foreign investors as a strong deterrent to invest in R&D in China (it is even noted that some local regulations propose even higher percentages of remuneration).

Assessment

While the Rules allow companies to draft their own incentive policies and sets of individual agreements, the system still presents two areas of uncertainty: (a) the exact relation between the principle of reasonableness set out in the law and the freedom to contract set out in the Rules and (b) the fact that, in many cases, the entity to which the patent is to be granted is not the employer of the inventor to be remunerated.

Obtaining clarification on these two issues is an absolute requirement for foreign enterprises to consider creating, maintaining or expanding their R&D centres in China.

(1) Many foreign companies have started or are planning to invest in R&D centres in China and a lot of them have established an inventors’ remuneration scheme in their local company or included it in individual local employment contracts. Great attention was paid to meet the reasonableness requirement mentioned in the patent law. There is, however, a concern about whether an employee inventor, who has signed an employment contract containing such kind of remuneration, or a contract referring to the company’s internal regulation stipulating such remuneration, might, later, be admissible to challenge the reasonableness of such remuneration, and ask a Court to order the payment of more money. The Working Group members take the view that such a challenge would be impossible. However, the issue is so crucial that they would very much appreciate receiving precise assurances in that respect, as proposed below.

(2) Research activities are frequently performed by local Chinese companies under a commission contract signed with another company (local or foreign). Or, they are performed directly by a foreign-invested R&D centre, created either in the form of a WFOE or a JV. In both cases, the right to apply for future patents usually belongs to the company providing the funds or to the foreign investor in the R&D centre. Therefore, the entity to which the patent is to be granted has no contractual relationship with the employee, nor does it have a company policy applying to China. When foreign companies raised this issue, it was orally replied by relevant authorities that the obligation to remunerate was the sole responsibility of the Chinese employer. In the 2009/2010 Position Paper, a request was made to obtain written confirmation of what had been orally said. Such confirmation is still not given, and there is therefore still concern about whether an employee of a local Chinese company or of a foreign-invested R&D centre could, subsequently, claim further remuneration directly from the funding company or from the foreign investor.

Recommendation

- Develop an interpretation of the relevant IP courts at the highest level (preferably Supreme People’s Court) of SIPO to give clear guidance to companies on how certain general questions of inventor remuneration issues will be handled in case of disputes. Especially
clarification that (1) only the direct employer of the employed inventor under a Chinese labour law contract is liable for inventor remuneration and (2) that labour contracts and/or company regulations should only be challengeable in exceptional cases of wilful neglect of inventors’ rights.

4. Trade Secrets

4.1 Plaintiff's Burden to Prove Trade Secret Misappropriation

Concern

European companies doing business in China face substantial risks of trade secret infringement. Although China has promulgated laws and regulations aimed at protecting trade secrets, these laws and regulations may be interpreted as imposing a heavy burden on the plaintiff to prove trade secret infringement. Therefore, when a company’s trade secret is misappropriated, it can often be very difficult for the company to enforce its rights and seek redress in Chinese courts.

Assessment

In China, plaintiffs in a trade secret misappropriation case must first prove the following three elements:

(i) Existence and ownership of trade secrets.
(ii) Defendant possesses information that is identical or substantially identical to the trade secret; and
(iii) Defendant used improper means to obtain the trade secret.

However, it is not clear what evidentiary burden the plaintiff has to show that the defendant used improper means to obtain the trade secret. If this means that the plaintiff has to show the process through which the defendant obtained the trade secret, then trade secret misappropriation cannot be proved for most cases especially considering that Chinese courts do not provide an effective mechanism for the plaintiff to obtain evidence from the defendant. Generally, the only evidence the plaintiff can possibly obtain is that the defendant had access to the trade secret and that the defendant now possesses the trade secret. Therefore the only practicable way is to shift the burden of proof and consider that, whenever the plaintiff presents evidence showing that the defendant has come into contact with the secret and possesses information similar to the secret, while it is unable to justify a legitimate method to obtain the secret, misappropriation (“improper means”) is established.

However, the Working Group’s understanding is that some judges in China (mistakenly) consider that there should be no burden shifting regarding element (iii) above - that defendant used improper means to obtain the trade secret. Other Chinese judges have taken the view that the burden of proof may shift.

We consider that Chinese law should be clarified so that burden shifting is explicitly applicable with respect to element (iii). If the owner of a trade secret used proper means to protect its trade secret, but another party came into contact with the trade secret and now possesses it, then it is reasonable to infer that this other party stole the trade secret unless it can disprove it.

Recommendation

- Clarify trade secret laws, e.g., issue a Supreme People’s Court judicial interpretation, so that it is clear to Chinese courts that the third element of proving trade secret misappropriation, e.g. defendant used improper means to obtain the trade secret, can be inferred from other facts such as access to and possession of the trade secret by the defendant, and inability of the defendant to justify any legitimate method to obtain the secret.

4.2. Online Document Sharing Websites

Concern

Recently, European companies have discovered that a large number of company confidential documents had been posted on Chinese document sharing websites, such as www.docin.com and wenku.baidu.com. Such websites allow anyone to upload documents online to share with others, and provide incentives for such document sharing. As such websites do not require users to register with their real identities, companies cannot track who posted the confidential documents online, and cannot effectively prevent such infringing activity from occurring.

Assessment

Over the last few years, the number of documents shared on these documents sharing websites has grown dramatically. Such websites have been widely criticized by IP owners in China because a large amount of content that has been uploaded is copyrighted material or contains company confidential documents, posing serious threats to
Currently, the Tort Liability Law, which provides for the liability of such website operators is unable to efficiently protect the rights of stakeholders affected by illegal uploading of their confidential documents. It is, indeed, extremely difficult to satisfy the requirement of the law, and prove that (1) the website operator refused to take down an infringing material after it has been duly notified of its infringing nature (which, in effect, shifts the entire burden of monitoring the service and sending takedown notices onto the rights owner), or that (2) the website operator "knows", i.e., has actual knowledge, that the uploaded material is infringing the rights of a third party (this is practically impossible).

This issue is well known and has been dealt with in the Network Distribution Right Regulations of July 2006, which provide, for instance, that a network provider providing links to infringing works will be jointly liable when it has either subjective or objective knowledge, of the infringing activity. This means that the right holder may successfully bring an action of joint liability (with the uploader) against the network provider, if it can prove that the network provider ought to know about the infringing activity.

In so far as the Tort Law applies to the activities of network service providers that operate document sharing websites such as those that are the principal concern to right holders, we consider that the scope of the Tort Law should be extended/clarified to introduce the concept of "knows or ought to know" in the conditions required to engage the website operator’s joint liability. In this clarification, in order to limit the application of this principle, it could be specified that such joint liability is not intended to be applied to service providers who are passive conduits of data, engaging in caching activities, or merely linking users to an online location.

Recommendation

- Extend/clarify the scope of the Tort Law so that it expressly provides that a document sharing website operator will be jointly liable when it has either subjective or objective knowledge, i.e. "knows or ought to know", that the documents that it makes available infringe.

5. IP Enforcement at Trade Fair

Concern

Ever since China enacted the guidance of IPR protection at trade fair, many Chinese local governments and trade fair organizers issued their own IPR protection regulations and established enforcement mechanism. However, in recent years, many IP right holders found it more and more difficult to get adequate and timely protection at trade fairs because such mechanisms contain restrictions which make it technically difficult, if not impossible, to enforce their rights against the worst kind of violation: the repeat offenders. Indeed, these regulations impose on the right holder to prove that it has already obtained an effective administrative or judicial decision, since the previous enforcement at the previous trade fair, which, given the duration of certain procedures, is sometimes impossible and, in any event, is beyond its control.

Assessment

As an example, according to Article 10 of the Measures for Complaints and Settlements of Infringements of Intellectual Property Rights (hereafter referred to as the Measures) issued by China Import and Export Fair (hereafter mentioned as Canton Fair) organizer, the IP complaining centre will not accept new complaints against old targets where complaints were made during previous trade fairs against them based on the same patent unless the rights owner can show documents that they had taken legal actions against the specific target and have received an "effective judicial verdict or administrative ruling". That is too strict and unrealistic for rights holders to meet.

There is only an interval of six months between two sessions of Canton Fair, while civil litigations or administrative proceedings usually last longer than 6 months (even longer if a foreign party or a patent case is concerned or if the case is appealed). There is little chance for right holders to get "effective judicial verdicts or administrative rulings" before the next Canton Fair.

We consider that, while it is reasonable to impose on the right holder to justify that it has taken steps against an infringer, based on the first act of enforcement, it is unreasonable to impose that a formal administrative or judicial action be terminated by a final decision before the right holder has the possibility to enforce again its right against the same defendant. It should be sufficient for the right holder to prove it has issued a warning or a cease and desist letter.
In could be seen as an encouragement for infringers to use all their local influences to drag the procedures for the longest possible time, during which they would enjoy immunity at trade fairs.

**Recommendation**
- Ensure consistency of local trade fair regulations with state trade fair regulations so as to ensure that provisions restricting enforcement against repeat infringers do not unduly limit the possibility of repeat enforcement to situations where the right holder has already obtained an effective judicial decision or administrative ruling against the (alleged) infringer.

**Abbreviations**

AIC  
Administration for Industry and Commerce

CTMO  
China Trademark Office

FIE  
Foreign Invested Enterprise

FYP  
Five Year Plan

IPR  
Intellectual Property Rights

JV  
Joint Venture

MOFCOM  
Ministry of Commerce

MOST  
Ministry of Science and Technology

NIIP  
National Indigenous Innovation Products

PSB  
Public Security Bureau

R&D  
Research and Development

SAIC  
State Administration for Industry and Commerce

SIPO  
State Intellectual Property Office

SPC  
Supreme People’s Court

Supreme People’s Procuratorate

TRAB  
Trademark Adjudication Board

TRIPS  
Trade-Related Aspects of Intellectual Property Rights

WFOE  
Wholly Foreign Owned Enterprise
Key Recommendations

1. Anti-Monopoly Law (AML)
   • Rules and Transparency:
     - Promptly issue comprehensive rules and guidelines on all remaining key aspects of the AML in order to promote fuller understanding and compliance by businesses and to offer them greater legal certainty. Where such rules or guidelines are unavailable, the Anti-Monopoly Enforcement Authority (AMEA) bodies should take this lack of clarity into account in their enforcement of the AML.
     - Support the efforts of the Supreme People’s Court (SPC) in promoting cases brought under the AML, and encourage publication of a judicial interpretation further clarifying the procedural rules governing AML-related cases, while providing guidance on damage claims, including standard of proof and the ultimate level of damages.
     - Adopt standard publication channels, such as websites, for all information relevant to AML enforcement, including new measures, decisions and consultations.
   • Concentrations:
     - Publish notices online, confirming that filings have been made, identifying the notifying parties and the sector involved in the transaction.
     - Apply and enforce the AML transparently, publishing as many detailed and reasoned decisions as possible 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.
   • International Standards:
     - Ensure that the implementation and enforcement of the AML does not unfairly discriminate between domestic and foreign-owned enterprises, in particular in the 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).
     - 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 economy.

2. Improve Arbitration Environment
   • Increase party autonomy with regard to the choice of arbitration institution, ad hoc arbitration, legal representation, selection of arbitrators and forum selection.
   • Narrow the standard of review for arbitral awards issued in domestic cases.
   • Encourage the systematic publication of court decisions and statistics on the enforcement of arbitral awards.
   • Improve the procedure for obtaining interim relief, such as the preservation of evidence and property in the context of arbitration proceedings.

3. Transparency
   • Standardise, public consultation process, allow for at least 6 weeks for comments on drafts of laws and
Section Two: Horizontal Issues

regulations, and acknowledge receipt of comments.
• Publish all laws and regulations prior to implementation, establish an official journal for recording all 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 an official journal.
• Publish all court judgments of the intermediate and provincial People’s Courts level on an official consolidated website.
• Ensure that all judgments issued by a Court can be consulted by any interested party, even if not necessarily the litigants or their counsels.
• Allow foreigners to attend civil and commercial hearings in the People’s Courts.
• In relation to state and commercial secrets:
  - Define more clearly and exhaustively what constitutes a "state secret" and a "commercial secret."
  - Include "safe harbour" provisions for legitimate commercial activity.
  - Issue concrete and practical guidelines as to what foreign businesses can do to ensure compliance with the law in this area.

4. Bankruptcy
• Apply and enforce the Enterprise Bankruptcy Law (EBL) as transparently as possible.
• Ensure that the application and enforcement of the EBL is consistent throughout China, so as to provide legal certainty for businesses.
• Institute dedicated bankruptcy courts or, as an alternative, adopt courts’ internal rules for the selection of experienced judges for bankruptcy cases.
• Adopt a more transparent process for the selection of bankruptcy administrators to ensure the selection of experienced administrators.
• Adopt measures to ensure that creditors participate in the selection of administrators.
• Introduce statutory criteria for the courts to determine when to terminate reorganization or conciliation proceedings and declare the debtor bankrupt.
• Clarify the provisions in the EBL on the recognition of overseas bankruptcy proceedings to facilitate the recognition of offshore creditors’ claims as equal to those of domestic creditors.
• Circulate a draft of the new SPC judiciary interpretation of the EBL for public consultation and allow sufficient time for all interested parties to submit comments.

5. Legal Services
• Extend the Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the mainland to foreign firms.
• Permit the creation of Joint Law Ventures (JLVs) between foreign and Chinese law firms.

Introduction to the Working Group

The Legal & Competition Working Group aims to promote greater legal transparency and awareness of legal developments affecting foreign investment in China.

The Working Group has fostered ties with various organisations and government bodies such as the Ministry of Justice (MOJ), Beijing and Shanghai Bureaus of Justice, the Ministry of Commerce (MOFCOM), the National People’s Congress (NPC), the Legislative Affairs Office of the State Council (SCLAO), the China International Economic and Trade Arbitration Commission (CIETAC), and the Shanghai Bar Association (SBA).

The Working Group was created in 2000 and now comprises over 520 individuals representing over 250 member companies. It is active in the Beijing, Shanghai and Pearl River Delta (PRD) chapters of the European Chamber. It consists of lawyers from European-based law firms registered
with the MOJ, European lawyers working in other foreign
law firms registered with the MOJ or for Chinese law firms,
as well as in-house counsels for European corporate entities
with a presence within China.

Member law firms are important in terms of facilitating
technology transfers to China and importing international
techniques, legal precedents and expertise in areas such
as venture capital, Mergers and Acquisitions (M&A), and
bank documentation.

European law firms are a training ground for future
Chinese international lawyers. Further steps to open up
the market and allow greater competition would help China
establish itself as one of the leading legal services markets
in the world.

Recent Developments

In April 2011, the National Development and Reform
Commission (NDRC) and MOFCOM released a draft of
the Catalogue for Guiding Foreign Investment in Industry
2011 (Draft Catalogue). In the new Draft Catalogue, there
are new encouraged and permitted sectors for foreign
investors. However, it is unclear whether limitations to
foreign investors’ shareholdings in some of these sectors
remain, for instance in components and parts for new
energy automobiles and medical institutions. The Working
Group welcomes regulations clarifying whether foreign
investors will be allowed to establish wholly-owned
companies in all the newly encouraged and permitted
sectors.

The Working Group welcomes the on-going work being
carried out by MOFCOM and the State Administration for
Industry and Commerce (SAIC) to broaden the range of
corporate vehicles and investment structures that may be
utilised by foreign investors. In particular, recent changes
to the regulations relating to Joint Ventures (JVs) and
in relation to private equity investment have generally
been well received, as have changes to the division of
responsibilities between Beijing regulators and their local
counterparts. The Working Group hopes that MOFCOM and
SAIC will now take the opportunity to continue their
work in reforming the complicated administrative approval
system for the establishment of companies in China,
which remains a concern. The Working Group would
encourage the introduction of an approval system for the
establishment of foreign-invested companies that is more
streamlined, particularly for operations in encouraged
sectors.

The Working Group recognises the significant efforts of
the AMEA bodies in finalising implementation rules under
the AML. The Working Group appreciates the opportunity
to comment on various implementation rules, including
in relation to anti-competitive agreements and abuse of
dominant market position, and welcomes the introduction
of clear procedures for enforcement of the AML. The
Working Group encourages MOFCOM to refine the interim
procedures it has promulgated in relation to the new
National Security Review (NSR) regime (for review of
proposed acquisitions of domestic enterprises by foreign
investors on national security grounds) in light of the
submissions that MOFCOM has received.

Key Recommendations

1. Anti-Monopoly Law (AML)

Concern
The Working Group welcomes the progress made to
clarify application of the AML. However, many aspects
of its application remain unclear. This risks delaying the
positive economic benefits that an effective competition
law promises to companies and consumers, as per Article
1 of the AML.

Assessment
The AML has been in effect for over three years. Although
progress has been made in the development of a broad
framework of rules to guide AML enforcement and
compliance, the law’s impact on market behavior in China
remains relatively low.

Business operators in China who are keen to comply with
the law to mitigate risk will continue to face challenges
due to the lack of clear standards and guidance on
enforcement methodology. In this context, adherence to
relevant international standards such as those in mature
antitrust jurisdictions such as the European Union (EU)
and the United States are an effective way forward.

Particular progress has been made in the area of merger
control under the AML, with MOFCOM publishing
provisional rules on remedies that it can impose before
approving some transactions. There have also been
discussions regarding the approach to be taken when a
company fails to notify a qualifying concentration and when
MOFCOM may review a transaction if applicable filing
thresholds are not met.
There have also been positive developments in relation to other aspects of the AML. The SAIC and the NDRC have each adopted implementation rules regarding abusive conduct, agreements between competitors, vertical restraints in distribution agreements, price-related restrictions, and even abuses of administrative power that result in the restriction or elimination of competition. Both SAIC and the NDRC have also adopted procedural rules regarding the investigation of anti-competitive agreements and abusive conduct.

The Working Group welcomes sharing its experience with the AMEA bodies.

Current Issues

Despite these positive developments, many guidelines remain outstanding or in draft form only. Furthermore, there is uncertainty among businesses as to the number and type of additional implementing regulations or guidance that can be expected from the AMEA bodies, due to the lack of any published work schedule showing the draft rules being considered by the AMEA bodies.

The majority of the key areas where further implementing regulations or guidance are required relate to:

- The control of concentrations, in particular:
  - The notions of “control” and “JV”.
  - The evaluation of remedies imposed as conditions for approving concentrations.
  - The assessment of horizontal and vertical concentrations.
  - The approach to failure to file and consequences for companies.
  - The circumstances in which MOFCOM may intervene if the filing thresholds are not met.
- The application of the AML to the exercise of Intellectual Property Rights (IPR).
- Clarification of:
  - The calculation for fines.
  - The market share threshold under which agreements will not be considered as monopoly agreement (De Minimis rules).
- Procedure and assessment:
  - Adopting automatic exemption for some types of agreements.
  - Clarifying how a request for exemptions may be submitted and assessed.
- Clarifying the inconsistency of the leniency programs between SAIC and the NDRC.

Transparency in the Enforcement of the AML

Ongoing transparency is a fundamental part of developing a competition policy. Thus, it is welcomed that MOFCOM has published some of its merger control decisions. The Working Group also welcomes that MOFCOM discloses progressively more details of its decisions to the parties and to third parties.

The Working Group also understands that several proceedings are ongoing before the NDRC and SAIC, with SAIC adopting its first official cartel decision under the AML in January 2011 (issuing fines against a trade association active in the cement sector). Courts have also continued to entertain private litigation cases. Transparency in the enforcement of these cases, while respecting the secrecy of the proceeding itself, would be welcome.

In this respect, it would be helpful if the AMEA bodies created websites on which all AML-related documentation could 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 law authorities worldwide have created such websites, in particular the European Commission and national competition authorities. The publication of such information also encourages compliance with the AML by businesses, by enhancing awareness of obligations.

The Working Group is keen to work with relevant EU and Chinese government bodies such as Directorate General (DG) Competition, the EU Delegation to China and MOFCOM 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 MOFCOM, SAIC and the NDRC.

Recommendations

- Rules and Transparency:
  - Promptly issue comprehensive rules and guidelines on all remaining key aspects of the AML in order to promote fuller understanding and compliance by businesses, and to offer them greater legal certainty. Where such rules or guidelines are unavailable, the
AMEA bodies should take this lack of clarity into account in their enforcement of the AML.
- Support the efforts of the SPC in promoting cases brought under the AML, and encourage publication of a judicial interpretation further clarifying the procedural rules governing AML-related cases, while providing guidance on damage claims, including standard of proof and the ultimate level of damages.
- Adopt standard publication channels, such as websites, for all information relevant to AML enforcement, including new measures, decisions and consultations.

- Concentrations:
  - Publish notices online confirming that filings have been made, identifying the notifying parties and the sector involved in the transaction.
  - Apply and enforce the AML transparently, publishing as many detailed and reasoned decisions as possible 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.

- International Standards:
  - Ensure that the implementation and enforcement of the AML does not unfairly discriminate between domestic and foreign-owned enterprises, in particular in the light of Article 7 of the AML.
  - Contribute to the development of international competition law policy through participation in the ICN.
  - 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 economy.

2. Improve Arbitration Environment

Concern
The arbitration environment in China is in a constant state of evolution. The European business community welcomes the efforts made in recent years to improve it. However, much remains to be done to bring the arbitration environment in China in line with international standards.

Assessment
Arbitration is usually the preferred method of dispute resolution for investors in China. The development of the rules of arbitration, especially the CIETAC rules, shows that Chinese legislation and practice are improving the relevant regulatory environment. However, a number of problems still exist.

Limited Party Autonomy
First, China should officially open the door to foreign arbitration institutions such as the International Chamber of Commerce (ICC), allowing those institutions to handle cases with a Chinese seat and allow the parties the freedom to opt for ad hoc arbitration in China.

Secondly, foreign lawyers, People’s Republic of China (PRC) lawyers who work for foreign law firms in China and all other foreigners should be explicitly allowed to present submissions on the application of PRC law in the context of both foreign-related and domestic arbitration claims.

Thirdly, parties should be permitted to submit not only foreign-related disputes but also domestic disputes to arbitration outside of China. As a preliminary step, disputes involving Foreign Invested Enterprises (FIEs) should be regarded as “foreign-related.”

Fourthly, all PRC arbitration institutions should be encouraged to cancel the current mandatory fee scales and allow more flexibility to ensure appropriate and acceptable remuneration of arbitrators.

Finally, parties should be allowed to choose the presiding arbitrator through an appointing authority who is jointly chosen by both parties in deviation from the current rules providing exclusively for appointment by the chairperson of the selected arbitration commission.

Standard of Review
Different standards of review between domestic and foreign-related arbitration cases should be abolished. The standards of review for domestic cases effectively open the gates for de novo review of the case by Chinese People’s Courts.

Increasing party autonomy and standard of review through the reforms proposed above will help modernise and upgrade China’s arbitration practice and make it more attractive to foreign investors.
Publication of Relevant Court Decisions on Enforcement

Although the evidence may be largely anecdotal, the perception of many foreign investors is that the enforcement of arbitration agreements and arbitral awards in China is uneven at best. There is also a general belief that it is difficult for foreign claimants to enforce arbitral awards against recalcitrant Chinese respondents through the PRC courts.

Having access to court decisions and statistics on enforcement would help clarify China’s actual record on enforcement of arbitration agreements and arbitral awards and help encourage confidence in Chinese arbitration among foreign investors. Existing notices of the SPC concerning publication of decisions concerning enforcement and evaluation of enforcement work should therefore be strictly implemented and systematic, unrestricted access to such decisions and statistics should be ensured.

Property and Evidence Preservation Measures

The current substantive and procedural requirements for obtaining interim relief, such as orders for the presentation of evidence or property, still do not effectively support the arbitration process in China. Improvements continue to be needed in this area.

Recommendation
• Increase party autonomy with regard to the choice of arbitration institution, ad hoc arbitration, legal representation, selection of arbitrators and forum selection.
• Narrow the standard of review for arbitral awards issued in domestic cases.
• Encourage the systematic publication of court decisions and statistics on the enforcement of arbitral awards.
• Improve the procedure for obtaining interim relief, such as the preservation of evidence and property in the context of arbitration proceedings.

3. Transparency

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, lack of transparent implementation of laws and regulations by the judiciary and the administrative authorities remains a problem for European companies operating in the Chinese market.

Assessment
A key element in China’s accession to the WTO relates to the transparency of laws, regulations and other rules related to trade and investment. There is a considerable mismatch between the WTO transparency requirements and the Chinese legal regime. The three principles of transparency - public availability of laws, procedural fairness in decision-making and an independent system of judicial review - as they are implemented in the Chinese legal system are of great importance. Particular attention must be paid to the framework of administrative decision-making, including the institutionalisation of broad administrative discretion, and to bureaucratic culture.

Public Consultation

The Working Group welcomes the progress that has been made on this front. However, promulgation by ministries of administrative rules and interpretations still sometimes lack the required transparency and often follows a consultation period that is too short to allow meaningful consultation to occur as was the case in relation to the consultation on guidelines under the Social Insurance Law (SIL).

The Working Group suggests standardising the procedure for public consultation among various authorities. Public consultation is a crucial element in the law-making process, not least because it facilitates the resolution of potential problems in the practical implementation of laws before their official promulgation. Transparency also requires legislators to provide feedback on comments they have received, within the framework of a public consultation. Thus, the Working Group strongly encourages the Chinese government to acknowledge receipt of stakeholders’ comments and provide feedback by displaying the results of public consultation on dedicated government websites. The Working Group also suggests that a standard consultation period is adopted, for instance six to eight weeks.

Official Journal

Upon its accession to the WTO, China also made a commitment to establish an official journal dedicated to
the publication of all laws, regulations and other measures pertaining to or affecting trade in goods and services, or the Agreement on Trade – Related Aspects of Intellectual Property Rights (TRIPS). We encourage the Chinese government to consolidate all laws and regulations regarding these matters in a comprehensive official journal in accordance with its WTO commitments.

State and Commercial Secrets

The foreign business community continues to be particularly concerned about PRC laws on state and commercial secrets.

Foreign companies doing business in the PRC wish to ensure that they fully comply with PRC laws in all their activities in the country. However, there is a concern that the laws surrounding state and commercial secrets are overly vague, which makes compliance by foreign companies difficult.

The Working Group is concerned that the law remains vague in this area, and foreign companies continue to have difficulty adhering to it. Specific points of concern are as follows:

- The definitions of "state secrets" and "commercial secrets" remain vague. For instance, "commercial secrets" may be regarded as "state secrets" with far more serious implications, merely because they relate to a State Owned Enterprise (SOE).
- The definitions are very broad and cover information relating to virtually all kinds of transactions in which foreign businesses may be engaged with Chinese companies.
- There does not appear to be any requirement that the information relate to national security or particular strategic sectors.

The Working Group is also concerned that, under the PRC Criminal Procedure Law, trials relating to state secrets are not conducted in open courts.¹

Predictability

Predictability is one of the key requisites of a country governed by the rule of law, as it increases trust in the legal system and allows companies and individuals to plan their activities.

Retroactive Application of Laws and Regulations

On occasion, regulations and circulars issued by PRC authorities apply retroactively, therefore creating uncertainties on the state of the law at any given time. By way of example, foreign investors have been particularly concerned about the potential retroactive application of the new NSR regime. In order to preserve the principles of legal certainty and legitimate expectations of business operators, PRC authorities and regulators should respect the general principle of non-retroactivity of laws and regulations and refrain from issuing regulations with retroactive effect.

Application of Regulations Still in Draft Form

Occasionally, rules and regulations circulated for comment are kept in draft form for extended periods of time, sometimes up to a year or more. This has particularly been the case in relation to implementation rules under the AML. This creates substantial uncertainty for companies whose activities or applications for approval or licenses and permits may be affected by new rules.

Court Judgements

European businesses welcome the increase in transparency and publicity of court judgments. They also appreciate the efforts that have been put into improving and extending the websites of the SPC (http://www.chinacourt.org/) and local courts (such as http://bjgy.chinacourt.org/), through which a growing selection of court judgments has now been made available.

In order to further increase judicial transparency and legal certainty, and promote consistency of judgments throughout China, all judgments from the intermediate and high People’s Courts should be made available to the public through an official consolidated website, freely accessible and searchable.

It is also encouraged that the courts provide explicit analysis of the reasoning process, giving detailed explanations of judgments affecting trade and economic activities in one official journal. In addition, foreigners should have full public access to commercial and civil hearings in the People’s Courts. Although transparency of

¹ In most jurisdictions criminal trials are generally conducted in open courts and only certain portions of the hearing may be held in camera or be subject to an injunction on media reporting. In China however trials relating to state secrets are held in closed courts, sometimes limiting even the access of the defendant’s attorney.
judgments has improved in some areas (such as litigation in relation to IPR, court judgments dealing with issues of white-collar crime, commercial secrets, and active or passive corruption have proven less transparent.

Recommendation

• Standardise the public consultation process, allow for at least 6 weeks for comments on drafts of laws and regulations, and acknowledge receipt of comments.
• Publish all laws and regulations prior to implementation, establish an official journal for recording all 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 an official journal.
• Publish all court judgments of the intermediate and provincial People’s Courts level on an official consolidated website.
• Ensure that all judgments issued by a Court can be consulted by any interested party, even if not necessarily the litigants or their counsels.
• Allow foreigners to attend civil and commercial hearings in the People’s Courts.
• In relation to state and commercial secrets:
  - More clearly and exhaustively define what constitutes a “state secret” and a “commercial secret.”
  - Include “safe harbour” provisions for legitimate commercial activity.
  - Issue concrete and practical guidelines as to what foreign businesses can do to ensure compliance with the law in this area.

4. Bankruptcy

Concern

The PRC EBL, which entered into force on 1 June 2007, sets out for the first time a unified insolvency regime for all types of enterprises in China, including SOEs.

Four years later, the EBL regulatory regime has several gaps that leave room for uncertainty at the courts’ discretion. Furthermore, in certain situations, the implementation of the EBL has been hampered by the lack of transparency and undue political influence.

Assessment

One of the main benefits of the new bankruptcy law to foreign investors is greater certainty of what the endgame will be if their investments face difficulty. However, implementation challenges still exist due to lack of transparency, a small number of qualified local practitioners, and the inexperience of the judiciary in handling bankruptcy cases for large enterprises.

Additionally, local courts sometimes refuse to accept bankruptcy applications, seemingly in order to keep respective case numbers low.

The Working Group acknowledges that tremendous steps forward have been taken to address the implementation issues of the EBL. However, further guidance from Chinese legislators and the SPC is recommended for the following matters.

Courts Jurisdictions and Judge Selection in Bankruptcy Cases

Currently, the local courts where the debtors are based have jurisdiction over bankruptcy cases. Local courts, especially those in less economically developed areas, may lack the experience to deal with the technicalities of a new law and the complexity of large bankruptcy cases.

Bankruptcy Administrators

Administrators in bankruptcy proceedings, including proceedings regarding reorganization of businesses, are usually selected randomly from local registers of domestic law firms, accounting firms and bankruptcy liquidation firms.

Recognition of Overseas Bankruptcy Proceedings

Although the EBL has general provisions on the recognition of overseas bankruptcy proceedings covering assets in China – subject to the existence of reciprocal international treaties - these provisions are themselves subject to several qualifications and requirements. As a result, it is unlikely that offshore creditors will be treated on equal footing with domestic creditors.

Against this background, the Working Group welcomes the preparation by the SPC of a new set of interpretation rules for the EBL. The Working Group underlines the importance of this judiciary interpretation to promptly address the uncertainties under the EBL and to promote its standardised application throughout China. Furthermore, the Working Group welcomes public consultation on the draft of this new judiciary interpretation.
Recommendation

• Apply and enforce the EBL as transparently as possible.
• Ensure that the application and enforcement of the EBL is consistent throughout China, so as to provide legal certainty for businesses.
• Institute dedicated bankruptcy courts or, as an alternative, adopt courts’ internal rules for the selection of experienced judges for bankruptcy cases.
• Adopt a more transparent process for the selection of bankruptcy administrators to ensure the selection of experienced administrators.
• Adopt measures to ensure that creditors participate in the selection of administrators.
• Introduce statutory criteria for the courts to determine when to terminate reorganization or conciliation proceedings and declare the debtor bankrupt.
• Clarify the provisions in the EBL on the recognition of overseas bankruptcy proceedings to facilitate the recognition of offshore creditors’ claims as equal to those of domestic creditors.
• Circulate a draft of the new SPC judiciary interpretation of the EBL for public consultation and allow sufficient time for all interested parties to submit comments.

5. Legal Services

Concern

Despite positive developments in many areas addressed by the Legal & Competition Working Group, substantive progress has not been made to ease the restrictions for foreign law firms and legal practitioners operating in China since China’s accession to the WTO. The Working Group’s concerns continue to relate to restrictions placed on foreign lawyers and foreign law firms operating in China, including in relation to the provision of advice and restrictions on such lawyers and firms appearing in court.

Assessment

Integration of foreign law firms into China is very important, and relevant Chinese authorities should pay attention to this issue. If China wants to improve its legal system in order to attract more foreign investors, the integration of foreign law firms into China is highly recommended.

Integration of foreign law firms into China

The Working Group continues to believe that in order to have a well-balanced legal services market, there must be closer cooperation and integration between local and foreign law firms in China. The ultimate goals should be: (1) to allow foreign law firms to practise Chinese law through the employment of Chinese-qualified lawyers and the ability to enter into partnerships with Chinese-qualified lawyers; and (2) to allow Chinese law firms to develop multi-jurisdictional practices, through the employment of foreign-qualified lawyers and the ability to enter into partnership with foreign-qualified lawyers.

Extension of the CEPA

The CEPA benefits are currently only extended to Hong Kong law firms and lawyers. In view of the limited benefits of the current arrangement, the Working Group believes that CEPA should be expanded to include formal joint law ventures between foreign law firms and Chinese law firms. Creation of JLVs between foreign and Chinese law firms.

Many jurisdictions, such as those of South Korea, Japan and Singapore, have started their liberalisation process through the implementation of JLVs. The adoption of this mode of co-operation with foreign law firms, if permitted in China, would benefit Chinese law firms and Chinese lawyers, and contribute to the development of a modern legal services market in China.

The Working Group acknowledges that full liberalization of the Chinese legal services market will take time. Therefore, the Working Group reiterates its suggestion that, as a first step, measures be taken to increase engagement and intensify collaboration between foreign and Chinese lawyers and law firms.

Recommendation

• Extend the CEPA between Hong Kong and the mainland to foreign firms.
• Permit the creation of JLVs between foreign and Chinese law firms.
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AMEA</td>
<td>Anti-Monopoly Enforcement Authority</td>
<td>MOFCOM</td>
<td>Ministry of Commerce</td>
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<td>AML</td>
<td>Anti-Monopoly Law</td>
<td>MOJ</td>
<td>Ministry of Justice</td>
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<tr>
<td>CEPA</td>
<td>Closer Economic Partnership</td>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<td>CIETAC</td>
<td>China International Economic and Trade Arbitration Commission</td>
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<tr>
<td>DG</td>
<td>Directorate General</td>
<td>NPC</td>
<td>National People’s Congress</td>
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<td>Draft Catalogue</td>
<td>Foreign Investment Industry Guidance Catalogue</td>
<td>NSR</td>
<td>National Security Review</td>
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<td>EBL</td>
<td>Enterprise Bankruptcy Law</td>
<td>PRC</td>
<td>People’s Republic of China</td>
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<tr>
<td>EU</td>
<td>European Union</td>
<td>PRD</td>
<td>Pearl River Delta</td>
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<tr>
<td>FIE</td>
<td>Foreign Invested Enterprise</td>
<td>SAIC</td>
<td>State Administration for Industry and Commerce</td>
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<td>ICC</td>
<td>International Chamber of Commerce</td>
<td>SBA</td>
<td>Shanghai Bar Association</td>
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<td>ICL</td>
<td>International Competition Law</td>
<td>SCLAO</td>
<td>Legislative Affairs Office of the State Council</td>
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<td>ICN</td>
<td>International Competition Network</td>
<td>SOE</td>
<td>State Owned Enterprise</td>
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<tr>
<td>IPR</td>
<td>Intellectual Property Rights</td>
<td>SPC</td>
<td>Supreme People’s Court</td>
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<td>JLV</td>
<td>Joint Law Venture</td>
<td>TRIPS</td>
<td>Trade – Related Aspects of Intellectual Property Rights</td>
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<td>JV</td>
<td>Joint Venture</td>
<td>WTO</td>
<td>World Trade Organization</td>
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<tr>
<td>M&amp;A</td>
<td>Mergers and Acquisitions</td>
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Marketing and Communications Forum

Introduction to the Forum

Participants in the Marketing and Communications Forum are marketing and communications professionals in different sectors, including advertising agencies, public relations consultancies and marketing and communications functions in various companies. The Forum provides a platform to exchange information, experiences and best practices among member companies in all industries on how to best use marketing and communications to achieve business objectives in China. Through regular meetings and seminars, the Forum aims to identify opportunities to improve the marketing and communications industry in China.

Recent Developments

China is in the midst of an attempt to steer its economy away from dependence on export and towards growth fuelled by domestic consumption. In the long run, it is hoped that this means greater opportunities for foreign companies to market their products to consumers in the Chinese domestic market.

Chinese media is increasingly going global, with both privately and state-owned media outlets producing foreign-language editions and seeking audiences beyond China. For foreign companies in China, this means relations with Chinese media, and the image portrayed through Chinese media will become increasingly important.

At the same time, social media such as forums, blogs and microblogs are reshaping the media landscape, making it possible for companies as well as their customers, employees and other stakeholders to instantly publish their opinions and reach potentially huge audiences. This creates new opportunities for companies to reach out to people, but also creates challenges such as living up to increasingly high expectations on companies to interact and be available online. Social media in China has also proven to be a platform where opinion can quickly and massively turn against companies, and where false rumors spread quickly.

Challenges

There are several issues of concern for those involved in marketing and communications; however these issues are not always of a regulatory nature. More prevalent are the concerns about behaviors or systemic problems in the Chinese media, public relations and online services industries. The solutions are therefore to be found in more sophisticated engagement with journalists, editors as well as marketing and communications professionals. This can be in the form of education and seminars to create a better understanding of the working conditions of each side. The support of the Chinese government is welcome here, as are initiatives from universities, media and Non-Government Organisations (NGOs).

Increasing the Credibility of Domestic Journalism

For companies present in China, the development of Chinese media is crucial to their abilities to communicate and reach out with their messages – and in the end, to succeed with their business objectives. If media functions poorly, there is less incentive to invest in marketing strategies that use them.

The government has made attempts to enhance the quality of domestic reporting, by fining several large newspaper companies and suspending journalists for presenting false information, as well as by publishing a circular in which it recommended fact checking and demanded newspapers not to give work to those who fabricate news.

The members of the Forum welcome the initiatives taken by the Chinese government to improve domestic journalism. We would like to see more such action, particularly support for initiatives to educate journalists and editors on ethical working standards.

Malpractices in the Public Relations Industry

It is well-known that companies and public relations agencies in China sometimes pay journalists to write favourably or arrange fake grassroots campaigns on online forums in order to shape public opinion. One high-profile incident was revealed by Chinese media in February of
2011, when it was claimed a major State Owned Enterprise (SOE) had initiated an online campaign using anonymous forum users in order to put a positive light on recent oil price increases.

These practices are a major concern as they undermine the credibility of traditionally produced media as well as social media, and sometimes create arms races between competitors who battle to control public opinion. There is a risk that foreign companies might succumb to local practices, and by doing so contribute to retain these practices as well as risk their own global brands.

Addressing these issues is complicated. Solutions need to strike a balance between creating incentives against these poor practices while at the same time avoiding introducing heavy restrictions on media outlets, site owners and companies. The Marketing and Communications Forum would like to contribute to finding solutions to these issues, together with the Chinese officials as well as media organisations. During the coming year, the Forum will therefore continue to arrange meetings and seminars where marketing professionals, journalists, media organisations and educators in this area can work together on how to best solve these issues.

**Abbreviations**

NGOs | Non-Government Organisations
---|---
SOE  | State Owned Enterprise
Key Recommendations

1. Increase Market Access
   - De-link Indigenous Innovation policies from government procurement at all levels, particularly at the local level
   - Issue a formal notice that clearly states the definition of domestic products and companies and consider all companies legally established in China as domestic companies regardless of the origin of their capital
   - Ensure a level playing field and equal treatment for wholly Chinese-owned enterprises and foreign invested enterprises (FIEs)

2. Improve the World Trade Organisation (WTO) Government Procurement Agreement (GPA) Offer
   - Encourage the exchange of information, academic and research resources with other GPA member states
   - Address the inconsistencies found in domestic legislation with GPA regulations to pave the way for a smooth accession
   - Submit a third revised accession offer as early as possible and accelerate accession negotiations

3. Strengthen Public Procurement Regulatory Framework
   - Streamline the legal framework for public procurement in line with GPA principles and international best practices
   - Ensure uniform enforcement of legislation governing public procurement nationwide
   - Ensure all bidders have equal access to information at the start of the bidding process
   - Enforce transparency and fair evaluation during the tendering process
   - Create efficient and meaningful remediation to raise objections in cases of perceived irregularities

4. Employ Green Public Procurement (GPP) and Life Cycle Cost (LCC)
   - Promote public procurement policies that encourage the development and diffusion of environmentally friendly goods, construction works and services
   - Allow for environmental considerations in technical specifications selection and award criteria, and contract performance clauses
   - Include LCC as an award criterion to identify the most economically advantageous tenders and favour higher quality solutions

5. Develop Electronic Public Procurement (E-Procurement)
   - Encourage contracting authorities to use centralised electronic systems for timely and transparent announcements of upcoming public tenders and to enable interested parties to register and submit proposals online
   - Adopt unified e-procurement system standards, and increase information resource sharing between the Ministry of Finance (MOF), Ministry of Industry and Information Technology (MIIT) and provincial governments

6. Encourage Public-Private Partnerships (PPP)
   - Issue clear guidelines to regulate PPP projects nationwide, reflecting a fair and efficient distribution of responsibilities between public and private partners
   - Allow more flexibility to the chosen private partner in the project implementation
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. The main objectives of the Working Group are to make constructive recommendations for improved public procurement processes, to ensure 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.

Recent Developments

Despite its significant importance, Public Procurement continues to be a relatively misunderstood sector in China. This is due to both a general lack of Western awareness and confusion with China’s own definition of Government Procurement. In response to this knowledge gap, the European Chamber published in April 2011 a comprehensive study entitled, Public Procurement in China: European Business Experiences, Competing for Public Contracts in China.

In this report and for the purposes of this Position Paper, public procurement is defined as:

Public Procurement is tendering by the central and sub-central government and other public entities and State Owned Enterprises (SOEs) projects that are of public interest and/or use of public funds.1

The public procurement market is governed by the two sets of law: the Government Procurement Law (GPL) and the Bidding Law (BL).

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Figure 1: Key differences between the Government Procurement Law and the Bidding Law2

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<thead>
<tr>
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<th>Government Procurement Law</th>
<th>Bidding Law</th>
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<tr>
<td>Estimated market value</td>
<td>CNY 842.2 billion</td>
<td>Approximately CNY 7.12 trillion</td>
</tr>
<tr>
<td>Typical Industries covered</td>
<td>Construction and maintenance of government buildings, railway, information technology, office equipment, government car fleets, purchases of services for ministerial buildings and non-commercial government entities (not SOE); other purchases are related to relief work, emergencies, geological and other surveys; police, medical and other emergency equipment</td>
<td>Mainly SOEs; renewable energy, power generation and supply, sewage, water supply and public transportation, most large construction projects e.g. All 2008 Olympic construction projects, highways</td>
</tr>
<tr>
<td>End-users</td>
<td>Government ministries and agencies at all levels (national, provincial, municipal etc.), public schools and universities, hospitals, and research institutions</td>
<td>State Owned Enterprises, Private Companies</td>
</tr>
<tr>
<td>SOEs</td>
<td>Does not apply</td>
<td>Applies</td>
</tr>
<tr>
<td>Coverage</td>
<td>Applies to state organs at all levels, public institutions</td>
<td>All public and private bidding</td>
</tr>
<tr>
<td>Scope</td>
<td>Supplies, works and services listed in the catalogue or above the threshold (except works covered by bidding law)</td>
<td>Works of public interest, publicly funded works and related supplies or services, research and development (R&amp;D)</td>
</tr>
</tbody>
</table>

Figure 1 continued on next page

1 Public Procurement in China: European Business Experience Competing for Public Contracts, European Union Chamber of Commerce in China, 20 April 2011, viewed 10 May 2011
2 Ibid
### Figure 1 continued: Key differences between the Government Procurement Law and the Bidding Law

<table>
<thead>
<tr>
<th></th>
<th>Government Procurement Law</th>
<th>Bidding Law</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Thresholds</strong></td>
<td>Supplies/Services: Central Government: over CNY 1.2 million; Other: over CNY 500,000; Works: Central Government: over CNY 2 million; Other: over CNY 600,000</td>
<td>Works: over CNY 2 million Works projects: over CNY 30 million</td>
</tr>
<tr>
<td><strong>Implementing Body</strong></td>
<td>Ministry of Finance (MOF)</td>
<td>National Development and Reform Commission (NDRC) and local Development and Reform Commissions, e.g. Beijing Development &amp; Reform Commission (BDRC).</td>
</tr>
<tr>
<td><strong>Available definition of ‘domestic product’</strong></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td><strong>Review and Remedies procedure</strong></td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

Currently covered by the World Trade Organisation’s (WTO) Government Procurement Agreement

State owned enterprises were excluded from the scope of Government Procurement Agreement (GPA) coverage. Some (low value) government entities have been included such as Xinhua news agency, Chinese Academy of Social Sciences and Chinese Banking Regulatory Commission. However, these institutions only procure goods and services for their own use – not public projects.

The public procurement market is worth as much as approximately CNY 7.96 trillion based on Organisation for Economic Co-operation and Development (OECD) estimates for developing countries (i.e. 20% of Gross Domestic Product (GDP)).

**Government Procurement Law**

The GPL defines government procurement as procurement of goods, works and services conducted with fiscal funds by state organs at all levels, public institutions and social organisations.

Since 2009, China’s government procurement market has expanded 13.6%, from CNY 741 billion to CNY 842 billion in 2010, which represents approximately 2.1% of the China’s Gross Domestic Product (GDP).

**Figure 2: Government Procurement of Goods and Services (2005-2010)**


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3 List of Entities includes: a) Xinhua News Agency b) Chinese Academy of Engineering c) China National School of Administration d) China Earthquake Administration e) China Meteorological Administration f) China Banking Regulatory Commission g) China Insurance Regulatory Commission h) State Electricity Regulatory Commission

4 ‘Fiscal funds’ cover both budgetary (government purchases) and extra-budgetary funds (government sponsored foundations and purchases covered by an administrative service charge).

5 Article 2, Government Procurement Law of the People’s Republic of China

The Bidding Law

The following private and public projects must be subject to tendering under the BL:7

1. Projects such as large-scale infrastructure facilities and public utilities involving the social and public interests and public safety (e.g. Olympic installations such as the “Bird’s Nest”);

2. Projects which are, completely or partly, invested by the state-owned funds or funded through state financing (e.g. an automobile manufacturer - necessarily a joint venture - expanding its production facilities);

3. Projects using loans or aid funds from international organizations or foreign governments (e.g. projects funded by bodies such as the World Bank or Asian Development Bank).

The BL is estimated to be worth up to CNY 7.12 trillion based on OECD general estimates.

Recent Developments

• A call for comments on the Draft Implementation Regulations on Tendering and Bidding Law - September 20098
• A call for comments on the Draft Implementation Regulations on Government Procurement Law - January 20109
• National Indigenous Innovation Product Accreditation 2010 - April 201010
• A call for comments on the Draft Management Measures for the Government Procurement of Domestic Goods - May 201011
• In July 2010, China submitted a revised second offer to the WTO GPA. This offer was rejected by WTO GPA members and is currently undergoing a third revised offer to be submitted by end of 2011, as promised in the EU-China High-Level Economic and Trade Dialogue (HED) in December 2010.12

The Public Procurement Working Group recognises the efforts taken by the government with regards to public procurement. However, the Working Group would like to see in 2011, a successful third offer submitted by China to join the WTO GPA, taking into account these suggestions below and at the same time, release the final Implementation Regulations on the Bidding and Tendering Law and the Implementation Regulations on Government Procurement Law. The Working Group will closely monitor any developments in this area.


7 Article 3, Tendering and Bidding Law of the People’s Republic of China
Key Recommendations

1. Increase Market Access

Concern
Public procurement under both China’s Government Procurement Law and the Tender and Bidding Law continues to discriminate against foreign enterprises in China.

Assessment
Access to public procurement market remains a major concern for European companies. Despite reassurances from the highest levels of China’s government, foreign companies are still discriminated against in public procurement in a number of concrete ways.

The definition of “domestic goods” continues to be interpreted in a variety of ways.

Under the GPL, the Chinese government issued in January 2010 a draft implementing regulations for the GPL, which clarified a “domestic” product as one that is “made within China’s borders and for which domestic manufacturing costs exceed a certain percentage of the final price,” which is said to be set at 50%.13

For the BL, however, actual practice varies from one industry to another and in some cases the local government has stipulated 70% local content requirement.

Although reassurances have been given from the highest level of the Chinese government,14 in practice, the requirement for ‘domestic goods’ in bidding documents and the lack of clear guidance has hindered foreign invested enterprises (FIEs) established in China from having equal access to public procurement contracts. Further clarification on the definition of “domestic products” and its application is needed.

The Working Group appreciates the Government’s statement that policies the Indigenous Innovation List (the catalogue) will not be linked to government procurement on both central as well as local governments. However, despite this, European FIEs continue to experience that local governments have implemented and compiled their own local catalogues. Products of FIEs that are not included in these catalogues will be discriminated against in government procurement bidding procedures, despite the fact that these companies have established manufacturing operations in China, often with important technology transfer and localised R&D operations. The Working Group calls for actions on de-linking Indigenous Innovation policies from government procurement at all levels, both central and local.

Some regions have started issuing procurement certificates which would allow or require a company/bidder to be pre-qualified prior to entering into the actual bidding process itself. The Working Group would like to receive a clarification from the Ministry of Finance (MOF) regarding the issuance and national validity of such certificates.

Recommendation
· De-link Indigenous Innovation policies from government procurement at all levels, particularly at the local level
· Issue a formal notice that clearly states the definition of domestic products and companies and consider all companies legally established in China as domestic companies regardless of the origin of their capital
· Ensure a level playing field and equal treatment for wholly Chinese-owned enterprises and FIEs

2. Improve the World Trade Organisation (WTO) Government Procurement Agreement (GPA) Offer

Concern
The Working Group is concerned that the accession into China’s WTO GPA will continue to be delayed and that the third offer to be expected by 2011 will not be sufficiently comprehensive.

Assessment
On 9 July, 2010, China submitted its second offer to join the WTO GPA.15 Compared with its initial offer in 2007, China’s revised offer shows progress but the Working Group has the following concerns:

· Limited coverage of SOEs: representing a large part of major infrastructure projects.
· Limited coverage of sub-central entities: representing

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the majority of China’s government procurement takes place at a local level.

- **Limited sectoral coverage of services and exclusion of several key sectors:** recognising that the list of services has partially been improved, exclusion of a number of significant sectors, especially in the utility sector, including roads, railways, civil aviation, ports, urban transportation, electricity, water resources, energy, postal services and telecommunications.

- **Limited access to public contracts in construction:** coverage of construction services is very limited and only includes construction of dwellings, hotels and entertainment buildings.

- **Extremely high contract value thresholds:** the thresholds have been reduced since the initial offer but remain very high, almost three times the level of most GPA members.

- **Potential deviation from national treatment:** General Notes 4 & 5\(^6\) may potentially give Chinese government leeway to deviate from national treatment and impose technology transfer requirements including the National Indigenous Innovation Product Accreditation (NIIP) policy.

The Working Group notes that the MOF expressed its intention to enhance communication with GPA members to improve its offer,\(^7\) and expects China to accelerate its GPA negotiation process and consider improving the upcoming revised offer taking the above concerns into consideration. Furthermore, the Working Group is aware of other potential institutional and conceptual obstacles that may impede China’s quick and smooth accession to GPA. The Working Group recommends including in the reviewing process the following considerations:

- **Access to the GPA is not only an opportunity to offer GP market access to other signatories but also a chance to establish a GP system on the basis of internationally recognised best practices that can achieve better value for money, help control government expenditures, encourage competition, curb corruption, and at the same time allow for the implementation of social and environmental policies such as those that would create opportunities for Small and Medium-sized Enterprises (SMEs).**

- **Ensuring the consistent application of national legislation within the provisions of the agreement is very important. Current challenges in this regard include the exclusion of public works projects from GP and the lack of coordination among different regulators to establish a strong GP regime that aligns better with the GPA requirements.**

**Recommendation**

- Encourage the exchange of information, academic and research resources with other GPA member states
- Address the inconsistencies found in domestic legislation with GPA regulations to pave the way for a smooth accession
- Submit a third revised accession offer as early as possible and accelerate accession negotiations

### 3. Strengthen Public Procurement Regulatory Framework

**Concern**

Currently, there remains a significant difference between China’s domestic procurement regulations and the provisions of the GPA. 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 BL, which calls for open bidding and equal competition.

**Assessment**

On the 10 April 2009, the General Office of the State Council issued Notice No.35 to promote government procurement in China.\(^8\) The Notice sets forth the direction for China to improve its government procurement regime, and aims to:

- Extend the applicable scope of government procurement: All projects using fiscal funds shall fall within the scope of government procurement
- Leverage government procurement to help carry out energy savings, environmental protection and indigenous innovation
- Create an import product review policy, and conduct research on the utilisation of government procurement to

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\(^6\)General Notes 4: When a specific procurement may impair important national policy objectives, the Chinese Government may consider it necessary in singular procurement cases to deviate from the principles of national treatment in the Agreement.

General Notes 5: Having regard to Article XVI of this Agreement and general policy considerations regarding development, the Chinese Government may require the incorporation of domestic contents, offset procurement or transfer of technology.


support SMEs

- Establish a nationwide Electronic Government Procurement Management and Transaction Platform to make procurement information publicly available

Further, the Draft Implementation Regulations of the GPL addressed irregular and non-transparent implementation of tendering procedures along with the lack of practical and effective channels to address cases that had been handled unfairly. However, fair adoption and enforcement are required. In addition, tendering timelines are often too short for companies to draft a meaningful bidding document and therefore, create an additional barrier for foreign companies to participate in the tendering process.

The BL has been applied partially and arbitrarily in cases where the GPL does not apply. The Working Group welcomes MOF’s continuous efforts and commitment (as expressed in the Circular published in February 2011) that it will work with relevant ministries to tackle the relationship between the GPL and BL.

According to Article 2 of the GPL, the law applies to all purchasing activities carried out with fiscal funds by government departments, institutions and public organizations at all levels, where the intended goods, constructions and services are those listed in the Centralised Procurement Catalogue published by the procuring authority, or those goods whose value exceeds the respective prescribed procurement thresholds for goods, projects or services.

Until now, central and local GP agencies have been drafting a yearly budget for items to be procured through bidding rules governed by MOF’s Management Methods of Bidding and Bid-inviting of Goods and Services of Government Procurement No.18. The agencies are related to the MOF and corresponding local Bureaus of Finance. The items listed by these agencies only cover a small percentage of the total construction that could be considered as government funded.

According to Article 3 of the BL, this law applies to:

- Projects involving social and public interests and public safety, such as large-scale infrastructure facilities and public utilities
- Projects that are either completely or partly invested in by state-owned funds or funded through state financing

Projects using loans or aid funds from international organisations or foreign governments

The majority of construction projects or projects of interest to European industry are currently not governed by the GPL, but rather by a partial and arbitrary application of the BL. The BL, however, does not provide the same level of bid remediation methods to challenge the bid procedure as under GPL. Also, for the remaining institutions whose purchasing activities should be governed by the GPL, there is a lack of consistency and transparency in its application.

Recommendation

- Streamline the legal framework for public procurement in line with GPA principles and international best practices
- Ensure uniform enforcement of legislation governing public procurement nationwide
- Ensure all bidders have equal access to information at the start of the bidding process
- Enforce transparency and fair evaluation during the tendering process
- Create efficient and meaningful remediation to raise objections in cases of perceived irregularities

4. Employ Green Public Procurement (GPP) and Life Cycle Cost (LCC)

Concern

Environmental impact and LCC are not sufficiently taken into consideration in public procurement decision-making in China, as covered by the GPL and BL.

Assessment

As both environmental protection and inclusive economic growth are two key goals under China’s 12th Five-Year Plan, encouraging GPP and LCC assessments in public procurement procedures are in the best interest of contracting authorities and society as a whole.

Article 9 of the GPL reads “Government procurement should be conducive to the fulfillment of economic and social development policies and the realisation of economic and social targets of the country, including protection of the environment”. In practice, however, environmental criteria are rarely taken into consideration in tender specifications and evaluations.Procuring products that are high in quality, recyclable and durable should be a greater government priority.
Recommendation
· Promote public procurement policies that encourage the development and diffusion of environmentally friendly goods, construction works and services
· Allow for environmental considerations in technical specifications selection and award criteria, and contract performance clauses
· Include LCC as an award criterion to identify the most economically advantageous tenders and favour higher quality solutions

5. Develop Electronic Public Procurement (E-Procurement)

Concern
E-procurement has not been fully developed and the government procurement cycle still cannot be fully executed online, as different government agencies have different IT system standards, so information sharing and interoperation have not reached their full potential.

Assessment
The MOF promotes the construction of a government procurement transaction platform and sets the tasks of unifying the plan, undertaking construction at different levels and sharing the basic database for 2011. The basic database will contain central and local vendors, goods information, appraisal experts and agents. The platform will handle procurement management, electronic transactions, procurement process monitoring, and data sharing among central and local governments. While this is the goal for building a unified government procurement IT system, different local governments are adopting different standards, and therefore the level of interoperation and compatibility is low. It remains to be seen how this situation will be addressed to allow the interoperability of databases to facilitate information sharing.

Recommendation
· Encourage contracting authorities to use centralised electronic systems for timely and transparent announcements of upcoming public tenders and to enable interested parties to register and submit proposals online
· Adopt unified e-procurement system standards, and increase information resource sharing between the MOF, MIIT and provincial governments

6. Encourage Public-Private Partnerships (PPP)

Concern
The Chinese regulatory framework does not allow genuine public-private partnerships and the so-called existing PPP projects are too rigidly administered.

Assessment
PPPs are widely used within the European Union, especially for transport, public health, public safety and all public utilities, so as to reduce the financial burden of public projects on central and local budgets and transfer risks to the private sector. In principle, the public partner should concentrate on project compliance and safeguarding public interest. This lets the private partner concentrate on meeting project requirements and freely use its industry knowledge and natural partners to ensure success. In China however, the awarded private partner has limited or no leeway to contract its suppliers and is forced to sub-tender the project components. This results in lower-quality finished projects and a waste of public funds.

Recommendation
· Issue clear guidelines to regulate PPP projects nationwide, reflecting a fair and efficient distribution of responsibilities between public and private partners
· Allow more flexibility to the chosen private partner in the project implementation
### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>BDRC</td>
<td>Beijing Development and Reform Commission</td>
<td>MOF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>BL</td>
<td>Bidding Law</td>
<td>MOST</td>
<td>Ministry of Science and Technology</td>
</tr>
<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
<td>NIIP</td>
<td>National Indigenous Innovation Product Accreditation Policy</td>
</tr>
<tr>
<td>E-Procurement</td>
<td>Electronic Procurement</td>
<td>OECD</td>
<td>Organisation for Economic Co-Operation and Development</td>
</tr>
<tr>
<td>FIE</td>
<td>Foreign Invested Enterprise</td>
<td>PPP</td>
<td>Public Private Partnership</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
<td>R&amp;D</td>
<td>Research and Development</td>
</tr>
<tr>
<td>WTO GPA</td>
<td>World Trade Organisation’s Government Procurement Agreement</td>
<td>SCLAO</td>
<td>Legislative Affairs Office of the State Council</td>
</tr>
<tr>
<td>GP</td>
<td>Government Procurement</td>
<td>SDR</td>
<td>Special Drawing Rights</td>
</tr>
<tr>
<td>GPL</td>
<td>Government Procurement Law</td>
<td>SME</td>
<td>Small and Medium-sized Enterprise</td>
</tr>
<tr>
<td>GPP</td>
<td>Green Public Procurement</td>
<td>SOE</td>
<td>State Owned Enterprise</td>
</tr>
<tr>
<td>HED</td>
<td>High Level Economic and Trade Dialogue</td>
<td>WTO</td>
<td>World Trade Organisation</td>
</tr>
<tr>
<td>LCC</td>
<td>Life Cycle Cost</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
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Introduction to the Forum

The Small and Medium-sized Enterprises (SME) Forum was established in 2005 and acts as a platform for European SMEs to share experiences and provide practical information to support their business success in China. The Forum also serves as a link between European multinationals and SMEs operating in China.

The Forum serves as a platform to monitor business conditions in China for SMEs and interacts with both industry-specific and horizontal Forums and Working Groups to keep abreast of industry and regulatory developments. The SME Forum also regularly organises focused events and seminars on topics that are of interest to SMEs. Seminars have been on the topics of accessing finance, corporate strategy, investment planning, labour law and HR, intellectual property rights (IPR), and standardisation, among others.

The official definition of the European Union (EU) limits SMEs to a maximum size of 250 employees and maximum annual turnover of EUR 50 million or total assets of EUR 43 million. In China, the definition of an SME varies by industry. Generally, much larger enterprises are considered SMEs in China than in the EU, especially with regards to the number of employees. Additionally, in the EU an SME must be an independent company, whereas in China this is not a requirement.

Besides the SME Forum, the European Chamber supports European SMEs in China through the following initiatives:

- EU SME Centre: The SME Forum is pleased about the establishment of the EU SME Centre in Beijing in November 2010. As one of the consortium partners, the European Chamber and its SME Forum have played and will continue to play an integral part in its development. The EU SME Centre will provide support services for European SMEs operating or looking to do business in China. For more detailed information, please refer to the Centre’s website: www.eusmecentre.org.cn
- China IPR SME Helpdesk: The China IPR SME Helpdesk supports European SMEs to both protect and enforce their IPR in or relating to China, through the provision of free information and services. For more detailed information, please refer to the Helpdesk’s website: www.china-iprhelpdesk.eu

Both the EU SME Centre and the China IPR SME Helpdesk are located next to each other and are a five minute walk away from the European Chamber office in Beijing.

Key Recommendations

1. Provide European SMEs in China with Better Access to Financing

- Chinese regulators should remove regulatory obstacles that currently limit foreign SMEs’ access to financing in China.
- The European Union should establish a dedicated fund for European SMEs in China to support their development in China.

2. Reduce the Regulatory and Administrative Burdens of SMEs

- Simplify and streamline the regulatory and administrative processes that affect SMEs.
- Provide a comprehensive and easily accessible “one-counter-service” resource platform to provide greater transparency and support for SMEs on the key requirements set out for them by multiple government agencies.

Business Climate for SMEs in China

SMEs are the backbone of an economy and make an immense contribution to economic growth, competitiveness and employment. They are the source of many innovative technologies, products and services and the EU acknowledges the key economic and social role played by SMEs as a major growth and job creation catalyst.

In Europe, SMEs have experienced worrying trends during the slow recovery from the global economic crisis. SMEs

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have been especially affected by worsening access to credit due to stricter lending policies and their poorer financial results. As a result, companies have had to set aside long-term investment plans to face short-term cash constraints and avoid liabilities.

Due to the sluggish economy in Europe, emerging markets are being viewed as more and more attractive places to do business. This is especially the case in China today. According to the results of the European Chamber’s 2011 Business Confidence Survey (the Survey hereafter), the vast majority of European companies feel that they have benefited from China’s rapid economic recovery from the global financial crisis and are optimistic about the further growth of their sector in China. The Survey also reveals that serving the Chinese market is the number one reason for European companies operating their business in China, reinforcing the strategic importance of the Chinese market for them. A substantial sixty-five percent of respondents of the Survey represented European SMEs in China.

China remains attractive even in the face of increasing concerns over a perceived unfair regulatory environment towards foreign-invested enterprises (FIEs). European SMEs feel that Chinese regulators are making it more difficult for foreign firms to access their market and economic stimulus funding. The Survey found that a substantial forty-one percent of European SME respondents feel that government policies towards FIEs have become less fair over the past two years, and a larger forty-six percent expect this to continue over the next two years.

1. Minimum Registered Capital Requirements

Every Wholly Foreign-Owned Enterprise (WFOE) set up in China must have a stated registered capital. This amount is provided in the Articles of Association of the company and is also noted on the company register. The registered capital usually includes all of the components of the initial investment, including its start up cash, contributed property and transferred intellectual property. This registered capital provides some notice to creditors of the capital adequacy of the company.

According to Chinese Company Law, the minimum registered capital of a limited liability company is CNY 30,000 (EUR 3,311) and CNY 100,000 (EUR 11,036) for a single shareholder company. However, in practice, the actual level of minimum registered capital required depends on a number of factors, including: the company’s industry, mode of operation, and whether the company intends to obtain certain administrative licences. For instance, additional legal requirements can apply with regard to minimum registered capital e.g. if the company wants to obtain a certain administrative licence. Furthermore, approval departments for FIEs can also have higher requirements in relation to minimum registered capital that are not transparently communicated, which can pose particular difficulties for SMEs that are not familiar with them. As a result, the minimum registered capital requirements often end up being higher than the CNY 30,000 and CNY 100,000 limits stated in the Chinese Company Law.

2. Financing Restrictions

Gaining access to financing is still a major problem for European SMEs operating in China. In comparison with developed financial markets, SMEs in China only have limited instruments with which to tackle liquidity shortages. Furthermore, foreign SMEs in China do not have access to the same range of financing channels (e.g. third party financing) as their Chinese SME counterparts. The results of the 2011 Business Confidence Survey revealed that “access to financing” in China is seen as a top five comparative disadvantage of FIEs compared to domestic companies.

In the aftermath of the global financial crisis, strategic investment and maintaining adequate liquidity have increased in importance for SMEs. Chinese financial and economic stimulus funding have not been sufficient to meet the need. SMEs must increasingly diversify their sources of capital. 

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2 European Chamber Business Confidence Survey 2011, 70% of respondents feel they participated in China’s economic recovery; 79% are optimistic about future growth in their sector.

3 European Chamber Business Confidence Survey 2011, SME defined as having less than 250 employees

4 European Chamber Business Confidence Survey 2011, 39% of respondents cited “access to financing” as a key comparative disadvantage of FIEs compared to domestic companies.
investment regulations, however, make it difficult for European SMEs to reach this objective.

a) Access to Credit / Bank Loans

The SME Forum welcomes the China Banking Regulatory Commission’s (CBRC) June 2011 announcement of policies to encourage lenders to offer more loans to small-scale enterprises. According to new regulations, a lower risk weighting (25-percentage-point less) will be applied when calculating the capital-adequacy ratio for loans of less than CNY 5 million (EUR 551,792) to each individual small enterprise. Although this extra support for SMEs is encouraging and much needed, these new policies do not ease the challenges of foreign SMEs gaining access to finance in China.

In practice, even short-term bank loans for FIEs can only be obtained against guarantees from banks outside China. The potential loan, however, is then limited by the Foreign Exchange Foreign Debt Quota (or “borrowing gap”) set out by the State Administration of Foreign Exchange (SAFE), which is based on the difference between a company’s registered capital and total investment of the company. For projects with a total investment of USD 3 million or below, the borrowing gap is set to only 30% of the total investment. The guarantee counts towards the borrowing gap if the guarantee is drawn. As part of the borrowing gap will often already be used for medium and long-term bank loans, the potential of SMEs to bridge liquidity shortages by using short-term bank loans is further reduced.

b) Shareholder Loans

Shareholder loans from the parent company typically granted in foreign exchange also fall under the previous Foreign Exchange Foreign Debt Quota and therefore often cannot be used by a foreign parent company to support its Chinese subsidiary.

In light of these financial restrictions, the SME Forum requests the relevant Chinese regulators to remove the regulatory obstacles that limit foreign SMEs’ access to financing in China, such as the limitations of the Foreign Exchange Foreign Debt Quota and the strict requirement for foreign guarantees for short-term loans. Furthermore, the Forum recommends Chinese regulators to take action to encourage financial institutions to open their services to SMEs (both domestic and foreign) and provide them with the financing needed to allow them to continue competing and contributing to the development of the Chinese economy.

It is encouraging to hear that the European Investment Bank’s objective of providing European SMEs with EUR 30 billion of loan support in the period of 2008 to 2011 was achieved by the end of 2010 (one year early). The SME Forum hopes that European SMEs will continue to have access to such financial support going forward and specifically recommends the EU to establish a dedicated fund to support European SMEs taking the risk to expand into China, leveraging their know-how, technology and brand to target an increasingly important but unpredictable market. Such financial support from the EU would complement well the EU’s other initiatives for supporting European SMEs in China, such as the newly opened EU SME Centre in Beijing.

3. New Challenges for Representative Offices

During 2010, Chinese regulators released a number of new rules for Representative Offices in China that have substantially increased the administrative and regulatory duties of foreign SMEs taking this legal structure in China. On 4th January 2010, China’s State Administration for Industry and Commerce (SAIC) and the Ministry of Public Security (MPS) jointly issued restrictive measures on representative offices of foreign companies, in which:

- A new limit was set on the number of Representatives to four (including the Chief Representative), forcing companies with large Representative Offices to set up companies (Joint Ventures and WFOEs).
- The validity of the Registration Certificate issued by the local Administration for Industry and Commerce (AIC) was reduced to one year (previously this ranged from three to ten years).
- The Foreign Company initiating the opening of a Representative Office needs to certify that it has been operating for at least two years, preventing newly formed foreign companies to enter the Chinese market through a Representative Office.

On 11th March 2010, the State Administration of Taxation (SAT) issued “Interim Implementing Measures Regarding Tax Management on Permanent Representative Offices”
of Foreign Enterprises”, which stipulates an increase in estimated profit from 10% to 15% for representative offices paying taxes on expenditures. This increases the amount of tax payable for such Representative Offices as the calculation formula is:

\[
\text{Calculation formula} = \frac{\text{expenditures}}{1 - \text{estimated profit rate} - \text{business tax rate}}
\]

Released on 10th November 2010 and effective on 1st March 2011, the State Council issued the “Administrative Regulations on the Registration of Permanent Representative Offices of Foreign Enterprises”, which set out new requirements with respect to the registration and operation of representative offices: the local AIC requires the annual inspection of Representative Offices and the submission of an annual report that must include information on the continued existence of the representative office’s head office, the representative office’s business operations and audited accounts.

As SMEs have less human resources to deal with such matters, this poses a further burden on the operation of SMEs compared with larger companies.

4. Regulatory Transparency and Access to Information

The relatively fragmented and opaque 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 especially a burden for SMEs who often do not have the resources and expertise to effectively deal with such processes.

The growing complexity of tax and accounting regulations has resulted in a complicated bureaucracy that requires an excessive number of reports to be submitted to about a dozen government agencies, covering tax declarations and many other reports. Very often the company is not adequately informed by the agencies of all the required reports (monthly and yearly), but is nevertheless required to provide detailed information.

In a similar vein, certain products have to be certified and examined by different government agencies to gain access to the Chinese market. The responsibilities of such agencies and related certification requirements sometimes greatly overlap, which causes confusion of requirements, duplication of costs and effort, and delayed access to market for the companies’ products. SMEs find this especially burdensome as they have to allocate their already limited resources to maintain large sets of documents to prove compliance with all relevant regulators. For more details on certification and standardisation issues of products, please see the Standards & Conformity Assessment section of this Position Paper.

These issues are intensified by the continuously evolving nature of the Chinese regulatory system where new regulations and amendments to existing ones are implemented regularly and often without an adequate level of transparency. Keeping track and adjusting to these frequent changes is therefore a considerable challenge for SMEs.

The SME Forum recommends the Chinese government to reduce the regulatory and administrative burdens of SMEs by simplifying and streamlining the regulatory processes that affect them. The Forum specifically requests the establishment of a comprehensive and easily accessible “one-counter-service” resource platform to provide foreign SMEs with transparency and support on the key requirements set out for them by multiple government agencies. This would greatly help SMEs to increase their efficiency and focus on their core business.

5. Increasing Tax Burdens

The unification of China’s tax system for FIEs, foreign enterprises and domestic enterprises has gone a step further since the harmonisation of the enterprise income tax in 2008 to 25%. As of 1st December 2010, foreign enterprises and FIEs have to pay the city construction tax and education surcharge for which they were previously exempted. Such tax exemptions for FIEs and foreign enterprises have often been considered by them as a welcome compromise for being limited in certain areas in China, such as in accessing finance and equity structure requirements in certain sectors. Whilst this recent removal of tax exemptions aims to put foreign enterprises and FIEs on an equal footing with domestic enterprises in tax terms, several of the other limitations on foreign enterprises and FIEs remain unchanged e.g. access to financing. The SME Forum calls for the Chinese government to provide foreign enterprises and FIEs with the same treatment across the board as their domestic counterparts, as with tax, to allow
all companies in China to compete on a level playing field. This recent requirement to pay the city construction tax and education surcharge has increased the cost of European SMEs operating in China. The city construction tax and education surcharge are two types of surtaxes, levied on taxpayers who pay value-added tax (VAT), consumption tax and business tax. Specifically, each surtax is calculated as a percentage of the actual amount of VAT, consumption tax and business tax paid by the taxpayers. The rate for the education surcharge is 3%. The rates for city construction tax differ according to location:

- 7% in city areas
- 5% in county and township areas
- 1% in other areas

6. Intellectual Property Rights (IPR) Infringement

As trade between Europe and China continues to flourish, the importance of IPR and its impact on the competitiveness of European SMEs in a global market continues to grow. European SMEs need assurance that their IPR is adequately protected on introducing their technologies, products and brands into the Chinese market. The SME Forum strongly encourages the Chinese government to continue its efforts to improve the enforcement of the existing IPR laws and regulations to tackle the persistent problem of IPR infringement in China. For more detailed information on this issue of IPR, please view the Intellectual Property Rights section of this Position Paper.

7. Standards

The proliferation of local standards and certifications in China that are not harmonised with international equivalents or norms represent another barrier for European SMEs willing to enter the Chinese market. The lack of reliable English translations of Chinese standards, as well as difficulties in accessing information on Chinese industry-specific standards creates additional challenges in this area. For more detailed information on the issue of standards, please view the Standards & Conformity Assessment section of this Position Paper.

8. Labour and Human Resources (HR)

One of the major concerns for SMEs regarding labour is that it is more and more difficult to recruit qualified people, especially now that the 2008 Labour Law reduces flexibility in HR management. In addition, some WFOEs or representative offices need to employ foreign staff with specific experience but who do not necessarily have a college or university degree. At present the law refuses to issue work visas to people without a higher degree. For more detailed information on issues related to HR and labour, please view the Human Resources section of this Position Paper.

Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>AIC</td>
<td>Local Administration of Industry and Commerce</td>
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<tr>
<td>CBRC</td>
<td>Chinese Banking Regulatory Commission</td>
</tr>
<tr>
<td>FIE</td>
<td>Foreign-Invested Enterprise</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>HR</td>
<td>Human Resources</td>
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<tr>
<td>IPR</td>
<td>Intellectual Property Rights</td>
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<tr>
<td>MPS</td>
<td>Ministry of Public Security</td>
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<tr>
<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
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<tr>
<td>SAIC</td>
<td>State Administration for Industry and Commerce</td>
</tr>
<tr>
<td>SAT</td>
<td>State Administration of Taxation</td>
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<tr>
<td>SME</td>
<td>Small and Medium-sized Enterprise</td>
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<tr>
<td>VAT</td>
<td>Value Added Tax</td>
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<td>WFOE</td>
<td>Wholly Foreign-Owned Enterprises</td>
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</table>
Introduction to the Forum

Sourcing Forum was established in Nanjing in 2006 and is comprised of purchasing professionals from companies in the manufacturing sector. It addresses the interests of approximately 60 European enterprises sourcing a range of materials in China, including equipment and tools, production materials, consumables and office materials.

The Sourcing Forum is an event-driven platform that regularly invites expert speakers to make presentations, all the while providing opportunities for roundtable discussions. The aim of the Forum is to facilitate the exchange of information, experience, and best practices among member companies. The forum generally addresses issues related to availability, price trends and quality of materials, as well as challenges and solutions for sustainable supplier relations.

Since its establishment, the Sourcing Forum has covered a wide range of topics including supplier development, project planning for purchasing operations, supplier negotiations, purchasing logistics and supply chain management. From May 2009, the Sourcing Forum has become active in the Pearl River Delta chapter of the European Chamber, where purchasing professionals from approximately 25 companies can exchange their experiences related to sourcing issues.

Recent Developments and Challenges

Central to China’s appeal as a location for European manufacturing companies is its competitive advantage in terms of global sourcing for goods. The Chinese supplier market continues to improve in quantity and quality. The range of available products and parts has widened, e.g. more and more quality industrial components can today be found in the country. While sourcing opportunities for foreign companies are increasing, risks and challenges remain:

- The pressure from factor costs is increasing. Copper, steel, plastic, rubber and even cotton prices are at historically high levels. Energy is becoming more expensive, and according to Chinese central government policy, the 12th Five-Year Plan is considering a better balance between rich and poor, and a boost of domestic consumption. Consequently we will see significant increases of labour costs. The increase in 2011 reached already nearly 20% compared to 2010 level.
- Exchange rate fluctuations in 2010 were less severe than in previous years. Yet, the Chinese renminbi yuan (RMB) has appreciated and its value is likely to further increase. For European companies sourcing in China for export, a stronger RMB in most cases means increased costs and reduced profit margins.
- The impact on the supplier base by the global economic crisis has been mainly felt in the low-cost consumer goods sector where thousands of Chinese companies have closed down their operations. European companies sourcing industrial goods have been less affected, as their supplier base remained largely stable.
- Trade friction between the EU and China continues, and bilateral anti-dumping duties on imports of carbon steel fasteners to the EU will remain in place. As completely compatible substitutions are not available in the local Chinese market, European companies have no option but to keep importing them, for significantly higher costs due to the imposed duties.
- A remaining policy challenge is the non-synchronized development of quality standards and specifications between China and other countries.
- Although improvements have been made, the lack of protection of intellectual property rights (IPR) still has a negative effect on the sourcing sector, as European companies decide against localisation of certain products due to fears of IPR infringement. The issue is particularly relevant for Small and Medium-sized Enterprises (SME). Signing non-disclosure agreements with all suppliers and importing critical components from abroad has provided only a temporary solution at best. European companies are looking for more support from the Chinese government on this matter.

Outlook

The economic environment will bring new challenges to the Chinese supplier market. As growth rates are declining, the higher cost levels cannot be compensated by the suppliers, and price increases in the downstream
supply chain are also limited. Labour-intensive processes are no longer competitive, and several suppliers see the solution in a higher level of automation.

On the supplier side, some company leaders have recognised that they need to develop new skills, like reverse engineering, process design or development and implementation of intelligent logistic concepts to identify and realise latent savings potentials.

As for sourcing, professionals need to challenge their suppliers, and demand the necessary transformation into a mature parts supplier. Their focus need to change from quantity to quality, and besides their expertise in manufacturing, they further need to develop competencies in the areas of RD, process automatization, logistics and management. Within the next three to five years, this will be crucial, to maintain competitive cost levels and a stable supply base.

This opens the door for international suppliers to settle in China because they already have developed the necessary competencies since many years.

The future scenario for a suitable supply base might be a healthy mix of mature Chinese suppliers and international suppliers.
Key Recommendations

1. Streamline the China Compulsory Certification (CCC) Process
   - Publish and enforce national consolidated regulations on operations, rights and duties of testing laboratories in China.
   - Allow commercially independent testing houses to engage in testing under CCC and allow foreign testing institutes to conduct initial factory inspections for CCC abroad.
   - Abolish duplicative testing/certification requirements and disassociate the CCC certification process from other certifications so that the CCC certification process is not dependent on certifications from other governmental agencies.
   - Continue efforts to simplify the CCC process:
     - Speed up the modifying process of CCC implementation rules for other products according to the requirement of the new version of “Regulations for Compulsory Product Certification” (CCC regulations).
     - Eliminate the testing of items irrelevant to the CCC purpose (items not in the scope of human and animal health and safety, environmental protection, and public safety).

2. Provide Equal and Fair Access to Standardisation in China
   - Allow all companies legally registered in China the opportunity for equal participation as members in all relevant technical committees (TC) and working groups (WG) for national and industry standards developed by the Ministry of Industry and Information Technology (MIIT), Ministry of Housing and Urban Rural Development (MOHURD), State Food and Drug Association (SFDA), China National Institute of Standardisation (CNIS) and other similar organisations.

3. Increase Transparency of Standardisation in China
   - Encourage all standards committees, WGs and TCs to develop written operating policies (including membership, fee structure, IPR policies, review process and complaint process), making them available to all members and applying them in day-to-day operations.
   - Promote information sharing through the websites of TCs, not only for the public but also among TC members.
   - Establish clear rules and procedures for the WTO/TBT notification of mandatory industry standards and standards to be included in mandatory certification schemes.
   - Abolish mandatory standards or at least limit them to only the most critical domains where the market cannot work effectively or quickly.
   - Avoid multiple or overlapping TCs formulating standards that are or might become mandatory.
   - Apply reasonable implementation and transition periods for mandatory standards and clarify the need for reasonable implementation periods in the regulations governing mandatory standards.

4. Encourage Chinese Standardisation Efforts in the Global Standards System
   - Harmonise Chinese standards (including national, industry and provincial standards) with international and global standards to foster international trade and increase domestic competitiveness.
   - Continue to implement updates of international standards in a timely manner and avoid incomplete adoption, adoption with slight alterations or premature or delayed adoption of updates of international standards.
   - Encourage more Chinese standardisation experts to join international standardisation working groups to improve China’s involvement in international standardisation efforts.
Standards and Conformity Assessment Working Group

Section Two: Horizontal Issues

5. Ensure Fair and Transparent Market Surveillance
   - Publish up-to-date information on the responsibilities and enforcement guidelines of the relevant market surveillance agencies.
   - Streamline the number of agencies/stakeholders involved in market surveillance in China to increase transparency and efficiency in this area.
   - Ensure consistent and non-discriminatory treatment regarding the frequency of in-market inspections.
   - Focus market surveillance on high risk products that have caused problems in the market in the past.

   - Adopt rules within standards development organisations (SDO) to increase visibility of licensing terms.
   - Adopt rules within SDOs that require participants to identify patents that they refuse to license.
   - Clarify that a participant’s commitment to license essential patents under an SDO’s IPR Policy implies the obligation to surrender the right to enjoin or prevent an implementer from the continued use of a standard essential patent.

Introduction to the Working Group

The Standards and Conformity Assessment Working Group was founded in 2008 and is open to all European Chamber members who engage in the manufacturing, import and export of goods to and from China. The Working Group is composed of standardisation and conformity assessment experts from sectors such as automotive, auto components, construction, cosmetics, healthcare equipment, electrical equipment, information and communication technology (ICT) equipment, and machinery.

The European Chamber’s 2011 Business Confidence Survey revealed that nearly 40% of respondents felt that the lack of harmonisation of Chinese standards with international standards is a significant obstacle to doing business in China.

The Working Group aims to support the development of China’s standardisation and conformity assessment systems in order to facilitate China’s integration into the world economy.

The Working Group identifies standards and conformity assessment issues of concern to European companies and proposes constructive recommendations that address those concerns. The recommendations set forth in this Position Paper are meant as a facilitator to meaningful and constructive dialogue with the relevant Chinese authorities.

Recent Developments

Over the past year, the final year of China’s 11th Five Year Plan period, Chinese government agencies responsible for standardisation and conformity assessment released the following important regulations. The impact of these will be discussed, among other issues, in the following pages:

In the area of standardisation, 2010/2011 saw the following developments:

- The Working Group is pleased to note the efforts of standards development organisations (SDO) in (1) promoting the structuring and systematisation of Chinese domestic standards (2) actively participating in international standardisation activities (3) paying closer attention to the adoption of international standards.
- The Working Group is encouraged by the key task presented at the 2011 National Standardisation Conference encouraging all standardisation working groups to focus their efforts on “building the legal and institutional framework for standardisation and strengthening constitutional, scientific and risk management in standardisation work”.
- The Working Group has always placed great importance on the revision process of the “China Standardisation Law” and looks forward to the prompt release of the revised law that takes into consideration both international standardisation rules and China’s national conditions.
Key Recommendations

1. Streamline the China Compulsory Certification (CCC) Process

Concern
- CCC implementation is still overly detailed in terms of product unit sorting, key component classification and testing requirements.
- The existence of double and triple certification in certain sectors adds substantial cost and delay in bringing products to market.
- In certain sectors, CCC certification is conditional upon the approval of other, unrelated certifications by other government agencies, which adds cost and time to the entire CCC certification process.

Assessment
CCC is a mandatory market access requirement for 22 product categories (as of April 2011), including household appliances, auto components, medical equipment, information technology equipment, and electrical machinery. It was established by the Administration for Quality Supervision, Inspection and Quarantine (AQSIQ) and is administered by the Certification and Accreditation Administration of China (CNCA). As CCC certification is the necessary pre-condition for market access for so many product categories, it is especially important that the CCC process is efficient and systematic. It is in this context that European industry has raised the following concerns, which are generally shared by domestic counterparts.

a) Little Improvement in the CCC Certification Process During 2010

The July 2009 revision of “Regulations for Compulsory Product Certification” (CCC regulations) came into effect on 1st September 2009 and aimed to simplify the CCC process. However, as of April 2011, new implementation guidelines to simplify the CCC process had only been published in the categories of household appliances, toy products, information technology equipment, and audio and video equipment. Other category products still have substantial, repetitive and unnecessary inspections, which are a waste of time and money.

The classification principles underpinning ‘product units’ and ‘key components’ for CCC certification is still unclear, and the increasing number of key component and mandatory testing items required in CCC certification has
left industry perplexed as to the guiding principle driving key component classification.

With the vast and expanding application of CCC certification, its official purpose to protect human health and safety, animal life and health, environment and public safety, has been changed and magnified. It has resulted in substantial unnecessary costs for local and foreign companies, which will eventually be transferred to consumers.

b) Duplication of International Testing Results, Factory Audits and Management System Checks

CCC is all the more burdensome to trade because a significant portion of CCC testing duplicates testing previously done to comply with international standards. Although a growing number of Chinese standards are based on international standards (ISO, IEC, ITU, UN/ECE), CCC testing is nonetheless required for products using these standards, even when a product has been certified for the original international standard on which a Chinese standard is based. Additionally, the China Quality Certification Centre (CQC), the main body for CCC certification, very rarely authorises foreign institutes to conduct plant/factory inspections under the CCC scheme. Mandating the use of Chinese institutes and the payment of travel costs add further costs and time to the certification process. Such additional requirements often prove prohibitive to smaller businesses, or for small product series and spare parts.

The duplicative testing process wastes company time and resources, which ultimately results in delayed product launches and increased product costs. Such practices harm not only foreign industry active in China, but also Chinese companies that aim to market their products in China and abroad. For some components, spare parts or products in short supply, the disproportionately high direct cost will deny their access to the market, which may increase the risk of smuggling and forgery.

c) Double and Triple Certification in Certain Sectors

The certification process consumes a great deal of time and resources. The “one-size-fits all” approach is the guiding principle for CCC in terms of mandatory certification schemes in China. However in practice, there are several supervision institutes in certain industries and thus several certification requirements. These might sometimes even overlap, as in the case of mobile phones. Although the standards and access evaluation are identical or nearly identical, the requirement of two or more certificates still results in an extra burden on industry resources and delayed time to market. In a similar vein, for certain sectors, unrelated certifications from different supervision institutions are a pre-requisite to the final CCC certification. This is the case in the telecommunications sector where CCC certification is conditional on the approval of the Network Access Licence (NAL) by the Ministry of Industry and Information Technology (MIIT). The need to wait on this MIIT approval often results in the approval of the CCC certification being delayed. In the end, the consumer suffers from higher product prices and delayed access to new products.

Recommendation

- Publish and enforce national consolidated regulations on operations, rights and duties of testing laboratories in China.
- Allow commercially independent testing houses to engage in testing under CCC and allow foreign testing institutes to conduct initial factory inspections for CCC abroad.
- Abolish duplicative testing / certification requirements and disassociate the CCC certification process from other certifications so that the CCC certification process is not dependent on certifications from other governmental agencies.
- Continue efforts to simplify the CCC process:
  - Speed up the modifying process of CCC implementation rules for other products according to the requirement of the new version of “Regulations for Compulsory Product Certification” (CCC regulations).
  - Eliminate the testing of items irrelevant to the CCC purpose (items not in the scope of human and animal health and safety, environmental protection, and public safety).

2. Provide Equal and Fair Access to Standardisation in China

Concern

SDOs developing national, industry and provincial standards routinely discriminate against foreign-invested enterprises (FiEs), their subsidiaries and joint-ventures by restricting access and participation in the standardisation process.

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2 See ICT section of this Position Paper for more detailed discussion on this.
Assessment
The Working Group is pleased to note that in recent years, wholly foreign-owned enterprises (WFOE) or foreign-invested joint ventures have been allowed to participate in many standardisation activities led by Chinese SDOs, including preliminary research for and drafting of national standards, industry standards and some mandatory standards. In certain fields, foreign enterprises’ access to standard-relevant activities has been profoundly enhanced. For example, Chinese standardisation and regulation-relevant activities in such fields as environmental protection and energy-saving have greatly benefited and have been accelerated by allowing full participation of FIEs, thereby integrating international best practices and positioning China as a global leader in these areas. Openness and transparency in standardisation activities towards FIEs and private enterprises as a whole also help to improve the participation and adoption rate of new standards. These approaches should be encouraged.

However, even in SDOs that allow participation of FIEs, representation of private enterprises and FIEs is still constrained. Some of the technical committees (TC) closed to FIEs are establishing standards that go on to underpin mandatory certification schemes such as CCC. Insufficient participation from FIEs will hinder the effective implementation of the certification as well as create barriers to trade. For example, FIEs and subsidiary joint ventures are denied participation or even observer status in standardisation activities (for both national standards and industry standards) in the areas of product safety, information security and internet security. Such a lack of information is directly translated as extra costs, difficulties in standard conformity and possibly reduced customer choice and satisfaction. Furthermore, this lack of access inevitably hampers the standards’ up-take at the international level due to their lack of transparency during formulation and revision.

Recommendation
- Allow all companies legally registered in China the opportunity for equal participation as members in all relevant TCs and working groups (WG) for national and industry standards developed by MIIT, the Ministry of Housing and Urban Rural Development (MOHURD), State Food and Drug Association (SFDA), China National Institute of Standardisation (CNIS) and other similar organisations.

3. Increase Transparency of Standardisation in China

Concern
- Lack of transparency in the Chinese standardisation process, with the development of industry standards being especially problematic.
- Multiple and often competing SDOs generating mandatory standards that restrict business and innovation.
- New standards often have very short transition periods, and this unpredictability imposes heavy financial costs on industry.

Assessment
An important element of creating successful markets is allowing free and fair access to information on standards for all industry players.

a) Opaque Standardisation Practices

The Working Group recognises that national standards projects are posted on the Standardisation Administration of China’s (SAC) website, and encourages industry and local standardisation projects to follow this positive practice. Not all TCs currently have websites easily accessible to the public with timely updated information. Even TC members sometimes find it difficult to see their comments reflected and taken into account during the standards drafting and commenting process. Furthermore, it is quite common for government organisations or TC secretariats and TC Chairs to approve standards despite a clear lack of consensus among TC members. Such practices limit the prospect of standard application due to limited stakeholder input. At the same time this lack of transparency fosters unpredictability.

b) Mandatory Standards

A major industry concern with the Chinese standardisation system is its reliance on so called “mandatory” standards. There are currently over 3000 Chinese national standards declared mandatory, which is equivalent to approximately 14% of the total number of national standards. European industry in China understands that such mandatory standards are intended to protect the Chinese population from harm. However, industry experience shows that mandatory standards create major obstacles to technical innovation, and they become especially harmful if built on outdated technologies or are developed in isolation of the global market’s demands.
Sixty two entities have the power to draft Industry standards in China. Most of the standards developed by these bodies have the potential to become national and/or mandatory. The potential for voluntary industry standards becoming mandatory, combined with the profusion of standard setting sources, makes China’s reliance on mandatory standards all the more challenging for industry.

The following points further highlight the challenges involved with China’s reliance on mandatory standards and the practice of adopting certain voluntary standards as mandatory:

- Mandatory standards are *de facto* technical regulations, which circumvent the legislative process and therefore provide less opportunity for input from key stakeholders.
- Chinese mandatory standards often address general performance related issues, rather than restricting themselves to major safety, health, or environmental concerns. A recent example is the standard for domestic gas cooking appliances (GB 16410-2007) whose official aim was “to provide the Chinese market with products that meet the demands of the food culture of the Chinese people.”

Industry believes that it is of the utmost importance that certification schemes are based on international standards, or in the absence of such standards, on globally recognised standards.

c) Use of Voluntary Standards in Mandatory Certification Schemes

The practice whereby voluntary industry standards are made mandatory through compulsory regulatory approval is a matter of serious concern. When promulgating mandatory standards, internationally-recognised due process includes timely notification under the World Trade Organisation’s (WTO) Technical Barriers to Trade (TBT) Agreement, transparent implementation rules and sensible transition periods. There is ample evidence that such due process does not always apply for industry standards used in Chinese compulsory regulatory approval schemes.

The Working Group recognises the SAC’s diligence in notifying mandatory standards to the WTO/TBT committee, but calls upon the other ministries overseeing standard setting bodies – MIIT in particular - to signal new standards which will be included into mandatory type approval schemes to SAC for WTO/TBT notification.

d) Short Transition Periods for Standards

Unfortunately, extremely short transition periods are also imposed on domestic and foreign industry once standards are announced. In some cases the standards apply to all the products on the market, not only the ones produced after the implementation date. Such sudden implementation of standards is extremely costly to businesses and pose a serious problem for both Chinese and foreign companies.

**Recommendation**

- Encourage all standards committees, WGs and TCs to develop written operating policies (including membership, fee structure, IPR policies, review process and complaint process), making them available to all members and applying them in day-to-day operations.
- Promote information sharing through the websites of TCs, not only for the public but also among TC members.
- Establish clear rules and procedures for the WTO/TBT notification of mandatory industry standards and standards to be included in mandatory certification schemes.
- Abolish mandatory standards or at least limit them to only the most critical domains where the market cannot work effectively or quickly.
- Avoid multiple or overlapping TCs formulating standards that are or might become mandatory.
- Apply reasonable implementation and transition periods for mandatory standards and clarify the need for reasonable implementation periods in the regulations governing mandatory standards.

4. **Encourage Chinese Standardisation Efforts in the Global Standards System**

**Concern**

- The following practices create obstacles to trade and make it more difficult for Chinese products to enter the global market:
  - Divergence of Chinese standards from international standards.
  - Incomplete adoption, adoption with slight alterations, premature or delayed adoption of updates of international standards.
  - Numerous industry standards and some provincial standards lack compatibility and harmonisation with
Absence of Chinese standards in certain areas as there is no process to temporarily use international standards.

- Deviation from global standards to encourage "indigenous innovation" isolates Chinese companies’ Research and Development (R&D) and consumers from the benefits of global markets.
- More participation is needed from key Chinese standardisation experts in international standardisation working groups.

Assessment

The European business community in China encourages increased Chinese participation in such multilateral standardisation bodies as the International Electrotechnical Commission (IEC), International Organization for Standardization (ISO) and other UN-related organisations, such as the United Nations Economic Commission for Europe (UN/ECE) and International Telecommunication Union (ITU). Increased participation facilitates inclusive standardisation in a truly mutually-beneficial manner by ensuring the alignment of interests in the standards making process itself, which in turn enables the full adoption of standards by all relevant parties. In this way, Chinese industry players can become full-fledged members of the global business community, and more of the jointly-developed global solutions can be adopted in China, thereby creating a win-win situation for consumers and manufacturers.

Meanwhile, the greater adoption of internationally accepted standards will allow Chinese companies to compete in the vast European market and, perhaps even more significantly, give Chinese consumers access to the same products enjoyed by European and other international consumers.

a) China’s Adoption of ISO and IEC Standards Should Continue

China announced that its adoption rate for internationally accepted standards will account for 85% of all standards by 2010. In practice, however, such statistics are difficult to assess and confirm. The adoption rate of internationally established and accepted standards in China refers to the rate of adopted international standard clauses in Chinese national standards. When a national standard only partially adopts an international standard, it is not clear whether it is considered as a complete adoption of an international standard according to the official Chinese calculation methodology. Using the internationally most common calculation method, the number of national standards which are completely identical to internationally established and accepted standards differs significantly from official statistics. Some member company statistics indicate that the number of Chinese national standards that are identically adopted (IDT), equally adopted (EQV), or adopted with modification (MOD) from internationally established and accepted standards might be as low as 30%.

The Working Group encourages China to continue to identically adopt internationally established and accepted standards. If China’s IDT adoption rate reaches the officially announced target of 85% of internationally established and accepted standards, it will be a highly significant achievement for China’s standardisation efforts. Such a success would go a long ways towards enhancing China’s domestic industry’s ability to compete globally. The Working Group encourages China to continue to be involved in international standardisation and international standard adoption.

b) The Adoption of Internationally Accepted Standards in China Should be Quickened

Meanwhile, the European business community has also witnessed a growing tendency for Chinese national and industry standards to be based on the delayed adoption, incomplete adoption, or adoption with slight alterations of internationally established and accepted standards. Furthermore, the number of identically adopted current internationally established and accepted standards has reduced in number. There is no clear safety or innovation rationale for this policy. Additionally, this policy substantially lowers the incentive for innovation in China by both domestic and foreign companies, as mandatory technical requirements based on these standards compel companies in China to use standards that are often five or more years old. The above-mentioned practice poses serious issues in terms of market access because it often forces manufacturers to make minor yet expensive alterations to conform to unique Chinese standards, and raises concern with regard to the fulfillment of all WTO/TBT...
requirements.\(^5\)

China should consider pursuing parallel voting and endorsement of international standards in a process similar to what has been laid down by the Vienna agreement between ISO and the European Committee for Standardization (CEN)\(^6\) and by the Dresden agreement between IEC and the European Committee for Electrotechnical Standardization (CENELEC).\(^7\) Not only would parallel voting and endorsement avoid duplication of work, it would also allow for systematic referencing and review of international-based standards for the sake of China’s sustained industrial competitiveness.

c) Absence of Standards or Delayed Implementation of Standards Restricts Market Access for Certain Products in China

Standards are immediately linked with type approval in China. For example, the CCC mark is a mandatory certification scheme and covered products cannot enter the Chinese market without it. If China, for any reason, lacks standards for a particular product or range of products, or if the local standards are different than globally accepted standards, market access is restricted and end users suffer from lack of access to globally available products and solutions.

Case Study: Delayed Implementation of Standards Creating Non-Tariff Barriers

In most major markets, the 3\(^{rd}\) edition of the IEC Electromedical Safety and Quality standard (IEC 60601-1) has been adopted, whereas China has yet to announce or make a strong move towards adopting the 3\(^{rd}\) edition (IEC 60601-1:2005). In Europe, the transition period for adoption, during which test reports according to both the 2\(^{nd}\) edition and 3\(^{rd}\) edition can be accepted, will expire in June 2012. At this point, many products designed and manufactured according to the 3\(^{rd}\) edition will not be compliant with the 2\(^{nd}\) edition. As the 2\(^{nd}\) edition will still be mandatory in China, such medical equipment will not be able to be registered for sale in China, thus providing a market access barrier and denying China and its patients access to the latest medical technology.

d) China Deviates From Global Standards to Try to Encourage Domestic Technology

Recently, there has been a trend for China to be part of the global family in technology standardisation and this must be encouraged. European business welcomes China’s continued efforts to establish an economy based on innovation. In some areas, such as in the field of information technology, information security and telecommunications, deviation from global standards has been promoted to enhance indigenous innovation and home-grown technology. For a more detailed discussion on this and case studies, see the Information and Communication Technology (ICT) and Information Security sections of this paper.

International experience shows that this pursuit of “indigenous innovation” and home-grown technologies sometimes cannot be compatible with globally driven technologies. There is strong concern that such efforts might be counterproductive: isolating China’s international standardisation efforts, preventing economies of scale for domestic and international industry, and reducing consumer choice in China.

e) More Participation is Needed from Key Chinese Standardisation Experts in International Standardisation Working Groups

In recent years, ISO/IEC has seen more of its Working Group secretariats and Chairs coming from China. This progress demonstrates China’s intent to be more involved in international standardisation. However, greater participation in Working Groups at the Chinese standardisation expert level is still needed. Having more Chinese standardisation experts join and actively participate in the working groups will improve China’s contribution to international standardisation as the key experts are in a better position to share technical knowledge and contribute at the stage of standard drafting.

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7 See CENELEC website, last accessed July 2011: http://www.cenelec.eu/aboutcenelec/whoweare/globalpartners/iec.html
Recommendation

- Harmonise Chinese standards (including national, industry and provincial standards) with international and global standards to foster international trade and increase domestic competitiveness.
- Continue to implement updates of international standards in a timely manner and avoid incomplete adoption, adoption with slight alterations or premature or delayed adoption of updates of international standards.
- Encourage more Chinese standardisation experts to join international standardisation working groups to improve China’s involvement in international standardisation efforts.

5. Ensure Fair and Transparent Market Surveillance

Concern
The unclear mandates of overlapping market surveillance agencies create opacity and with it the risk of discriminatory practices and reduced efficiency.

Assessment
Market surveillance is a very good way to monitor and contribute to the success of market growth. Biased handling of in-market inspection, opaque procedures and unclear relationships between overlapping agencies damage end user benefits and hamper sustainable growth.

The agencies responsible for market surveillance in China are AQSIQ and the State Administration for Industry and Commerce (SAIC). The exact mandate of each agency is currently unclear. The overlap of responsibility in the area of market surveillance compounds the confusion caused by similar opacity in the areas of standardisation and conformity assessment. Further complications arise from the fact that the respective market surveillance mandates of AQSIQ and SAIC seem to vary from province to province. There is still a risk that market surveillance will become a way to cause corruption in some regions of China. This complex and opaque situation affects domestic and foreign companies producing goods for the Chinese as well as export markets.

While there is a lack of clarity with regards to market surveillance mandates at the local level, there is also a clear need to develop the capabilities, independence and impartiality of local market surveillance agencies. European industry is concerned about discrimination: the triggers and frequency for in-market inspection are often perceived as being variable and/or arbitrarily enforced. This is of particular concern, since arbitrary market surveillance increases the probability of unsafe products going undetected because bureaucratic resources are being expended to target specific companies for market driven or other purposes. European experience has shown that market surveillance can be a major tool to prevent unsafe products in the market and provides some measure of flexibility and efficiency that compulsory certification schemes lack. However, the system must be transparent and demonstrate meaningful levels of independence and impartiality otherwise it will hinder normal business practices and fail to prevent unsafe products from circulating in the market.

Case Study: Inconsistent Market Surveillance in the Lighting Products Sector

In the field of lighting products, China identicaly adopts IEC safety and EMC standards as China National Mandatory Standards to protect human health and safety of consumers. To reinforce the implementation of these mandatory standards, the Chinese government stipulates that some of the products, e.g. most types of the ballasts and some types of luminaries, are in the scope of CCC (China Compulsory Certification).

However, products that do not comply with applicable safety and EMC standards are commonly sold on the market. Many of the leading domestic manufacturers have such products on the market that fail to comply with the following:


Some of these products even bear CCC marks, even though they are not within the scope of CCC.

Since the necessary safety and EMC functions are missing, such non-complying products enjoy price advantages ranging from 10% to 50%. Non-compliance to the above standards means that these products pose a serious risk to consumers. Such non-complying
products are more often found outside Tier 1 cities. Consistent market surveillance for all products on the market – not just focusing on FIEs’ products - would reduce the risk to consumers by removing non-compliant and fraudulent products from the market.

Recommendation

- Publish up-to-date information on the responsibilities and enforcement guidelines of the relevant market surveillance agencies.
- Streamline the number of agencies/stakeholders involved in market surveillance in China to increase transparency and efficiency in this area.
- Ensure consistent and non-discriminatory treatment regarding the frequency of in-market inspections.
- Focus market surveillance on high risk products that have caused problems in the market in the past.


Concern

The landscape for standards development and intellectual property is changing and continues to evolve internationally. Historically, some degree of international consensus existed as to the meaning of FRAND (fair, reasonable and non-discriminatory), the obligation describing licensing terms associated with standard essential patents. However, recently, that consensus has been weakened for a number of reasons, including the emergence of an increasingly liquid market for patents through the acquisition of essential patents by non-practicing entities (NPEs), companies that typically acquire patents solely to assert them and obtain higher royalties than they would have obtained in a balanced ecosystem.

Therefore, what constitutes a fair, reasonable, and non-discriminatory licensing term is changing and the visibility into such licensing terms is diminishing as well. In some instances, this attack on FRAND has brought into question FRAND’s ability to constrain the hold-up value (i.e. the value if the patent holder prevents an implementer from using the essential patent) that standard essential patents can attain, thereby potentially increasing the overall royalty rate and costs associated with implementing the product. As such, the balance among various stakeholders (intellectual property right holders, technical contributors, standards implementers, the public at large, and the government) is shifting, with the public at large and the government potentially at greatest risk of absorbing the costs associated with the changing definition and licensing terms.

Assessment

Standards, intellectual property rights (IPR), and the role of government continue to be evolving issues internationally. With China’s focus on developing its standardisation system, as expressed in China’s 12th Five Year Plan, the interplay between standards and intellectual property becomes increasingly important. It is important for China to take note of some of the activities and issues being addressed internationally in this field. As more standards essential patents are developed and recognised within China, the issues discussed below will eventually manifest and become more important in China.

For example, on 14th December 2010, the European Commission published its revised rules for the assessment of cooperation agreements between competitors, commonly known as horizontal co-operation agreements (the “Guidelines” hereafter). The Guidelines emphasise the pro-competitive effects to standards setting and encourages increased transparency in disclosures and ex ante licensing terms in the standards setting process. However, the Guidelines also recognise that there are risks to SDOs, including the risk of patent hold-up when IPR rules for the SDO are weak, especially in light of the opportunistic behaviour by standards-setting participants and purchasers of essential patents.

Many of the ICT industry’s key players have in parallel been discussing FRAND and its implications in the practical aspects of standardisation work through the essential industry platform offered by the European Telecommunications Standards Institute (ETSI). ETSI provides an IPR Database, which allows public access to information on IPR that have been notified to ETSI as being essential, or potentially essential, to ETSI Standards and Technical Specifications.

The implications of these developments for the standards development system are profound and inter-related: the ICT “patent thicket” (proliferation of IPR in industries like telecommunications, computing, and semiconductors)
means that the implementation of even a single standard may require licences to dozens or hundreds of patents owned by numerous licensors e.g. smart-phones or notebook computers. A recent article estimates that a notebook computer implements no fewer than 251 interoperability standards.9 Furthermore, the rise of NPEs, as active purchasers and asserters of patents means that the ownership of patents essential to implement particular standards may become even more dispersed, and that a significant number of patents essential to implement standards will be owned by entities that are motivated solely by the desire to monetise patents they have acquired. The unpredictability, in many cases, of the above implications could lead to the future imbalance among stakeholders, with consumers and government stakeholders at greatest risk as they are the ones required to absorb the costs associated with the lack of predictability.

Recommendation

- Adopt rules within SDOs to increase visibility of licensing terms.
- Adopt rules within SDOs that require participants to identify patents that they refuse to license.
- Clarify that a participant’s commitment to license essential patents under an SDO’s IPR Policy implies the obligation to surrender the right to enjoin or prevent an implementer from the continued use of a standard essential patent.10

Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Definition</th>
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<tbody>
<tr>
<td>AQSIC</td>
<td>General Administration of Quality Supervision, Inspection, and Quarantine</td>
</tr>
<tr>
<td>CCC</td>
<td>China Compulsory Certification</td>
</tr>
<tr>
<td>CEN</td>
<td>European Committee for Standardization</td>
</tr>
<tr>
<td>CENELEC</td>
<td>European Committee for Electrotechnical Standardization</td>
</tr>
<tr>
<td>CNCA</td>
<td>Certification and Accreditation Administration of People’s of Republic of China</td>
</tr>
<tr>
<td>CNIS</td>
<td>China National Institute of Standardisation</td>
</tr>
<tr>
<td>CQC</td>
<td>China Quality Certification Centre</td>
</tr>
<tr>
<td>EQV</td>
<td>Equally Adopted (in relation to international standard adoption)</td>
</tr>
<tr>
<td>ETSI</td>
<td>European Telecommunications Standards Institute</td>
</tr>
<tr>
<td>FIE</td>
<td>Foreign-invested Enterprise</td>
</tr>
<tr>
<td>FRAND</td>
<td>Fair, Reasonable and Non-Discriminatory (obligation describing licensing terms associated with standard essential patents)</td>
</tr>
<tr>
<td>ICT</td>
<td>Information and Communication Technology</td>
</tr>
<tr>
<td>IDT</td>
<td>Identically Adopted (in relation to international standard adoption)</td>
</tr>
<tr>
<td>IEC</td>
<td>International Electrotechnical Commission</td>
</tr>
<tr>
<td>ISO</td>
<td>International Organisation for Standardisation</td>
</tr>
<tr>
<td>ITU</td>
<td>International Telecommunications Union</td>
</tr>
<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
</tr>
<tr>
<td>MOD</td>
<td>Adopted with Modification (in relation to international standard adoption)</td>
</tr>
<tr>
<td>MOHURD</td>
<td>Ministry of Housing and Urban Rural Development</td>
</tr>
<tr>
<td>NAL</td>
<td>Network Access Licence</td>
</tr>
<tr>
<td>NPE</td>
<td>Non-Practicing Entity</td>
</tr>
<tr>
<td>SAC</td>
<td>Standardisation Administration of China</td>
</tr>
<tr>
<td>SDO</td>
<td>Standard Development Organisation</td>
</tr>
<tr>
<td>SAIC</td>
<td>State Administration for Industry and Commerce</td>
</tr>
<tr>
<td>SFDA</td>
<td>State Food and Drug Administration</td>
</tr>
<tr>
<td>TBT</td>
<td>Agreement on Technical Barriers to Trade (WTO)</td>
</tr>
<tr>
<td>TC</td>
<td>Technical Committee</td>
</tr>
<tr>
<td>UN/ECE</td>
<td>United Nations Economic Commission for Europe</td>
</tr>
<tr>
<td>WG</td>
<td>Working Group</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organisation</td>
</tr>
</tbody>
</table>


10 This obligation to surrender exists (1) if an implementer of the standard has a bona fide intention to take a licence under FRAND terms and (2) at least until an objective third party, such as a court or arbitrator, has determined that the patent owner has offered to license on reasonable terms. The prohibition should not however extend to the defensive assertion of an essential patent in response to the actual or threatened assertion of a patent claimed as reading on the same product range.
Section Three: Trade in Goods
Trade in Goods in China in 2011

Trade relations between the European Union (EU) and China have grown significantly since China’s accession to the World Trade Organisation (WTO) in 2001. In 2010, trade in goods between the EU and China rose from €67bn in 2001 to €344bn (see Graph 1 below). In 2010, the EU became the number one trading partner of China and China became the EU’s number two trading partner (see Table 1 below). The top three goods China exports to the EU are electrical, machinery and clothing items, while the EU’s top three exports to China are automobile, mechanical and electrical products.¹

Graph 1: EU’s Import/Export to China in Trade in Goods from 2001 to 2010

In addition, from the vantage point of investment, EU firms have been one of the biggest contributors to various industries in China, ranging from Automotive to Cosmetics, and from Energy, to Pharmaceuticals. This has brought new capital, technology, employment opportunities and advanced management styles into China.

Table 1: Major Trade Partners of the EU and China in 2010

<table>
<thead>
<tr>
<th>Rank</th>
<th>The EU</th>
<th>Partners</th>
<th>Mil Euro</th>
<th>%</th>
<th>China</th>
<th>Partners</th>
<th>Mil Euro</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>United States</td>
<td>411</td>
<td>14</td>
<td>EU27</td>
<td>344</td>
<td>17</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>China</td>
<td>344</td>
<td>12</td>
<td>United States</td>
<td>291</td>
<td>13</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Russia</td>
<td>244</td>
<td>8</td>
<td>Japan</td>
<td>224</td>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Switzerland</td>
<td>189</td>
<td>6</td>
<td>Hong Kong</td>
<td>172</td>
<td>7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Norway</td>
<td>121</td>
<td>3</td>
<td>South Korea</td>
<td>156</td>
<td>7</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: IMF (DoTS)

At the same time, many European firms experience more intensely than ever before the difficulties of carrying out doing business in China. In a practical sense, this prevents China from fully realising its stated goal of becoming a strong, innovative economy. There are numerous examples of unequal treatment, as well as various regulatory concerns. These challenges consist of lack of market access for foreign companies, Research and Development (R&D) restrictions, weak protection of Intellectual Property Rights (IPR), vague laws and regulations, and lack of, or recognition of, international standardisation. These issues are elucidated in the section that follows, with examples to illustrate them. They cover the following sectors: Aerospace, Automotive, Auto-Components, Cosmetics, Energy, Healthcare, Heating, Lighting, Pharmaceutical, Smart Grid, and Rail industries.
Key Recommendations

1. Improve Customs Regulation on Repair of Aviation Components
   - Simplify processes for aviation components’ movement for repair purposes.
   - Allow exchange of aviation components on the aircraft.
   - Allow parts repair by Chinese subcontractors within bonded facilities.
   - Cancel deposit for bonded material and allow guarantee letter only.

2. Improve Customs Regulation on Storage of Aviation Parts
   - Allow parts having more than two years of non-movement to remain in public bonded warehouses for the benefit of on-time delivery and performance of Chinese airlines.
   - Provide a written position on this to ensure consistency for changing administrations and officers interpreting the regulations.
   - Allow bonded parts to move freely within bonded facilities.

3. Provide Better Protection of Intellectual Property Rights
   - Increase IPR monitoring across the aviation and aerospace industry to ensure safety.
   - Promote the growth of smaller private companies across the industry driven by technological leaps.

4. Unify Regional Aircraft Import Tax
   - Have a uniform import tax of 5.04% for aircraft of all categories.

5. Open the Lower Altitude Airspace
   - Entrust a single agency to take responsibility to avoid bureaucracy and conflict of interests between the various stakeholders.
   - Create a series of activities with the objective of training pilots, drafting and formulating industry standards, management policies and a comprehensive system that regulates operation, safety procedures as well as risk assessment and emergency administration.
   - Create a multilateral consultation body to enable European industries to share their experience with the relevant authorities and to carry out proposals and solutions.

Introduction to the Working Group

The European aerospace industry develops and manufactures a broad range of products: civil and military aircraft, aero-engines, helicopters, unmanned aerial vehicles, as well as space systems and equipment. It also comprises maintenance and service companies which carry out repairs, training or other activities linked to the different products. The Aerospace Working Group is comprised of major European companies in this field, most of which have been active in China for many years.

The European aerospace industry’s annual turnover is EUR 100 billion and directly employs more than half a million people, with almost two million indirectly, which make it one of the most dynamic aerospace markets in the world. The sector is highly innovative; research and
development (R&D) spending amounts to about 15 percent of revenues and enjoys a leading position in all fields of aerospace.

Most member companies of the Aerospace Working Group have already established multiple joint ventures with the Chinese aerospace industry, strengthening their position over the last decade, especially in the area of aircraft development and manufacturing, making China a partner in the development of most of its future aerospace programs.

Recent Developments

The country’s opening-up policy and growth in the aerospace sector has led many companies to benefit from important growth in the country. Moreover, China has provided European companies with partnerships that have helped strengthen their position in the country and internationally.

Safety in the Aerospace industry is particularly important, and members urge the government to remain vigilant as Chinese air travel continues to surge. With passenger numbers up significantly year-on-year, continued improvements in air safety are still necessary, especially for the purpose of aerospace modernization.

Civil Aviation Cooperation Programme

The EU-China Civil Aviation Cooperation Programme is fundamental in promoting the mutual understanding between Chinese and European institutions as well as Chinese and European business, and has been one of many factors contributing to the current favourable situation for the European aerospace industry in China. As Chinese air traffic is projected to grow further over the next five years, EU support will be essential to ensuring the continued healthy growth of this market. In that respect, the next phase of cooperation should place additional emphasis on sustainability, airworthiness and airspace liberalisation. The latter should also include fostering exchanges between officials so as to guarantee the compatibility of the future air traffic management systems being developed by both China and Europe.

Private Sector

The emergence of a more structured aerospace sector in China is moving the country one step further in technological prowess. While the Working Group welcomes this move as it positively contributes to building a more structured model of their cooperative initiatives with the national industry, this has resulted in high barriers of entry for small and medium-sized, privately-owned players, which had started to emerge several years ago and now have all but disappeared.

The aerospace sector benefits significantly from the role that smaller companies play in providing new ideas and technologies. These companies foster innovation both on the technological and managerial side of the sector, and are a great source of value to larger organisations.

Case Study:

The European aerospace industry has traditionally fostered innovation and development in smaller companies. In the case of one European SME in Europe, after more than 50 years of experience, they have developed into one of the key suppliers for a major aerospace manufacturer. This company has been able to play an important role in the development of aerostructure and developing the latest technology in solid rivets.

Members encourage the Chinese government to enact regulations that can again foster the emergence of these smaller players and allow foreign companies to build links with them to further strengthen the sector’s capabilities.

Safety

China still possesses one of the best safety records in air travel. However, given the rapid growth of the Chinese air travel market, the relevant government departments and airlines must remain vigilant that safety lapses do not occur. Over the last decade, the aerospace sector has seen a series of measures aimed at remedying the shortage of qualified personnel, and the Working Group recognizes these efforts. In addition, the Group recommends that efforts in the development of an independent framework for aircraft incident investigation and constant improvement of training for qualified personnel needs to be continued.

Single European Sky ATM Research (SESAR)

The SESAR (Single European Sky ATM Research) programme is one of the most ambitious research and development projects ever launched by the European Community. The programme is the technological and
operational dimension of the Single European Sky (SES) initiative to meet future capacity and air safety needs.

The mission of the SESAR Joint Undertaking is to develop a modernised air traffic management system for Europe. This future system will ensure the safety and fluidity of air transport over the next 30 years, will make flying more environmentally friendly and reduce the costs of air traffic management.

The complexity of Chinese airspace (fragmented and without national integrated flow management unit), non-flexible use of civil airspace, rigid operations and a double-digit annual increase of air traffic volume, among other factors might have influence in the operational performances and safety on the air traffic management field in China. In this context, developments in SESAR might fit into China’s need for development and optimisation of air traffic, management operations and infrastructure. Therefore, the SESAR concept needs to be promoted by SESAR Joint Undertaking to CAAC/ATMB in China, with the support of European industries.

Key Recommendations

1. Improve Customs Regulations on the Repair of Aviation Components

Concern
- Chinese Customs do not recognise the possibility to exchange aviation components on aircrafts (components with the same reference but different serial number).
- Cumbersome and time consuming customs processes, which increase turn-around time for aviation components.

Assessment
The possibility to exchange components is critical for the support of repair activities and in particular in the frame of offering maintenance flight hour services (or pay by the hour services). Chinese customs do not recognise the possibility to exchange aviation components on the aircrafts (components with same reference but different serial number).

Exchange is needed when a component cannot be repaired in a turnaround time requested by the customer, and the customer needs the component back for re-installation onto the aircraft. When such a request occurs, time is of the essence. If the suppliers are not allowed to exchange a component of the same part number for a different serial number, then the airlines will have to wait for the return after the achievable Turn-Around Time (TAT), thus causing the airlines operational needs. Reducing or relaxing controls on these exchanges will benefit the Chinese aerospace industry by allowing them to have fast access to spare parts when a repair done out of China cannot be finished in the time requested. This will improve their stock utilisation, eventually saving the cost of spare parts for the airlines.

In addition, if a repair supplier doing business in China wants to serve customers outside China, the customs process is very difficult, increasing aviation components TAT, which reduces international competitiveness of Chinese companies. Bank deposits based on a percentage of an aviation component’s list price must be deposited into the Customs’ service’s bank account in order to allow components to be imported.

Due to the escalation of these regulations, the time and difficulty involved in importing aviation components has increased; as a result, the repair business makes sense only within the Chinese mainland and for Chinese Customers only. Poor on-time delivery performance is not acceptable to customers from outside China.

Recommendation
- Simplify processes for aviation components’ movement for repair purposes.
- Allow exchange of aviation components on aircraft.
- Allow parts repair by Chinese subcontractors within bonded facilities.
- Cancel deposit for bonded material and allow guarantee letter only.

2. Improve Customs Regulations on Storage of Aviation Parts

Concern
The Provisions of the Customs of the People’s Republic of China on Bonded Warehouses and Cargos Stored Therein [GAC Order No. 105] was imposed by Customs on aviation public bonded warehouses (PBW) where aviation parts without movement for more than two years shall not be stored1 (Chapter IV, Article 24). Until now a special authorisation by Customs has allowed exception to this

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1 The aviation parts has been on the shelf for two years starting from the date it arrived in the inbound warehouse, regardless of whether it is new or used.
requirement on an annual basis. At the end of 2010, PBWs were faced with difficulties because Customs was not keen to extend such authorisations. This resulted in a blockage to the aviation parts outbound system.

This regulation would create a major supply chain blockage to the Chinese aviation industry as parts need to be stored outside China and then imported on demand.

Assessment
Many original equipment manufacturer (OEM) established PBW in order to satisfy requests from Chinese officials and customers, with the goal of having efficient support for customers. This includes the ability to deliver parts to the customer within hours, in case of an aircraft being grounded for maintenance. This process contributes to the safe operation of the aircraft fleet in China, with the quick dispatch of the right aviation part with the right certification, according to local regulations.

The issue and return of material from PBWs causes administrative non-value workload which could be greatly reduced, if the facility could be declared bonded instead of the PBW only.

In order to fulfil this commitment, OEMs store aviation parts used in the operations of Chinese aircraft fleet (average age of parts being around five years). Many aviation parts remain on the aircraft for many years before they need to be replaced. Due to service issues, aviation parts are sometimes needed within a short period of time, often the same day.

It is important to maintain, close to the customer, an inventory of aviation parts that correspond to the type of aircraft they are operating. Some OEMs have a network of PBW around the world that support each other, and where many aviation parts are stored long-term, sometimes for longer than 10 years.

There is also parts design evolution, where parts fitted on a new generation of aircraft are sometimes different than those on older aircraft. Hence it is not surprising in the aviation industry to have aviation parts without movement for two years to support customers operating a mixed fleet of aircraft (old and new aircraft).

The Customs regulation in question would create a significant problem for OEMs in their daily support efforts, not only for customers in China, but also worldwide. This may lead to the unavoidable option of taking all those aviation parts out of the China PBW and re-importing the parts when needed by customers.

This would create an unacceptable time delay, as current Customs processes for inbound shipments do not support same-day delivery. This would result in aircraft grounded for a longer time and potentially major delays in flights. Alternatively, customers would have to invest in huge amounts of spare parts that would drastically impact their costs of operations.

Recommendation
- Allow parts having more than two years of non-movement to remain in public bonded warehouses for the benefit of on time delivery and performance of Chinese airlines.
- Provide written positions on this to ensure consistency for changing administrations and officers interpreting the regulations.
- Allow bonded parts to move freely within bonded facilities.

3. Provide Better Protection of Intellectual Property Rights

Concern
The way transfer of technology is conducted and Intellectual Property Rights (IPR) protection is enforced can have a serious impact on the safety of products manufactured in China using advanced technologies if not correctly addressed.

Assessment
Transfer of technology remains a concern for companies operating in the aerospace sector. The current restrictions imposed on the industry regarding foreign ownership mandate, in most cases, partnering with local players that are among only a few vertically integrated corporations. This partnering entails to a certain degree the transfer of technology if it is to obtain official approval. This is of particular concern as it places at risk the IPR obtained by the foreign company. This know-how may be misused in Chinese made products without the technology being properly mastered. This is especially serious in the field of aerospace, where such methods can lead to safety lapses during the manufacturing process and fatal failures in crucial components can lead to casualties.

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2 Notice of the Legislative Affairs Office of the State Council on the Solicitation of Public Opinions on the ‘Catalogue of Industries for Guiding Foreign Investment (Revision Draft for Soliciting)’, Legislative Affairs Office of the State Council, April 2011, XIX, Article 14
From a technological perspective, innovation in the aerospace industry often arises from private SMEs willing to differentiate themselves from similar-sized competitors. The absence of such SMEs in China makes the innovation process in the industry dependent on much larger, vertically-integrated corporations that experience difficulties in adapting new methods to traditional ones.

**Recommendation**
- Increase IPR monitoring throughout the aviation and aerospace industry to ensure safety.
- Promote the growth of smaller private companies in the industry, driven by technological innovation.

### 4. Unify Regional Aircraft Import Tax

**Concern**
According to the relevant Chinese tax regulation, the import tax, including import duty and import value added tax (VAT), on foreign aircraft to China has different regulations depending on the aircraft’s maximum operating empty weight (MOEW). This high import tax, in the case of regional aircraft, is unfair for Chinese aircraft operators as well as foreign aircraft manufacturers, and is incompatible with the development of regional aviation in China.

**Assessment**
Initially, the import tax covering all aircraft with MOEW between 15 tons and 45 tons was fixed at 22.85%.

With the development of the Chinese economy, the aviation industry is becoming increasingly important. In order to promote the civil aviation industry, the import tax on aircraft was adjusted according to an aircraft’s MOEW.

Since 1996, for aircraft with MOEW between 25 tons and 45 tons, the import duty was reduced twice to 1%, and then in 2001 and 2004 the import VAT followed the same trend, and was reduced twice to 4%. Today, the applicable import tax on aircraft of this category is 5.04% in total.

However, for aircraft with MOEW between 15 tons and 25 tons, the import tax remains at 22.85%.

In sum, the import tax on aircraft with MOEW lower than 45 tons is as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Import Duty</th>
<th>Import VAT</th>
<th>In Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aircraft, 25 tons &lt; MOEW &lt;= 45 tons</td>
<td>1%</td>
<td>4%</td>
<td>5.04%</td>
</tr>
<tr>
<td>Aircraft, 15 tons &lt; MOEW &lt;= 25 tons</td>
<td>5%</td>
<td>17%</td>
<td>22.85%</td>
</tr>
</tbody>
</table>

With the high import tax, the acquisition cost per seat of aircraft with MOEW below 25 tons is at least 30% more than other aircrafts, and creates a big obstacle for foreign regional aircraft to enter the Chinese market.

The high import tax can be considered as a protection of the local aerospace industry, since regional aircraft made in China would be exempt of any importation tax.

**Recommendation**
- Have a uniform import tax of 5.04% for aircraft of all categories.

### 5. Open the Lower Altitude Airspace

**Concern**
Low-altitude airspace is currently almost inaccessible and its management is heavily affected by tight military control that requires a huge amount of ad-hoc procedures to be fulfilled.

**Assessment**
The Working Group welcomes recent developments in the loosening of the low-altitude airspace regulations, especially after the publication of the “Guidelines on the Administration of Low-altitude Airspace” jointly issued by State Council and Central Military Commission at the end of 2010. This enables pilot projects to be carried out in selected area of the country with the final objective of completely opening low-altitude airspace by the end of 2020. However, these steps represent a limited improvement, especially taking into account the commitment and the high level of investments already carried out by European industries in the aerospace sector in China.

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3 Guidelines for Management Reform on Low-Altitude Airspace, State Council and Central Military Commission, 14th November 2010
Recommendation

• Entrust a single agency to take responsibility to ensure normal control operation of airspace and to avoid bureaucracy and conflict of interests between the various stakeholders.
• Create a series of activities to train pilots, draft and formulate industry standards, management policies and a comprehensive system that regulates operation, safety procedures as well as risk assessment and emergency administration.
• Create a multilateral consultation body to enable European industries to share their experience with the relevant departments and to offer proposals and solutions.

Abbreviations

ATM  Air Traffic Management
CAAC  Civil Aviation Administration of China
IPR  Intellectual Property Rights
MOEW  Maximum Operating Empty Weight
OEM  Original Equipment Manufacturers
PBW  Public Bonded Warehouses
R&D  Research and Development
SME  Small and Medium-sized Enterprise
SESAR  Single European Sky Air Traffic Management Research
TAT  Turn-Around Time
VAT  Value Added Tax
Key Recommendations

1. Standards Issues
   a. Food Additives
      • Implement sufficient transitory measures of GB2760-2011 covering both imported and locally-produced food products.
      • Continue updating GB 2760 using a scientifically based approach with continuous reference to relevant international standards/codes such as FAO/WHO’s CODEX, JECFA to better incorporate new additives that are already extensively used worldwide.
      • Establish a fast track application process for food additives that offer no safety concerns, for example, those already listed in internationally recognised standards such as Codex and JECFA.
      • Develop and maintain a timely updated online version of GB 2760, freely accessible for public consultation.
   b. Labelling
      • Provide a sufficient transition period (e.g. at least three years) for the coordinated implementation of all labelling standards being revised and under revision.
      • Increase local inspection authorities’s understanding of the labelling regulatory requirements and encourage communication between different local bodies (AIC, CIQ, TSB) when an issue of compliance arises.
   c. Alcoholic Beverages
      • Recognize the importance of product quality standards and update the standards defining Western alcoholic beverages to bring them in line with relevant international standards, particularly ensuring that the limits of the analytical parameters set for vodka will take into account those properties linked to flavoured vodkas.
      • Revise GB 2757-1981 to set methanol limits in accordance with relevant international standards so as to accommodate traditional European alcoholic beverage products such as grappa and tsipouro, fruit spirits, as well as Mexican tequila.
   d. Cheese Products
      • Remove the yeast limit for natural cheese in GB 5420-2010.
      • Revise cheese products standards and make more precise the application of microbiological criteria, bearing in mind the variety of cheese products and their characteristics.
   e. Paediatric Nutrition
      • MOH to clarify that FSMP products should be regulated under GB 25596-2010, which comes into effect from January 1, 2012, onward. Before this date, all current products, especially those imported, should be treated as status quo, i.e., as those imported products without national standards.
      • MOH to draft and publish an ordinance on implementation of GB 22596-2010, in which a designated agency should be available for filing/evaluation of the FSMP product based on scientific data and safety assessment. Such a filing/evaluation record should be made an indispensable element to the issuing of product licence (i.e. QS licence) by AQSIQ as well as to the Customs clearance. Such an approach will split the oversight and responsibility amongst ministries, and thus might have a better chance of being accepted in today’s situation.
      • MOH to take the lead for revision of the current China code of Marketing of Beast Milk Substitutes.
• Set up the monitoring system on market violation.

• Keep the current practice of on-pack label claim.

f. Pet Food
• Officially recognise the petcare professional industry and set up all relevant legislation and standards for the pet food industry.
• Involve the petcare industry in the drafting procedure of regulations and standards so as to benefit from the industry’s international know-how and best practice.
• Consider developing a similar “Guide to good practice for the manufacture of safe pet foods” written by FEDIAF

g. Feed Additives
• Recognise the EU controls, by an EU and China bilateral agreement, on the assessment and approval of feed additives and simplify the registration process for the import of EU-authorised feed additives into China given that the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) order 118 (2009) includes risk assessment.
• Ensure that the approved feed additives list is on a publicly accessible government website including all conditions for the additives’ use and registration.

h. Application Procedure
• Provide sufficient guidelines and training for all local offices of the Inspection and Quarantine Bureau of the People’s Republic of China (CIQ) to ensure consistency of interpretation and implementation of the regulations.

i. Sanitary (Hygiene) Certificate for Imported Food and Beverage Products
• Ensure sufficient resources to speed up the processing of certificates.
• Authorise independent third-party-certificated organisations and laboratories to satisfy the growing demand of certification and testing.
• Continue to improve facilities on a national level and ensure adequate storage (particularly temperature-controlled storage) at both CIQ and Customs.
• Ensure that Sanitary (Hygiene) Certificates issued at one port of entry be accepted throughout China without need to apply for certificate filing for the same cargo in other places where distribution occurs
• Provide a tracking system for certificate processing and timing.

2. Traceability Issues
a. Food and Beverage Related
• Protect existing foreign lot codes on imported products in the Chinese market
• Fully and efficiently implement the Food Safety Law Recall provisions

b. Feed Additives, Feed Materials and Compound Feed
• Adopt legislation to cover ‘edible agricultural products and feed’ to help ensure a high level of protection of public health, taking into account the protection of animal health and welfare.
• Introduce compulsory requirements for suppliers of feed additives, feed materials and compound feeds to be accountable for risks associated with biological, chemical and physical hazards.
• Introduce a supervisory system to ensure traceability of feed additives, feed materials and compound feed from manufacturer to final user.
• Update existing Chinese feed legislation to bring it in line with this proposed framework.
3. Agriculture Issues

a. Arable Farming
   - Adopt systematic and concrete measures to encourage land consolidation.
   - Encourage more efficient use of agro-chemicals through the development of schemes similar to FACTS and provide training on the application of these schemes to reduce over-use of chemicals and soil-contamination issues.
   - Encourage the adoption of advanced seed technologies.
   - Protect agricultural intellectual property rights.
   - Further invest in improvements in rural infrastructure.

b. Animal Nutrition

I. Quality and Safety Control of Feed Additives, Feed Materials and Compound Feed
   - Adopt a compulsory requirement for the suppliers, processors and producers of manufactured feed and feed materials and compound feeds to be responsible for the information on the product label.
   - Ensure that the new catalogue for feed materials includes a description of the product concerned and, where appropriate, any process involved in its production, especially if there is the presence of any chemical impurities and/or processing aids.
   - Ensure the published list of undesirable substances applies to all manufactured feeds and feed materials and compound feeds.
   - Adopt controls for imported products that are no more onerous to those imposed on products produced in China, and recognise the EU catalogue as required under regulation 787/2009 on the marketing and use of feed for imported feed materials.
   - Ensure controls as defined in Regulation 118 are appropriately and consistently enforced to help protect the integrity of the Chinese export market.

II. Develop Assurance Programmes for Quality and Safety in Animal Food Products
   - Work to develop appropriate auditing schemes and professional qualifications to ensure the quality and safety of feed additives, feed materials and compound feeds.
   - Adopt an annual audit developed in partnership with an internationally recognised organisation specialising in feed and food assurance on all suppliers of feed additives, feed materials and compound feeds to help improve traceability.
   - Develop a specialised training programme for inspection officials to increase the number of suitably qualified and experienced inspectors who possess adequate facilities and equipment to carry out their duties.
   - Make specific reference to HACCP principles and the likely hazards and effective controls. The methodology to be used for official tests should be available to the industry to enable manufacturers to carry out their own quality control of the products they use and produce.
Introduction to the Working Group

The European Union (EU) plays a key role in the world trade of agricultural products and food and beverages. It is now the world’s largest exporter1 (total EUR 53.7 billion in 2009, showing a 8.0% decrease over 2008) and importer (total EUR 50.8 billion in 2009, showing a 14.2% decrease over 2008) of food and drink products worldwide (excluding intra-EU trade with a total surplus of EUR 3 billion).

Established in 2003, the Agriculture, Food and Beverage (AFB) Working Group, is a communication platform between European companies in the food and beverage sectors and the Chinese regulators and supervising authorities. The group aims to foster positive discussions and ensure better understanding and implementation of policies and regulations, and greater levels of food safety.

The working group (WG) includes a wide range of companies in the food, beverage and agriculture sectors including importers, manufacturers and distributors of food and beverage products, food additives, animal feed, and feed additives, as well as catering service providers, specialised testing laboratories, food and beverage engineering companies and consultancies in marketing and food communication. This chapter also covers issues of the China desk of paediatric nutrition as well as of the European starch industry. Currently the working group has roughly 90 member companies with more than 250 participating individuals.

As in previous years, China is still listed as one of the top 10 export destinations for EU agricultural, food, and feed industries a national priority. The Food Safety Law issued in 2008, the establishment of the National Food Safety Commission, and the Food Safety Work Plan 2010 are major steps in creating China’s nationwide system designed to protect both the industry and the consumers.

Recent Developments

China has made safety and quality within the agriculture, food, and feed industries a national priority. The Food Safety Law issued in 2008, the establishment of the National Food Safety Commission, and the Food Safety Work Plan 2010 are major steps in creating China’s nationwide system designed to protect both the industry and the consumers.

With these systems in place nationally, China aims to ensure quality at every step from farmer to fork. However, industry experts have noted that within the framework of these new laws and policies some issues remain that will hinder their overall implementation and feasibility. These issues are present both at the national and local levels. Some of the issues include: a lack of international standardisation in processes or allowances, thus inhibiting the ability of international and domestic producers to make full use of acceptable resources; an absence of sufficient cross-ministry coordination and overlapping administrative responsibilities that cause significant delays and increase costs; unclear implementation rules and transitory measures that result in a decreased ability to enforce food safety provisions, and a lack of consistency in consolidation, training, and resources that create risk to both food and feed safety. These areas of concern will each be improved by utilising insider knowledge from the domestic market and abroad, and through applying international standards that have been tested and proven through a scientifically based approach. China and the EU must continue to work together through open communication on improving the framework on which the Chinese Government has placed such a high priority.

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1 All data from the Confederation of the Food and Drink Industries in the EU (CIAA) 2010 annual market report: “Data & trends of the European Food and Drink Industry 2010”
Commitment to product safety on both sides reinforces a desire for trade. Improving coordination of trading standards and traceability will create a mutually beneficial atmosphere. Unfortunately, technical barriers to trade continue to impede imports of a number of European agricultural and food products into China. Even for experienced EU companies operating globally, the diversity of technical requirements and certification schemes coupled with a lack of predictability and consistency are a significant burden that may hamper trade development as companies incur significant delays and additional costs.

Risk communication, together with risk assessment and risk management form the risk analysis framework central to contemporary food safety control. It is in the interest of all to increase the effectiveness of food-risk communication, especially among non-food professionals such as consumers and the media. The working group would be keen to bring in and share more European and international experience and resources on this with local stakeholders.

The European Chamber welcomes the continuous efforts to revise the existing food quality standards, health standards, and industry standards in order to: 1. address missing, duplicated, or conflicting problems in the standards; 2. establish a sound scientific and unified food safety standards system on the basis of risk assessment, and 3. to extend the approach to cover feed and feed additives.

The WG supports the ongoing dialogue between China and the EU on geographical indications (GI). The WG also suggests exploring ways to make the concrete use of the GI as a legal tool to protect the product and enhance the implementation of granted GIs.

The AFB working group firmly believes in China’s commitment to open dialogue on behalf of the industry with relevant authorities throughout China and the EU in the interests of all.

Key Recommendations

1. Standards Issues

The setting of standards is one of the key elements for the free flow of goods in international trade. The WG would like to attract the attention of relevant local authorities on the potential negative effects of inadequate revisions of legislations and on the need to better integrate international standards.

The development of compulsory national food safety standards shall be more grounded on food safety-related parameters with reference to risk analysis. The lack of streamlined coordination between ministries leads to overlong authorisation delays and disproportionate costs for companies.

a. Food Additives

Concern

Massive changes are included in the GB2760–2011 that was published in May this year for implementation on June 20. At the time of writing, no transitory measures have been published. Specific consideration would in particular be needed as regards the additives that are covered by international standards but not Chinese ones.

Assessment

Transitory measures are deemed necessary to avoid trade and investment disruptions. Transitional periods shall be meaningful enough for companies to adapt recipes and to file applications for additives or usages not included in the Chinese legal provisions. They should also clarify that certain types of products manufactured before the adoption of the revised standards are not concerned. According to the current system, promulgation of the national food safety standard by MOH is a prerequisite for AQSIQ to accept the application of production license for that food additive. Transitional production licences should be given to EU companies producing in China until clarification on rules or until applications for the currently used additives can be approved.

There is vast difference between Codex and GB 2760-2011, in terms of number of food additives included, indicates. For public health purposes, a restricted list of permitted food additives is not necessarily the best solution for combating the use of harmful substances added to food. On the contrary, a comprehensive list of modern food additives can help companies produce safer food with a higher efficiency and often lower costs. The latter is more effective in discouraging the use of banned and/or risky substances.

The WG members agree that it is reasonable to be cautious in the registration procedure for novel and rare food additives. However, the WG maintains that a fast track should be in place to facilitate the registration
procedure for food additives that offer no safety concerns, for example, those that have already been listed in Codex for many years, and which are used extensively worldwide. Simplified application procedures should also be sought for additives that are already authorised in China for some products but not for others. This will not only help lessen an enterprise’s operational burden but also optimise the administrative resources of government agencies.

**Recommendation**

- Implement sufficient transitory measures of GB2760-2011 covering both imported and locally-produced food products.
- Continue updating GB 2760 using a scientifically based approach with continuous reference to relevant international standards/codes such as FAO/WHO’s CODEX and JECFA to better incorporate new additives that are already extensively used worldwide.
- Establish a fast-track application process for food additives that offer no safety concerns, for example, those already listed in internationally recognised standards such as Codex and JECFA.
- Develop and maintain a timely updated online version of GB 2760, freely accessible for public consultation.

**b. Labelling**

**Concern**

A number of national standards for food safety that are related to labelling modifications have been or will be in place sequentially since 2010. Transitory measures, if not missing completely, are very often tardy or not comprehensive enough for companies to adapt to massive changes. Consequently, manufacturers need to invest substantial resources to rearrange packaging, which will result in unnecessary waste and a negative impact on sustainability and environment protection.

<table>
<thead>
<tr>
<th>A non-exhaustive list of revised regulations and standards relevant to labelling and their effective time</th>
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<tbody>
<tr>
<td><strong>Name of regulations or standards</strong></td>
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<tr>
<td>AQSIQ (Notice on the implementation of the newly revised &lt;Food Labelling Regulations&gt; (General Notice No. 100, 2009)</td>
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<tr>
<td>AQSIQ ( Notice on the enterprise Product Manufacturing License Label) (General Notice No.39, 2010), requested the modification of the Quality &amp; Safety (QS) label</td>
</tr>
<tr>
<td>66 national food safety standards of dairy products</td>
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<tr>
<td>National Food Safety Standard for Uses of Food Additives (GB2760-2011) including massive changes</td>
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<tr>
<td>National Food Safety Standard for the labelling of Pre-package Food (GB7718-2011)</td>
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<tr>
<td>National Food Safety Standard for Nutritional Fortification Substances in Food (GB14880-xxxx)</td>
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<tr>
<td>The National Food Safety Standard for Nutrition Labeling (GB xxxx-xxxx)</td>
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<tr>
<td>Revised version of hygiene standards for fermented and distilled alcoholic beverages GB 2758 and GB 2758 (still under WTO notification status) include new labeling requirements. Any other national food safety standards that would involve labelling modifications?</td>
</tr>
</tbody>
</table>
Assessment

As massive changes are included, a long transitional period is required to permit companies to adapt. In the EU, the average grace period for food legislation is from three to five years depending on the size of the company. As stated in last year’s paper, the WG members have encountered operational difficulties in coping with the insufficient transitional period for GB7718—2011.

Recommendation
• Provide a sufficient transition period (e.g. at least three years) for the coordinated implementation of all labelling standards being revised and under revision.
• Increase local inspection authorities’ understanding of the labelling regulatory requirements and encourage communication between different local bodies (AIC, CIQ, TSB) when an issue of compliance arises.

C. Alcoholic Beverages

Concern
Chinese general classification standard for alcoholic beverages (GB/T 17204-2008) and the specific product standards of western alcoholic beverage products (GB/T 11856-2008 for brandy, GB/T 11857-2008 for whisky, and GB/T 11858-2008 for vodka) are not in full conformity with relevant international standards for western alcoholic beverages. The WG is concerned that these problems could potentially lead to consumer deception by allowing for the production and marketing of Western alcoholic beverage products that are subject to less stringent standards than those made in the EU with no guarantee of administrative or legal enforcement.

Also, the ongoing amendment proposal on Chinese Hygiene Standard for Distilled Spirits and Integrated Alcoholic Beverages (GB 2757-1981) sets a methanol limit that could block traditional European grape marc spirits such as grappa and tsipouro, fruit spirits, as well as Mexican tequila from entering the Chinese market.

Assessment
I. The General Classification Standard of Alcoholic Beverage GB/T 17204-2008, adopted in 2008 only defines brandy, whisky, rum, gin and vodka, and these definitions are lacking in substance in the following aspects:

a. Absence of minimum alcoholic strength for categories of products without specific product standards such as gin or rum. This could potentially allow products of extremely low alcohol strength to be sold under the name of gin or rum, even though their taste would bear no likeness to the genuine product, and even lower versions could be allowed, thus blurring the difference between spirits, wine and beer.

II. The specific product standards (GB/T 11856-2008 for brandy, GB/T 11857-2008 for whisky, and GB/T 11858-2008 for vodka) are overly stringent in some areas, potentially leading to trade barriers:

a. Analytical parameters set in GB/T 11858 for vodka have been designed for neutral vodkas and are not adapted to flavoured vodkas. A regulatory solution needs to be found so as flavoured vodkas can be integrated in the Chinese regulatory framework. GB 11856 for brandy, GB/T 11857 for whisky and GB/T 11858 for vodka are not in line with relevant international standards, such as the EU standards, and the limit on higher alcohol, which has been removed from the Chinese Hygiene Standard for Distilled Spirits and Integrated Alcoholic Beverages (GB 2751-1981), has been retained in GB/T 11858 for vodka.

b. Limitations on naturally occurring substances for whisky (acetic acid, esters, etc.), vodka, and other ethyl alcohols are not in line with international practices.

III. They are weaker than EU definitions in certain areas, opening a door to substandard products, hence potentially leading to situations of unfair competition:

a. The standards do not set specific distillation strength for the ethyl alcohol used to make the various spirits categories. Maximum distillation strength is intended to prevent the addition of ethyl alcohol to products that have to retain the organoleptic characteristics derived from their raw materials. Conversely, minimum distillation strength is intended to ensure the quality of those other spirits relying on ethyl alcohol, so that the alcohol reaches the necessary level of purity. Therefore, the standard fails to make a fundamental distinction between spirits in which raw materials are not distilled all the way through for taste purposes (whisky, brandy, etc.) and spirits in which distillation is carried out at very high levels to better accommodate the use of flavourings (vodka, gin, aquavit etc).

b. Raw materials for vodka should be indicated when the materials used are not traditional (i.e. cereal or potato).
c. The use of flavourings is currently not explicitly prohibited in GB/T 11856-2008 for brandy and in GB/T 11857-2008 for whisky. However, it is defined in EU regulations.
d. Prohibition on the use or addition of ethyl alcohol. In the case of brandy (GB/T 11856-2008), however, it is allowed when using the term “blended brandy”. This expression may be confused by the consumer with “blended whisky”, which in Europe has a different meaning and is not allowed to contain ethyl alcohol at any time.

IV. The currently proposed amendment on Chinese Hygiene Standard for Distilled Spirits and Integrated Alcoholic Beverages (GB 2757-1981), if adopted, would pose a threat to the trade of some alcoholic beverages given its mandatory nature. The proposed new limits on methanol levels are not in conformity with relevant international standards. For instance, the current limit on the level of methanol is based on a product classification that could potentially block grappa and tsipouro, traditional fruit-based spirits, as well as Mexican tequilas, from entering the Chinese market. Some products that are not subject to any methanol limitation in Europe would fall under the restriction of this new Chinese standard without any proper scientific justification for deviating from generally accepted standards in other regions of the world.

Recommendation
- Recognize the importance of product quality standards and update the standards defining Western alcoholic beverages to bring them in line with relevant international standards; particularly ensuring that the limits of the analytical parameters set for vodka will take into account those properties linked to flavoured vodkas.
- Revise GB 2757-1981 to set methanol limits in accordance with relevant European standards so as to accommodate traditional European alcoholic beverage products such as grappa and tsipouro, fruit spirits, as well as Mexican tequila.

d. Cheese Products Related

Concern
Cheese naturally contains yeast. This yeast has been proven to be harmless to humans and, therefore, should not be subject to maximum restrictions in corresponding standards.

Assessment
Yeast are generally widespread in the environment because of their great capacity for adaptation to many substrates. It is normal to find yeast in dairy production and, moreover, lactic yeasts come about naturally. It has been proven that the presence of yeast in cheese products does not form any part of a recognised pathogenesis and thus does not present any danger to the consumer.

In other markets, such as the EU, where cheese consumption has a much longer history, there is no safety concern or limit set for yeasts in dairy products in general. More information can be found in European regulations concerning the hygiene of foodstuffs such as CE N°852/2004 and CE N°2073/2005.

In March 2010, China issued GB 25192-2010 and GB 5420-2010 both of which will come into effect on December 1, 2010, to replace GB 5420-2003. The WG appreciates the effort required to update the standards, but the members remain concerned that the maximal level of yeast is still restricted to 50 cfu/g. This restriction cannot be achieved for natural cheese and does not take into account the manufacturing techniques of natural cheese, which are different from processed cheese.

The Working Group is concerned about the application of the microbiological criteria for yeast and mould as indicators for the safety and quality of cheese. The microbiological criteria for yeast and mould should only be applicable when a proper interior sample is taken. Without a proper sample, the general criteria will lead to confusion, given the varied characteristics of different types of cheeses.

Recommendation
- Remove the yeast limit for natural cheese in GB 5420-2010.
- Revise cheese products standards and make more precise the application of microbiological criteria, bearing in mind the variety of cheese products and their characteristics.

e. Paediatric Nutrition

Concern
The missing and incomplete measures in the national standard of special food for medical purposes intended for infants (GB 25596-2010) hamper the implementation of this standard and jeopardise Chinese customers’ access to products that are indispensable for the dietary management of babies with special needs.
Assessment
GB 25596-2010 comes into effect from January 1, 2012, onward. As the national standard for infant formula GB 10765-2010 comes into effect on April 1, 2011, some of the existing FSMP products in the market are facing the risk of being rejected by falsely being assessed with GB 10765-2010 or GB25596-2010.

At present, it is required that specifications be prepared for all categories of products listed in Appendix 1 of GB 25596-2010, which has no previous experience domestically and internationally. Such a requirement resulted in some of the specifications having an unexpected huge range from minimum to maximum values that may satisfy the needs of the products being tested and assessed. However, it cannot prevent the arbitrary production of FSMP based on those specifications of huge ranges like that for LBW and HMF, thus attracting concerns of health risk to preterm and low birth-weight babies.

Special products designed specifically to meet the particular nutritional requirements of infants and young children with a specific disease, disorder or medical condition are indispensable for the dietary management of these individuals and are to be used in accordance with medical advice. The safety and efficacy of FSMP products should have science substantiations.

Recommendation
- MOH to clarify that FSMP products should be regulated under GB 25596-2010, which comes into effect from January 1, 2012, onward. Before this date, all current products, especially those imported, should be treated as status quo, i.e., as those imported products without national standards.
- MOH to draft and publish an ordinance on implementation of GB 25596-2010, in which a designated agency should be available for filing/evaluation of the FSMP product based on scientific data and safety assessment. Such a filing/evaluation record should be considered as an indispensable element to the issuing of a product licence (i.e. QS licence) by AQSIQ as well as to the customs clearance. Such an approach will split the oversight and responsibility among ministries, and thus might have a better chance of being accepted in today’s situation in which the crime of dereliction of duty of food safety was just added to the Chinese Criminal Law.

Concern
Weak implementation of the Chinese Code of Marketing of Breast Milk Substitutes (China code) causes concern over aggressive promotion of infant formula in China, which interferes with the implementation of the International Code of Marketing of Breast Milk Substitutes (WHO code) and those related WHA resolutions. At present, breast milk substitutes are aggressively marketed and promoted, especially by local companies, while the multinational companies are in line with their headquarters to comply with the WHO code. Such an unbalanced practice between local and multinational companies causes concern about unfair competition in the market.

Assessment
The key message from the WHO code is to protect and promote breast feeding and ensure the proper use of breast milk substitutes when necessary. These points are also the same in the China Code. The current China Code was published in 1995. It needs to be changed to integrate new WHA resolutions into it.

Recommendation
- MOH to take the lead for the revision of the current China code of Marketing of Breast Milk Substitutes.
- Set up a monitoring system on market violation

Concern
In October 2010, the MOH proposed revising the National Standard of General Standard for the Labelling of Pre-packaged Foods for Special Dietary Uses (GB13432-2004). The draft revision significantly restricts both content and functional claims on the packaging label. Such a wide restriction would eliminate the most direct channel for consumers and healthcare professional to learn about essential product information and to make informed decisions on product selection. For FSMP products, on-pack function claims provide critical information for correct usage. Such restriction of direct communication to the consumer may discourage innovation.

Assessment
Current National Standard GB13432-2004 allows nutrient content and function claims on infant formula (0 to 6months) and follow-up formula (6 to 36months). There have not been safety issues due to on-pack label claims because AIC has been monitoring the validity of the claims effectively.
On-pack claims and other information are an important means for consumers and healthcare professionals to obtain important nutrition information and select the right products for the babies. It is extremely crucial for FSMP users.

Restriction on claims could significantly discourage the industry’s innovation.

Removing label claims is not consistent with Codex standards and the practice in EU countries and Australia/New Zealand.

**Recommendation**
- keep the current practice of on-pack label claims

**f. Pet Food**

**Concern**
There are a significant number of pet food manufacturers and their products in the Chinese market, particularly at the lower end of the industry. However, there is currently a grey area between the feed and pet food industry, and no specific standard has yet been applied to the pet food industry.

**Assessment**
Without an official definition of the pet food industry, the application of standards of the raw material specification, GHP/GMP and food safety of pet food can vary widely and remain subject to individual interpretations. With no recognition of pet food as a professional industry, and with no specific legislation pertaining to it, an unregulated market has developed where people can manipulate the ambiguity of standards so as to avoid product-quality obligations that eventually put animal health and safety at risk.

**Recommendation**
- Officially recognise the petcare professional industry and set up all relevant legislation and standards for the pet food industry.
- Involve the petcare industry in the drafting procedure of regulations and standards so as to benefit from the industry’s international know-how and best practice.
- Consider developing a similar “Guide to good practice for the manufacture of safe pet foods” written by FEDIAF

**g. Feed Additives Related**

**Concern**
Where feed additives have already been approved in the EU, valuable resources in China could be better appropriated through having a fast-track registration system.

**Assessment**
Provided controls underpinning additive approval in the EU meet controls in place in China, feed additives that have already been approved should be more readily available to the feed industry via a fast track system. There is already a comprehensive regulation in the EU on the assessment and approval of feed additives. New provisions are being introduced in China that are designed to improve the supervision and management of new feed additives. The WG would welcome the opportunity to work with the Chinese authorities in developing and implementing this legislation.

**Recommendation**
- Recognise the EU controls, by an EU and China bilateral agreement, on the assessment and approval of feed additives and simplify the registration process for the import of EU authorised feed additives into China given that the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) order 118 (2009) includes risk assessment.
- Ensure that the approved feed additives list is on a publicly accessible government website including all conditions for the additives’ use and registration.

**h. Application Procedure**

**Concern**
With regard to the application procedure, labelling regulations are not being thoroughly and uniformly interpreted and implemented throughout the country.

**Assessment**
The European Chamber welcomes, in principle, the 2006 AQSIQ Notice No. 44, ‘Notice on Modifying the Labelling Audit System for Import and Export Foods and Cosmetics’, which took effect on April 1, 2006. This renders the pre-labelling verification process by central AQSIQ unnecessary and shows AQSIQ’s attempts to improve the labelling process.

While the abolition of the pre-labelling verification


procedures should lead to a more efficient process for companies importing food and beverage products into China, industry members continue to encounter widespread inconsistencies in regulation interpretation and fulfilment three years after the initial implementation. The lack of pragmatic guidelines and training at the local China Inspection and Quarantine Service (CIQ) offices has hampered the implementation and has thus prevented the delivery of positive results.

Also, the lack of a coordinated national system has meant that some companies have encountered a situation whereby a label accepted at one port of entry is refused at another. This causes unnecessary delays and costs to the importer. It should be the case that if a label has been given approval by one office of the CIQ it is recognised nationally and will then be automatically approved by all other CIQ offices.

Recommendation
   • Provide sufficient guidelines and training for all local CIQ offices to ensure the consistency of interpretation and implementation of the regulations.

i. Sanitary (Hygiene) Certificate for Imported Food and Beverage Products

Concern
Three key issues continue to jeopardize businesses of...:
1. The continued unpredictability and inconsistency in both the testing time and methodology; 2. Sanitary (Hygiene) Certificates issued in one location are not accepted in others; 3. There is a lack of adequate storage facilities at ports of entry.

Assessment
It is essential to obtain a Sanitary (Hygiene) Certificate before customs clearance. However, this testing process can be lengthy, with little clarity on timing required for approval. The availability of a timing reference for certificate processing can help the importer/distributor to better prepare and plan.

In order to speed up testing and achieve efficiency, it is essential for authorities to be equipped with sufficient resources. The WG is concerned about laboratory issues, which include a lack of transparency of testing methodology, laboratory facilities and professional training of staff. There are currently only state-owned laboratories involved in testing and these are seriously overloaded. It is suggested that the government authorise independent and third-party laboratories to satisfy the growing demand for these laboratories.

As far as testing standards are concerned, sufficient guidelines and technical training are needed to ensure consistency and transparency of interpretation at all local CIQ offices throughout China. The WG also suggests that hygiene certificates issued in one location be accepted by the CIQ in other locations.

In instances where distribution takes place in an area other than the port of entry, importers/distributors are asked to apply for certificate filing for the same cargo and pay ‘local application fees’ again in the distribution area. This duplicate registration and fee brings forth unnecessary delays and burdens for importers/distributors, which could also eventually hamper the government’s efforts to control food-price inflation.

Finally, while significant improvements have been made over the past 10 years in providing storage facilities for imported goods at local CIQ and customs houses, the national average is much lower than the industry requires. Greater investment is still needed to ensure that storage facilities meet the actual requirements of both importers and distributors.

Recommendation
   • Ensure sufficient resources to speed up the processing of certificates.
   • Authorise independent and third-party-certificated organisations and laboratories to satisfy the growing demand for certification and testing.
   • Continue to improve facilities on a national level and ensure adequate storage (particularly temperature-controlled storage) at both CIQ and customs.
   • Ensure that Sanitary (Hygiene) Certificates issued at one port of entry will be accepted throughout China without the need to apply for certificate filing for the same cargo in other cities where distribution occurs.
   • Provide a tracking system for certificate processing and timing.

2. Traceability Issues

a. Food and Beverage

Concern
The Chinese Food Safety Law highlights the importance
of the food-recall system. While welcoming the initiative of the Chinese government to better protect the consumer’s rights and interests, the WG is concerned that the absence of measures to facilitate traceability impedes an enterprise’s capability to trace and recall imported products. Should this happen, it poses a threat to local consumers and hampers an enterprise’s capability to cooperate with the Chinese government on food safety initiatives.

Assessment
Under EC regulations, all food and beverage products manufactured in the EU must be labelled with a lot code. Thus, all products exported from the EU will bear a manufacturer’s lot code at the time of export. EC regulations also require manufacturers of food and beverage products in the EU to provide a mechanism that allows traceability of its products throughout the supply chain. These lot codes then allow for an effective product recall system if a recall is required.

However, there have been cases where the genuine products imported had their trace codes intentionally removed before the products entered the Chinese market. Removal of the original manufacturer’s lot code greatly hampers a manufacturer’s ability to trace and recall a product globally in the event of a problem. Importation of food and beverage products without the original manufacturer’s lot code allows the importation of tampered products, reduces the global traceability of products, and unnecessarily increases the risk to local consumers. Hence penalties should be imposed on those tampering with lot codes on food products and products bearing evidence of a tampered lot code should not be allowed for sale on the Chinese market.

Recommendation
• Protect existing foreign lot codes on imported products in the Chinese market
• Fully and efficiently implement the Food Safety Law Recall provisions

b. Feed Additives, Feed Materials and Compound Feed Related

Concern
Many food scares have their origins in feed additives and feed materials that are incorporated into compound feeds produced either commercially or on farms and used to feed livestock. This causes great concern among the general population in China and consequent lack of confidence in feed and food producers as well as the authorities. It has also alerted countries that import Chinese feed ingredients to the need to assess the risks of such goods before use.

Assessment
The availability of wholesome feed and feed additives, feed materials and compound feeds free from contaminants is essential for the feed and food industry in China. Only certain chapters of China’s Food Safety Law, effective on June 1, 2009, apply to ‘edible agricultural products’ and, thereby, livestock products. A supervisory system to ensure traceability of products from manufacturer to final user would assist in any recall procedure when and where necessary.

Recommendation
• Adopt legislation to cover ‘edible agricultural products and feed’ to help ensure a high level of protection of public health, taking into account the protection of animal health and welfare.
• Introduce compulsory requirements for suppliers of feed additives, feed materials and compound feeds to be accountable for risks associated with biological, chemical and physical hazards.
• Introduce a supervisory system to ensure traceability of feed additives, feed materials and compound feed from manufacturer to final user.
• Update existing Chinese feed legislation to bring it within this proposed framework.

3. Agriculture Issues
a. Arable Farming

Concern
Although the Chinese Government is encouraging land consolidation for rural areas, local farmers lack the incentives and regulations needed for them to change their land status. For foreign investors in the agriculture sector or food processing industries, land consolidation is usually an important condition for promoting mechanisation, introducing advanced technologies to agriculture and improving crop yield and quality. The implementation of favourable regulations would assist both the growers and investors in achieving an increase in overall yield.

Also affecting growers is the use of pesticides, herbicides, and other agro-chemicals. These chemicals are produced and sold by numerous factories and dealers. Although both central and provincial governments have attached great
importance to supervising this market, the regulations and enforcement are far from sufficient to ensure product safety and quality.

In the Guidance of Foreign Investment Industries promulgated in November 2007 by the National Development and Reform Commission (NDRC), foreign investment in relevant seed technologies is listed in either restricted or prohibited catalogues. This is also true for some cereal processing industries. It is understood that China needs to keep control over the seed sector because of national security concerns. However, the explicit restrictions and inflexible enforcement of the policies prevent China from gaining access to many of the most advanced seed technologies in the world. Intellectual property rights (IPR) are also an issue of great concern on the part of the European companies when investing in Chinese agriculture sectors.

**Assessment**

Land sufficiency, crop yield and agricultural productivity remain the key elements to ensure long-term sustainable national food security. There are several key elements that are required to achieve the maximum benefit including land consolidation, knowledge sharing, investment and effective use of agro-chemicals. However, the critical changes that are required in order to make these improvements cannot happen without land consolidation.

Once consolidation has been achieved, technologies and best practice from Europe can help to accelerate China’s plan to upgrade arable practices to increase yields. Access to these technologies and know-how requires a more open approach to foreign investment. The total foreign direct investment (FDI) in the sector accounts for only 2% of the total foreign investment that China receives from the world. Regulatory restrictions on many agricultural processing industries discourage foreign investors from committing substantial investment in this area for any length of time.

More efficient use of proven modern agro-chemicals would also help to improve yields, improve food quality and safety, and eliminate highly toxic chemicals. Recently the presence of toxic vegetable products in some areas has raised concern. This increases the relevance of facilitating market entry for internationally established chemical products that will offer safer and more efficient alternatives. Meanwhile, the WG suggests the government further improves transparency and decision-marking within rural investment projects to ensure efficiency. Private sector investment in irrigation systems, road building, and electricity supplies can also be encouraged to attract more capital.

**Recommendation**

- Adopt systematic and concrete measures to encourage land consolidation.
- Encourage more efficient use of agro-chemicals through the development of schemes similar to FACTS. Training on the application of these schemes to reduce over-use of chemicals and soil-contamination issues.
- Encourage/adopt advanced seed technologies.
- Protect agricultural IPR.
- Further invest in improvements in rural infrastructure.

**b. Animal Nutrition**

Improved efficiency and efficacy within the animal feed sector in Europe was a result of adopting simple, practical controls that were developed jointly by the industry and the regulators at no cost to the government. Developing standard assurance schemes for different aspects of the feed supply chain would help to deliver legislative requirements within the market. Practical controls and comprehensive assurance schemes would be an excellent way to support and sustain growth of the animal feed sector in China.

**I. Quality and safety control of feed additives, feed materials and compound feed**

**Concern**

There should be measures in place to ensure the safety of manufactured feeds and feed materials with equivalent controls on both imported and exported products.

**Assessment**

The feed industry in China should be able to use wholesome feed materials. There are comprehensive legislative controls in place in the EU that include, under feed hygiene measures, provisions on the need to adopt hazard analysis and critical control point (HACCP) principles, provisions on undesirable substances, and a recently agreed-upon regulation on the marketing and use of feed. Equivalent controls in China would be valuable. Equally, the ability to import feed materials from the EU produced under these controls with minimal additional regulation would be beneficial.
Recommendation

- Adopt a compulsory requirement for the suppliers, processors and producers of feed additives, feed materials and compound feeds to be responsible for the information on the product label.
- Ensure that the new catalogue for feed materials includes a description of the product concerned and, where appropriate, any process involved in its production, especially if there is the presence of any chemical impurities and/or processing aids.
- Ensure the published list of undesirable substances applies to all feed additives, feed materials and compound feeds.
- Adopt controls for imported products that are no more onerous to those imposed on products produced in China, and recognise the EU catalogue as required under Regulation 767/2009 on the marketing and use of feed for imported feed materials.
- Ensure controls as defined in Regulation 118 are appropriately and consistently enforced to help protect the integrity of the Chinese export market.

II. Develop assurance programs for quality and safety in animal food products

Concern

The legislation controlling the production of safe animal feeds is onerous and complex. Producers of feed additives, feed materials and compound feeds can range in size from very large companies to very small organisations. In order to ensure that the integrity of the feed and food chain is maintained and the legislation is fully complied with, all producers would greatly benefit from guides for good practice.

Assessment

Most feed scares have their origins in the feed ingredients used. Ensuring feed ingredients at the source is the most cost-effective way of controlling most feed-related hazards before they happen.

In European countries, three schemes have been developed to cover feed ingredients, feed manufacture and sales, combinable crops and their transport and storage. They are inter-related and include legal compliance, risk assessment (HACCP), good manufacturing practice (GMP), system controls (similar to ISO 9001), and traceability. There is also a fertiliser industry assurance scheme (FIAS) in the UK that covers fertiliser security and traceability.

Since 2006, under feed hygiene regulations, the EU has encouraged the development of community guides to good practice in the feed sector and for the application of HACCP principles. The following guides have now been positively assessed:

- Community guide to good practice for the EU industrial compound feed and premixtures manufacturing sector for food-producing animals — European Feed Manufacturers Guide (EFMC).
- Community guide to good practice for feed additive and premixture operators FAMI-QS — European Association for Feed Additives and Premixtures Quality System.
- European Good Hygiene Practices Guide for the collection, storage trading and transport of cereals, oilseeds and protein crop European cereals, rice, feedstuffs, oilseeds, olive oil, oils and fats and agrosupply trade (COCERAL).
- European Guide to good practice for the industrial manufacture of safe feed materials. The “Association des Amidonniers et Féculiers” (AAF) and The EU Oil and Proteinmeal Industry (FEDIOL) within the framework of the European Feed Ingredients Platform (EFIP).

Guides should be used as an important part of the enforcement risk assessment. Companies using guides can therefore have an assured status that will help to improve the efficiency of the inspection process.

Recommendation

- Work to develop appropriate auditing schemes and professional qualifications to ensure the quality and safety of feed additives, feed materials and compound feeds.
- Adopt an annual audit developed in partnership with an internationally recognised organisation specialising in feed and food assurance on all suppliers of feed additives, feed materials and compound feeds to help improve traceability.
- Develop a specialised training programme for inspection officials to increase the number of suitably qualified and experienced inspectors who possess adequate facilities and equipment to carry out their duties.
- Make specific reference to HACCP principles and the likely hazards and effective controls. The methodology to be used for official tests should be available to the industry to enable manufacturers to carry out their own quality control of the products they use and produce.
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>AQSIQ</td>
<td>General Administration of Quality Supervision, Inspection and Quarantine</td>
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<td>CCFH</td>
<td>Codex Committee on Food Hygiene</td>
</tr>
<tr>
<td>CCNFSDU</td>
<td>Codex Committee on Nutrition and Foods for Special Dietary Uses</td>
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<tr>
<td>CIAA</td>
<td>Confederation of the Food and Drink industries in the EU</td>
</tr>
<tr>
<td>CIQ</td>
<td>Inspection and Quarantine Bureau of the People's Republic of China</td>
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<td>EFMC</td>
<td>European Feed Manufacturers' Code</td>
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<tr>
<td>EC</td>
<td>European Commission</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>FAO</td>
<td>Food and Agricultural Organisation</td>
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<td>FCM</td>
<td>Food Contact Material</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FEDIAF</td>
<td>The European Pet Food Industry Federation</td>
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<td>FEMAS</td>
<td>Feed Materials Assurance Scheme</td>
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<td>FIAS</td>
<td>Fertiliser Industry Assurance Scheme</td>
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<tr>
<td>FSANZ</td>
<td>Food Standard Australia New Zealand</td>
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<tr>
<td>GB</td>
<td>Guo Biao (National Standard)</td>
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<tr>
<td>Gi</td>
<td>Geographic Indications</td>
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<tr>
<td>GMO</td>
<td>Genetically Modified Organisms</td>
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<tr>
<td>GMP</td>
<td>Good Manufacturing Practice</td>
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<tr>
<td>HAACP</td>
<td>Hazard Analysis and Critical Control Points</td>
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<tr>
<td>HCP</td>
<td>Health care professional</td>
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<tr>
<td>IT</td>
<td>Information Technology</td>
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<tr>
<td>IFSMP</td>
<td>Infant formula for special medical purposes</td>
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<tr>
<td>JECFA</td>
<td>Joint FAO/WHO Expert Committee on Food Additives</td>
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<tr>
<td>MNC</td>
<td>Multinational Company</td>
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<tr>
<td>MOFCOM</td>
<td>Ministry of Commerce</td>
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<td>MOH</td>
<td>Ministry of Health</td>
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<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>PRC</td>
<td>People's Republic of China</td>
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<tr>
<td>QS</td>
<td>Production Licence</td>
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<tr>
<td>RASFF</td>
<td>Rapid Alert System for Food and Feed</td>
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<tr>
<td>R&amp;D</td>
<td>Research and development</td>
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<tr>
<td>SME</td>
<td>Small and Medium-sized Enterprise</td>
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<td>SPS</td>
<td>Sanitary and Phytosanitary</td>
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<tr>
<td>TASCC</td>
<td>Trade Assurance Scheme for Combinable Crops</td>
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<tr>
<td>UFAS</td>
<td>Universal Feed Assurance Scheme</td>
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<td>WHO</td>
<td>World Health Organization</td>
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</table>
Automotive Working Group

Key Recommendations

1. **Remove Limitations to Foreign Investment**
   - Allow foreign majority investment and eliminate the 2+2 regulation.

2. **Simplify Type Approval/Homologation Requirements**
   - Streamline the administrative responsibilities of various ministries regulating the automotive industry; adhere to the UN/ECE 1958 Geneva Agreement as soon as possible.

3. **Improve Fuel Quality Standards**
   - Coordinate environmental legislation with progress in standardising fuel quality and find ways to ensure the simultaneous development of the auto and petroleum industry. It is necessary to establish a monitoring system to ensure fuel quality will satisfy standards.

Introduction to the Working Group

The member companies of the Automotive Working Group are also members of the European Automobile Manufacturers Association (Association des Constructeurs Européens d’Automobiles, ACEA), which is composed of the 15 major European car, truck and bus makers. Jointly, the European automotive industry has invested more in China than any other European industry.

Recent Developments

2010 was another spectacular year for China’s automotive industry:
- Total vehicle sales surged 32% compared to a year ago, to 18 million units.
- Passenger car sales increased 33% to a record of 14 million units. Passenger car imports, largely from Europe, rose over 90% compared to 2009, to 800,000 units valued at approximately EUR 22.5 billion.
- Commercial vehicles hit 4.3 million units, a growth of 30%.

Sales of heavy duty commercial vehicles amounted to more than one million vehicles. However, the one million vehicles sold reflect huge inefficiencies in the transport sector and seem totally out of proportion with the amount of goods transported in China in a year.

On the bus side only 15,000 buses and coaches above 12 meters were produced and sold in China. Considering the huge population of China this also reflects huge inefficiencies. It means that too many and too small buses are used to transport people in China. This is not sustainable.

2011 looks set to be different. The purchase tax on vehicles with engine displacement of less than 1.6 L, temporarily lowered when the economic crisis struck, has been restored to its former level (10%). Fuel prices are on the rise; they have already been raised twice this year, and are now 30% higher than in 2008, yet are still below the international market price. Moreover, the explosive growth of car sales in the past two years has put strains on the ability of urban infrastructure to cope; as a consequence, Beijing Municipality decided to drastically reduce vehicle registrations to only 20,000 units per month from January 2011 (a measure meant to stay in effect for three years), a number only about one-third of car sales in the previous two years. This number does not include existing car owners who wish to buy new cars, or incentivised vehicles such as electric or other alternative fuel cars.

As the car market in 2011 may witness only single-digit growth, the case for consolidation in the domestic auto industry becomes ever stronger and mergers and acquisitions should accelerate. At the same time, China’s vehicle ownership ratio of less than 50 units per 1000
people (compared to the world average of 120 units) means that the demand for cars will continue for many years to come, roughly in line with overall GDP growth. This underlines the fundamental importance to the authorities of promoting more energy-efficient, as well as alternative-energy (notably electrical) vehicles.

The European automotive industry is well-placed to deliver fuel-efficient vehicles, both passenger cars and commercial vehicles, through local manufacturing with Chinese partners (see hereunder, “Key Recommendations”, 1) or by importation. With respect to electrical vehicles, the Chinese government’s motives are mixed: they intend both to reduce China’s dependency on imported oil, and to foster the creation of a strategic new industry, centered on electric vehicles, that propels China to the forefront of the car industry of the future. The latter, a nationalistic objective, is not designed to allow for a maximum of international cooperation.

Focusing on the present, though, rather than the future, the members of the Working Group believe that improvements in government itself may contribute substantially to the development of a healthy and sustainable, fuel-efficient and environmentally responsible automotive industry. The unclear division of responsibilities and overlapping responsibilities among Chinese government bodies is a major problem for the auto manufacturers, and the improvements in the government itself may contribute substantially to the development of a healthy and sustainable automotive industry.

Case study:
No fewer than four ministries (NDRC, MIIT, MEP, MOT) have the remit to reduce the average fuel consumption and emissions level of automotive products, and regulate accordingly, often at cross purposes. Before a motorised vehicle is allowed on the road, it has to pass approval by MIIT (production type-approval), AQSIQ (CCC certification), MEP (environmental catalogue) and MPS (vehicle license). As opposed to this proliferation of regulatory bodies, no single authority is in charge of overall transport policy.

The Automotive Working Group looks forward to the day when the world’s largest automotive market will also be the strongest, also in terms of governance.

Key Recommendations

1. Remove Limitations to Foreign Investment

Concern
For a foreign automobile manufacturer wanting to invest in China, the only permissible business structure is a joint venture with a Chinese partner. The foreign investor’s maximum share is limited to 50%. In addition, a foreign investor is limited to establishing no more than two such Sino-foreign joint ventures for the production of passenger cars, and two for commercial vehicles (“2+2”).

Assessment
To reach decisions in a 50/50 joint venture, consensus between the partners is required; reaching a consensus is no easy matter when the partners’ interests diverge. Unfortunately, such divergence leads to management inefficiency in a competitive landscape that demands efficient decision-making. In contrast with joint ventures, the fastest-growing domestic carmakers are those who simply buy, and then successfully assimilate technological know-how in the open market, and who neither need nor want a foreign partner; so this argument is fast being superseded by the reality unfolding before any impartial observer. As the Working Group has long argued, investors in the automotive industry (foreign or otherwise) should be allowed to hold a percentage of shares in an automobile-producing venture proportional to the business risk they are prepared to take. Mandatory 50/50 partnerships are counterproductive; moreover, in a market economy, they are an anomaly. In addition, with a view to furthering the consolidation of the automotive industry, mergers and acquisitions should not be hampered by the corollary regulation that foreign investors are limited to a total of two joint ventures for the production of passenger cars and two for commercial vehicles.

Recommendation
- Allow foreign majority investment and eliminate the 2+2 regulation.

2. Simplify Type Approval/Homologation Requirements

Concern
The automotive industry in China is administered by a variety of uncoordinated authorities. Type approval/homologation procedures are a case in point. Moreover one of these, the China Compulsory Certification (CCC)
system in effect since 2002, puts obstacles in the way of import and export trade.

**Assessment**

As mentioned in “Recent Developments”, automotive products in China are subject to more than one type-approval/homologation requirement. The following case study will illustrate the process.

**Case study:**

A new heavy-duty truck model is type-approved by MIIT, checking its conformity to a set of technical standards that will soon include a fuel consumption standard. Once approved, the truck model is published on the MIIT “Gazette” and its production authorized. In parallel, it needs to comply with the requirements of the China Compulsory Certification (CCC) system run by the Certification and Accreditation Administration of People’s of Republic of China (CNCA) under AQSIQ. The MIIT test results can be submitted to CNCA to fulfil these requirements, but the need again to file a comprehensive set of technical data – as with MIIT – in fact doubles the administrative burden for the manufacturer. The CCC certificate that results from this procedure allows the vehicle to be sold. Not quite, however: since, to prove compliance with the current National Phase IV emissions standard, the truck model needs also to undergo emissions testing administered by MEP, and, if meant to be sold in Beijing, separate emissions testing by the Beijing Environmental Protection Bureau. Duly approved for production and sale, the truck needs now to be tested for its fuel consumption by MOT, according to an MOT fuel consumption limits standard for commercial vehicles; this results in a Commercial Transportation Permit for the truck in question. Finally, in order to be issued a license plate, the truck is checked again by MPS in accordance with its own standard for vehicle safety, GB 7258.

The duplication and lack of coordination between these various procedural requirements saddle domestic and foreign manufacturers alike with a costly and time-consuming burden, of little benefit to industry or society.

The CCC system, in particular, has been singled out in previous editions of this Paper as a cause for concern, because it forces importers to re-test in Chinese laboratories automotive products and components already type-approved in Europe. This would be superfluous if China, instead of operating the CCC certification system, were to accede to the UN/ECE 1958 Geneva Agreement on globally harmonised standards and testing methods for the automotive industry. Accession would mean recognising EU type-approvals obtained for their products by European exporters, without re-testing them in China. It would also mean in addition that automotive components produced and type-approved in China need no further testing when exported to the contracting parties of the Geneva Agreement, which include all of Europe. As the domestic automotive industry increasingly looks at export opportunities, avoiding repetitive testing is surely also in China’s own interest.

**Recommendation**

- Streamline the administrative responsibilities of various ministries regulating the automotive industry; adhere to the UN/ECE 1958 Geneva Agreement as soon as possible.

3. Improve Fuel Quality Standards

**Concern**

Fuel quality (gasoline and diesel) and emission standards do not equate, and improvements in fuel quality lag behind the introduction of emission standards for cars and trucks.

**Assessment**

The technology that auto manufacturers put into place to filter out nitrogen oxide and particulate matter from exhaust pipe emissions, so as to comply with mandatory emission norms, depends for its optimal effect on the availability on the market of fuels of corresponding quality. In Europe, Euro 4/IV quality fuels were made available before the present Euro 4/IV emission standard entered into force.

China is different. Gasoline adapted to the National Phase 3 emission standard (equivalent to Euro 3) became available nationwide from December 31, 2009, two and a half years after this emission standard became a mandatory type-approval requirement for all new car models. Last year, on July 1, 2010, the National Phase 4 emission standard came into force for new gasoline car type-approvals; but no date has been announced for when Euro 4 gasoline shall become available nationwide (it exists in Beijing, Shanghai and the Pearl River Delta). Beijing will introduce National Phase 5 as a requirement for all new vehicle registrations in 2012, and supply of the matching fuels will be assured; but there is no indication when the rest of the country will follow. The National Phase
5 emission standard is set to enter into force in 2016. As for diesel, the situation is worse. Today, the only mandatory quality standard for diesel (GB 252-2000) allows a sulphur content of 2000 parts per million (ppm), equivalent to Euro I-grade diesel in Europe 15 years ago; whereas the National Phase III emission standard has been a requirement for the type-approval of new commercial vehicles models since 2007. In spite of this problem, the National Phase IV emission standard for new diesel vehicle type-approval entered into force in January 2010. As originally scheduled, all in-production heavy-duty trucks were to comply with the National Phase IV standard from January 2011; but in a last-minute change of heart, MEP let it be known that this effective date is now moved to “January 2012 at the earliest”.

Needless to say this situation is frustrating manufacturers’ efforts at rational product planning. Equally or more seriously, the mismatch of fuel quality and emission standards cannot produce the intended emission reductions. Consequently, the air quality will not improve as intended; and the substantial investments made by vehicle makers to upgrade their technology will not generate the social benefit that should have justified such investments in the first place.

The Working Group appreciates that partial progress has been made: Euro III-grade diesel will become available nationwide from June 30 this year.

**Recommendation**

- Coordinate environmental legislation with progress in standardising fuel quality and find ways to ensure the simultaneous development of the auto and petroleum industry. It is necessary to establish a monitoring system to ensure fuel quality will satisfy standards.

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**Abbreviations**

- **ACEA** Association des Constructeurs Européens d’Automobiles
- **AQSIQ** General Administration of Quality Supervision, Inspection and Quarantine
- **CCC** China Compulsory Certification
- **CNCA** Certification and Accreditation Administration of People’s of Republic of China
- **EU** European Union
- **EUR** Euro
- **GDP** Gross Domestic Product
- **MEP** Ministry of Environment Protection of People’s Republic of China
- **MIIT** Ministry of Industry and Information Technology
- **MOT** Ministry of Transport
- **MPS** Ministry of Public Security
- **NDRC** National Development and Reform Commission
- **ppm** parts per million
- **UN/ECE** United Nations Economic Commission for Europe
Auto-Components Working Group

Key Recommendations

1. Fuel Quality
   - Develop a government led initiative working directly with fuel providers to create achievable timelines for better quality fuel introduction, which is subsequently linked to target emission standards.
   - Improve fuel quality at the pump to achieve targets for future emission standards.

2. Vehicle Taxation & CO₂ BalanceTaxation
   - Replace the currently applied consumption tax and vehicle purchase tax with a CO₂-based or alternatively, a kilometers-per-liter consumption tax scheme attaching a single value to each gram of CO₂/litre of fuel.

3. Restrictions on Research and Development (R&D)
   - Ease the restrictions on importing used prototypes and test samples for R&D applications.

4. Safety Standards for Passenger Vehicles and Road Users
   - Harmonise Chinese and Economic Commission for Europe (ECE) safety standards with respect to crash testing to promote the development of safer passenger cars.
   - Improve the safety of vulnerable road users such as pedestrians and bicyclists.

5. Limitations on the Draft of the Catalogue for Guiding Foreign Investment in Industry 2011 (Draft Catalogue)
   - Remove the 50% limit on foreign capital in key components of new energy vehicles, thus allowing foreign companies to establish majority-owned Joint Ventures (JVs) and Wholly Owned Foreign Enterprises (WOFEs).

6. High-performance Radial Tire Development
   - Adopt corresponding regulations and standards to encourage development of high-performance radial tires with environmentally friendly and energy-saving features, most importantly the low rolling resistance tire.
   - Develop systems for smooth collection of retreadable tires.

Introduction to the Working Group

The members of the Auto-Components Working Group consist of more than 100 European 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.

Recent Developments

China achieved auto sales of 18 million units in 2010 and the country remains the world’s largest auto market for a second year. Market expansion was not only attributed to underlying economic growth but was also positively impacted by the continuation of government-led incentives supporting the purchase of small engine vehicles (≤1.6L displacement), the scrapping of old vehicles and financial incentives for the purchase of new energy vehicles.

China has demonstrated its commitment to the promotion of environmentally friendly technologies and new energy sources for vehicles, punctuated by the release of the 12th
Five-Year Plan. China’s legislative direction is driving the auto industry towards the development of new-energy vehicles and has been identified as a Strategic Emerging Industry (SEI).

China has targeted new-energy vehicle sales of 15 million units by 2020. Through the creation of complimentary regulations and a CNY 100 billion (EUR 10.75 billion) commitment to support supply chain development. The Working Group is excited to work with the Chinese government in the realisation of these new energy vehicle goals.

The Working Group has seen significant improvements in doing business in China since last year and is very optimistic for the future. Through the introduction of environmental and safety legislation which closer represents the homologation requirements of the European Union (EU), Chinese auto makers are finding it easier to enter foreign markets successfully. The Chinese government will also enforce China’s national standard V emission regulation in 2012 ahead of schedule, which alongside complimentary legislation is seen as a very positive step forward by the Working Group.

C-NCAP safety compliance requirements are also becoming stricter, which will see holistic benefits for both the Chinese auto industry and consumers as a whole. The introduction of both rear end crash testing, pedestrian crash testing and the inclusion of female crash test dummies will also help drive the domestic market towards cutting edge innovative technologies and facilitate domestic auto brands access to the EU, which is welcomed by the Working Group.

**Key Recommendations**

1. **Fuel Quality**

   **Concern**
   Fuel quality (gasoline and diesel) and emission standards in China are below EU standards. Improvements in fuel quality lag behind the introduction of emission standards for cars and trucks.

   **Assessment**
   Gasoline adapted to the National Phase 3 emission standard became available nationwide as of 31 December 2009, which is two and a half years after this emission standard became a mandatory type-approval requirement for all new car models. The National Phase 4 emission standard came into force for new car type-approvals on 1 July 2010; but the corresponding grades of gasoline will be available only in Beijing and Shanghai municipalities.

   The GB/T-Standard (GB/T19147-2009) on EU3 diesel fuel quality (sulphur 350ppm) was released only on 12 June 2009, but this standard is not mandatory. In the EU, Euro 3/III and 4/IV grade fuels were introduced before vehicles were upgraded to include Euro 3/III and 4/IV emission technology, since the technology requires the appropriate fuel quality in order to achieve the legislators’ aim such as reducing exhaust pollutants by a given and precise percentage.

   If the fuel itself does not comply with fuel standards, it is then difficult for vehicles to fully meet emissions standards. Indeed, implementing EU3 would reduce sulphur content in the fuel, and per se, decrease emissions. It would also be easier for Chinese carmakers to export, as they would upgrade the vehicles with the appropriate technology.

   Government control over the actual compliance of heavy vehicles is poorly monitored and difficult to achieve regarding the diesel standards that are applied. It should be better enforced for truck manufacturers, both for heavy vehicles at the end of the assembly line and in operation. The supply of diesel quality should be secured since it would facilitate the compliance with diesel standards of truck manufacturers.

   **Recommendation**
   - Develop a government led initiative working directly with fuel providers to create achievable timelines for better quality fuel introduction, which is subsequently linked to target emission standards.
   - Improve fuel quality at the pump to achieve targets for future emission standards.

2. **Vehicle Taxation & CO₂ Balance Taxation**

   **Concern**
   The currently applied consumption tax and purchase tax for vehicles is based on engine size rather than fuel efficiency. Moreover, as the vehicle purchase tax is an equal percentage tax on each vehicle, it does not address fuel efficiency or encourage the demand for low-emitting vehicles.
Assessment
Offering fiscal incentives for the consumer to choose a fuel-efficient vehicle is an effective mechanism to provide a market ‘pull’ that supports the ‘push’ created by the fuel economy regulations addressed to the manufacturers. Therefore, the industry supports the use of these instruments in China as it does in the EU, where by now the majority of EU states have implemented CO₂-based vehicle taxes. By putting a price tag on each gram of CO₂ emitted per kilometre, the consumer receives a clear and unambiguous 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 their current engine-size related taxation. The taxation should 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 CO₂ emissions per car has become a major target. However, evidence shows that some bigger engines have less CO₂ emissions than smaller ones. The Working Group is willing to help develop rules that better cater to the need to protect the environment.

Recommendation
• Replace the currently applied consumption tax and vehicle purchase tax with a CO₂-based or alternatively, kilometres-per-litre consumption tax scheme attaching a single “value” to each gram of CO₂/litre of fuel.

3. Restrictions on Research and Development (R&D)

Concern
In an international development environment, it is necessary to bring used test samples and prototypes in and out of China. Nevertheless, Chinese customs regulations prohibit or restrict the import of certain used products.

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 have become a part of the global engineering network of a company.

The development process of products includes testing of prototypes to make sure the product meets the specified requirements. To make optimum use of its global engineering resources, in an international company these tests might be done in different locations, both within China and outside 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. 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 to China.

Recommendation
• Ease the restrictions on importing used prototypes and test samples for R&D applications.

4. Safety Standards for Passenger Vehicles and Road Users

Concern
In the first half of 2010, there were almost 100,000 traffic accidents in China resulting in the deaths of more than 27,000 people. In addition to this incalculable human loss, the direct economic loss was more than CNY 400 million.

Assessment
China’s current impact regulations define frontal impact tests against a rigid barrier including 100% overlapping and impact velocity of 50 km/h. The EU standard defines a frontal impact test against a deformable barrier with 40% overlapping and impact velocity of 56 km/h. EU test methods better reflect what happens in real crash cases. It is very rare that a car would hit a barrier with 100% overlap; most accidents occur between car and car, and not between car and wall. EU test methods have been created to better protect the passengers by simulating the majority of accidents that occur on the streets.
China’s automobile frontal impact standard GB11551-2003, “The protection of the occupants in the event of a frontal collision for passenger car”, is not equivalent to the ECE R94 and is different in collision angle and speed. The Working Group recommends the harmonisation of these regulations to support a global standard on safety.

In order to improve the safety of vulnerable road users such as pedestrians and bicyclists before, and in the event of, a collision with a motor vehicle, the EU introduced directive (2003/102/EC) in 2005. This regulation can be met either by the modification of the bumper and front-end mechanical behaviour and/or by the usage of an active hood system. An update to this regulation was published in 2009 that contains further enhanced requirements for pedestrian protection (2009/78/EC). It would be beneficial for all Chinese citizens if similar laws and regulations were enacted in this critical area of pedestrian safety.

Recommendations

- Harmonise Chinese and ECE safety standards with respect to crash testing to promote the development of safer passenger cars.
- Improve safety of vulnerable road users such as pedestrians and bicyclists.

5. Limitations on the Draft of the Catalogue for Guiding Foreign Investment in Industry 2011 (Draft Catalogue)

Concern

The Working Group would like to thank the State Council for providing the public with the opportunity to offer comments on the Draft Catalogue for a full 30-day period, reflecting a positive effort to provide more transparency and produce outcomes more widely supported by various stakeholders in China. While the Working Group was pleased to see a number of positive developments in the newly-released Draft Catalogue, it is concerned that the revised draft has many investment restrictions.

Assessment

The Working Group has noted with concern that the National Development and Reform Commission’s (NDRC) latest Draft Catalogue proposes to limit foreign investment in projects to produce key components of new-energy vehicles. This limit is namely less than 50% in a (mandatory) Sino-foreign JV enterprise. It is new and, if confirmed, would mark a step backwards in China’s long-standing policy to attract foreign investment.

Faced with the obligation to transfer technological know-how to domestic partners in Sino-foreign JV in which they have less than 50% share, foreign investors may hesitate to share core competencies, let alone engage in R&D. This is not in China’s interest. The electrical vehicles of the future will most likely be assembled from components supplied from an international variety of sources, in an increasingly borderless world.

The clause (19), “The Transport Equipment Manufacturing Industry” of the Draft Catalogue proposes restrictions on foreign investment in the core components of new energy vehicles. In the following key parts of new energy vehicles, the proportion of foreign investment is restricted to a maximum of 50%.

- Energy type power battery (energy density ≥ 110 Wh/kg, cycle life ≥ 2000 times), battery management system, motor management system, electric vehicle, and electric controlled integrated parts.
- Electric vehicle driven motor, car with DC/DC, high power electronic devices (IGBT, voltage level≥600V, current≥300A), plug-in electric hybrid driven by electromechanical coupling system.
- Idle stop system.
- Hub motor systems, hydrogen storage for fuel cell stack and its parts, systems, car charger, a car-charging device.

The Working Group believes that an open investment environment without pre-conditions for access allows all companies to equally contribute their experience and best practices to China’s economic development, especially in important areas to Chinese policymakers such as high-tech manufacturing, advanced technologies, and new energy vehicles.

Recommendation

- Remove the 50% limit on foreign capital in key components of new energy vehicles, thus allowing foreign companies to establish majority-owned JVs and WOFEs.

5. High-performance Radial Tire Development

Concern

Tire performance has been identified as a key contributing factor to vehicle associated pollution. In order to reduce vehicle emissions, the EU is implementing regulations to
support the introduction of high performance radial tires.

Assessment

In order to support China’s low emission legislative agenda, it is the considered opinion of the Working Group that efforts should be made to replicate upcoming EU regulations R661 and R1222, being introduced in November 2012, mandating threshold and grading for tire rolling resistance, emission noise and wet grip. Radial tires represent the most cost effective and technologically advanced solution to support this regulatory target and are readily available to the market at competitive prices.

Tests\(^1\) have been concluded demonstrating that tires with low rolling resistance can reduce fuel consumption by between 8-20% for passenger cars, and 25-35% for trucks and busses. Through the introduction of regulations supporting high-performance radial tires, there will be a twofold benefit, one in advancing the technological base of the Chinese tire industry and secondly, contributing to the reduction of fuel consumption and CO\(_2\) emissions in line with low-carbon economic development in China.

Over 200 million waste tires were generated last year, and as the auto industry continues to grow this number is only going to increase. A well-designed and properly maintained radial tire can be renewed through retreading one to three times, which significantly reduces natural rubber consumption. Currently in China, less than 5% of tires are retreaded. Developing an advanced tire retreading mandate is an essential part of the recycling process and the absence of a systematic channel to collect retreadable used tires has resulted in huge volumes of material waste, which cannot be supported in an ever increasing auto market with limited resources.

Recommendations

- Adopt corresponding regulations and standards to encourage development of high-performance radial tires with environmentally friendly and energy-saving features, most importantly the low rolling resistance tire.
- Develop systems for smooth collection of retreadable tires.

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\(^1\) By RWTUV in Germany and Chinese Chemical Industry Special Tyre Inspection Center

### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
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<tr>
<td>ECE</td>
<td>Economic Commission for Europe</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>EUR</td>
<td>Euro</td>
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<tr>
<td>Draft Catalogue</td>
<td>The Draft of the Catalogue for Guiding Foreign Investment in Industry 2011</td>
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<tr>
<td>JV</td>
<td>Joint Venture</td>
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<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>ppm</td>
<td>parts per million</td>
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<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
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<tr>
<td>SEI</td>
<td>Strategic Emerging Industry</td>
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<tr>
<td>WOFE</td>
<td>Wholly Owned Foreign Enterprises</td>
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Key Recommendations

1. Promote the Advancement of the CDM as a Project Finance Mechanism that Incentivises Private Sector Investment in Climate Change Mitigation Projects
   - Reduce investor uncertainty by the European Commission (EC) and China working to reach an international agreement on targets and commitments post-2012 in order to continue the global carbon market post-2012
   - Recommend that the EC and the EU Member States should provide clarity and guidance to the private sector on the potential acceptance of CDM credits into the ETS through the use of bilateral and any ongoing multilateral arrangements
   - Encourage China and the EU to engage in a bilateral agreement for the trading of high quality CDM credits that may be defined as micro-scale projects, small scale projects in sectors not subject to international leakage (such as transportation or buildings), and projects developed in China’s underdeveloped zones or underdeveloped sectors
   - Urge China, the EU and all parties under the UNFCCC to push for continued advancement of the CDM as it is the only private-sector finance mechanism for developing countries, specifically calling for development of and support for standardised baselines and reforms to the rules for PoAs
   - Encourage Chinese negotiators to continue to highlight the steps China is taking domestically as part of their contribution to international GHG mitigation

2. Provide Clarity in the Approach to Post-2012 Market Through the Implementation of Sustainable Practices and Price Structures
   - Clarify the post-2012 regulatory process for the CDM, including the process (commitments and pricing structures) for obtaining a post-2012 LoA
   - Allow flexible pricing structures post-2012 linked to the secondary CER market price, which could include an indicative price based on flexible pricing structure linked to the secondary CER market price

3. Provide Clarity on Domestic Greenhouse Gas Emissions Reduction Mechanisms in China and the Role of the Private Sector
   - Clarify the role of pilot voluntary schemes in the context of establishing a mandatory pilot ETS in China, particularly if participation (as an emitter or trader) is voluntary
   - Explore the complementary role, if any, between future renewable energy credit/energy savings (e.g. white certificate) scheme and GHG ETSs
   - Create a regulatory body that plays an overarching role, linking different pilot domestic schemes under a national approach nationally with the goal of managing GHG emissions and mitigating climate change impacts
   - Clearly define metrics for carbon and energy intensity targets defined under the 12th Five-Year Plan in order to measure the effective implementation of its targets over time
   - Clarify the roles of and relationships between different market players and stakeholders in the design of the carbon market schemes
   - Share experiences and knowledge from EU stakeholders, including the private sector, regarding the design and operation of domestic schemes, with Chinese counterparts
   - Engage the private sector in the design of domestic schemes
4. Promote Mechanisms Complementary to the CDM to Scale up Greenhouse Gas Emissions
Management and Reductions in China

- Encourage the UNFCCC to develop high level guidance for standardised baseline proposals as soon as possible so project proponents in China can put forward new proposals
- Urge the EC and/or individual Member States through bilateral agreements could accept into Phase III of the EU ETS credits from all PCDM or specific types of PCDM projects even if they are registered post-2012
- Urge China to press the EC for clarity on the eligibility of CERs from CPAs included post-2012 into PoAs registered pre-2013
- Develop a basket of new market-based mechanisms complementary to the CDM that recognise differences in national and sector circumstances ("common but differentiated responsibilities") in order to scale-up emission reductions globally, and allow the private sector to work with policymakers on the design
- Recommend to climate change country representatives that new market-based mechanisms should have clear and ambitious goal(s) to shape, drive and create market demand
- Urge country representatives to clarify the interaction (or lack thereof) between each mechanism, while recognising that the decision of how existing and new mechanisms at various levels interact is up to each country involved

Introduction to the Working Group

The Carbon Market Working Group (WG) is comprised of over 70 member companies representing all aspects of the Clean Development Mechanism (CDM) sector including project developers, carbon funds, investors, lawyers, auditors, consultants as well as financial institutions. Working Group activities include breakfast seminars, networking events and meetings with Chinese and European authorities.

The WG is particularly interested in working with Chinese, other national and international officials and regulators to ensure that there is a viable future for emission reduction projects in China and other countries. With continued uncertainty about the CDM post-2012, the WG is keen to address these topics in greater detail in this Position Paper.

Recent Developments

Following China’s pledge at the 2009 Copenhagen Summit to reduce carbon intensity per Gross Domestic Product (GDP) by 40-45% by 2020 compared to 2005 levels, a series of policies and plans were announced in China in 2010 to provide a regulatory and legal framework to reduce emissions and mitigate climate change.

In 2009, China started work on a regulatory and legal framework on climate change and emission reductions. Expected to be announced in 2011, China is developing the Measures on Trade of Voluntary Emission Reduction of Greenhouse Gas Activity in China (Draft), which will regulate the market for Voluntary Emissions Reduction (VER) projects. According to the National Development and Reform Commission (NDRC) of China, Chinese CDM projects approved by NDRC but not yet registered by the CDM Executive Board (EB) will be eligible for trading in this market. In March 2011, the 12th Five-Year Plan was adopted, containing a Carbon Intensity Target of 17% (reduction in carbon emissions per unit of GDP from 2010 levels by 2015), an Energy Efficiency Improvement Target of 16% and a Non-Fossil Fuels in Total Energy Mix Target of 11.4%. Also during this time, the NDRC called for a public consultation at Climate Change Mitigation Law.

At the local level, five provinces (Hubei, Guangdong, Liaoning, Shaanxi, and Yunnan) and eight cities (Baoding, Chongqing, Guiyang, Hangzhou, Nanchang, Shenzhen, Tianjin and Xiamen) were chosen as Low Carbon pilot provinces and cities. These areas are expected to develop a low-carbon roadmap to restructure their economy and establish pilot projects, such as for emissions trading, green buildings and transportation. Guangdong province set its carbon intensity target at 30% below 2005 levels by 2015 and plans to establish voluntary carbon trade pilot projects in 2012 as well as to launch provincial-level carbon trading officially in the next three to five years.
Beijing established its environment exchange in 2008 that announced the first VER standard, the Panda Standard, in China in 2010. Cities not selected as a Low Carbon pilot are also keen to gain access to carbon finance. The results of international negotiations in the next two years will also shape the development of the Chinese carbon market. The current lack of an international agreement on a second commitment period under the Kyoto Protocol may mean that bilateral agreements can be options to help China achieve its emission reductions and gain financial support in the absence of international consensus. According to the latest European Union (EU) provisions (reflected in amendments to EU Emission Trading Scheme (EU ETS) Linking Directive), CDM credits from projects registered after 31st December 2012 will only be allowed into the EU ETS if such projects are located in Least Developed Countries (LDC). Therefore, to continue emission reductions through the CDM in the absence of an international agreement, China needs to reach agreement with individual EU Member States. If Chinese emission reduction credits can only be traded on domestic platforms in China, this will reduce liquidity and increase abatement costs for EU Member States. One of the urgent examples is the inclusion of Chinese airlines in the EU ETS. Starting from 1st January 2012, all airlines flying in and out of the EU will face an absolute cap on carbon emissions under the EU ETS. Despite strong opposition by the China Air Transportation Association (CATA) to include Chinese airlines, the Civil Aviation Administration of China (CAAC) in April 2011 set an Energy Intensity and Carbon Intensity Target for Chinese civilian airlines of 22% reduction from 2005 levels by 2020. By reaching a bilateral agreement with the EU, China can create potential domestic and bilateral demands for emission reduction credits.

The carbon market in China is maturing and moving up the abatement curve towards increased transfer of technology and know-how. However, the combination of domestic policy, EU restrictions and the lack of an international agreement on the market post-2012 pose a severe restraint on the development of the carbon market. The WG is confident that a combination of international engagement and domestic policy can stimulate finance and significant transfers of technology and know-how so as to achieve the ambitious carbon and energy intensity targets that China has set for itself.

Key Recommendations

1. Promote the Advancement of the CDM as a Project Finance Mechanism that Incentivises Private Sector Investment in Climate Change Mitigation Projects

Concern

The first commitment period under the Kyoto Protocol (2008-2012) is coming to a close and, as yet, there are no internationally agreed targets for a second commitment period beginning in 2013. This severely inhibits the growth of carbon finance, particularly private sector finance, up to a level necessary to promote technology transfer, mitigate Greenhouse Gases (GHGs), implement adaptation actions or promote capacity building, and limits mobilization of the necessary flows of private sector financing to fight climate change.

The EU ETS will continue to accept credits post-2012, but only for projects registered before 1st January 2013 and for projects registered after that date which are located in a LDC. As it stands, there will be no new investment in CDM projects in China post-2012 since the EU ETS remains the main market for CDM credits.

Assessment

The CDM is the first internationally approved mechanism to provide private sector finance for GHG emission reductions in developing countries. The CDM has been incredibly successful in reducing emissions and mobilising private sector finance. Over 6,000 projects have either been registered or are in the CDM pipeline, of which over 50% are located in China, with an estimated emission reduction of 2.7 billion tonnes of Carbon Dioxide Equivalent (CO₂e) by 2012, of which 2 billion tonnes will come from projects already registered with the United Nations Framework Convention on Climate Change (UNFCCC).

The CDM has seen vast improvements following decisions made at the UNFCCC climate change talks in Copenhagen (2009) and Cancun (2010). These decisions have shortened the time for project registration, brought about simplified modalities for micro-scale projects, introduced the concept of standardised baselines to improve the efficiency of project development and called for the simplification of Programmes of Activities (PoAs).

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Despite the success of the CDM, continued improvements to it, and the fact that the CDM is the only international carbon finance mechanism for the private sector, its future remains uncertain.

The Cancun Agreements called for the continuation of the CDM, specifically stating that “emission trading and the project-based mechanisms under the Kyoto Protocol shall continue to be available to Annex I Parties as a means to meet their quantified emission limitation”. However, given the uncertainty surrounding an agreement on quantified emission limitations post-2012, there remains uncertainty over the future use of CDM credits.

The EU ETS will allow the entrance of CDM credits after 2012, but with restrictions. Currently, credits from projects registered post-2012 allowed into the scheme will be restricted to projects in LDCs. If an international agreement is reached, the eligibility of CERs entering into the EU ETS could be extended beyond LDCs to also allow projects in underrepresented sectors and regions. If an international agreement is delayed, individual Member States can engage in bilateral agreements with non-LDCs, such as China, regarding CER eligibility to meet their specific emission reduction targets. Importantly, there is currently no clarity on either of these two scenarios.

Furthermore, the Copenhagen Agreement called for scaled-up finance for mitigation in developing countries, specifically agreeing to a target of USD 100 billion per year by 2020 with funding from both public and private sources. New mechanisms have been proposed for the private sector, such as a sectoral mechanism, however the modalities of such a mechanism do not exist yet.

It should be remembered that it took seven years after the Kyoto Protocol was agreed in 1997 for the first CDM project to be registered and more than ten years for that same project to reach its first issuance. Therefore, the private sector is concerned that unless specific prompt start provisions are made, there remains a risk that new mechanisms will not contribute significantly to mitigation efforts prior to 2020. Consequently, the private sector is looking to the continued advancement of the CDM to scale up investment and complement any new mechanism(s).

The Working Group welcomes the reforms to the CDM that have improved the efficiency of the mechanism and its attractiveness as a financial instrument and looks forward to its continued advancement. However, the fundamental issue of how the credits can be traded post-2012 must be addressed first. It is critical that the CDM continues to play a significant role in attracting private finance to mitigation activities and that, where possible, mechanisms for scaling up the CDM to maximise the mitigation impact is sought, e.g. the introduction of standardised baselines and reform of the rules for PoAs.

**Recommendation**

- Reduce investor uncertainty by the European Commission (EC) and China working to reach an international agreement on targets and commitments post-2012 in order to continue the global carbon market post-2012
- Recommend that the EC and the EU Member States should provide clarity and guidance to the private sector on the potential acceptance of CDM credits into the ETS through the use of bilateral and any ongoing multilateral arrangements
- Encourage China and the EU to engage in a bilateral agreement for the trading of high quality CDM credits that may be defined as micro-scale projects, small scale projects in sectors not subject to international leakage (such as transportation or buildings), and projects developed in China’s underdeveloped zones or underdeveloped sectors
- Urge China, the EU and all parties under the UNFCCC to push for continued advancement of the CDM as it is the only private-sector finance mechanism for developing countries, specifically calling for development of and support for standardised baselines and reforms to the rules for PoAs
- Encourage Chinese negotiators to continue to highlight the steps China is taking domestically as part of their contribution to international GHG mitigation

2. Provide Clarity in the Approach to Post-2012 Market Through the Implementation of Sustainable Practices and Price Structures

**Concern**

Considering the restrictions in the EU ETS (highlighted in section 1), which is the main market for CDM credits, it is the goal of players in the carbon market in China to successfully register projects before the end of 2012 and
to maximise the value of the carbon credits generated via a sustainable and equitable commercial agreement.

The approach to the issuance of post-2012 Letters of Approval (LoA) by the NDRC, China’s Designated National Authority (DNA), is still unclear, both in terms of the required commitment and allowed pricing structure. This uncertainty limits funding for project development, reduces the number of projects able to enter the pipeline and incentivises speculative market approaches that do not bring sustainable value to either Chinese or European market participants.

**Assessment**

The vast majority of projects starting development now will not be able to reach issuance of credits pre-2013; hence the development of these projects is financially justified only by taking into account the emission reductions that will be issued after 31st December 2012. Certainty on obtaining the post-2012 LoA and commitments required by parties to obtain this is essential in order to evaluate the investment to develop a CDM project.

The Chinese CDM industry has reached a remarkable maturity: project proponents are aware of international regulations, regulatory risks, market prices and fair returns. The function of price indication fulfilled so far by the indicative floor price is now unnecessary. Most buyers are now ready to offer a discount price over the EU ETS secondary CER market. This provides an excellent valorisation of CERs, making sure that, at every market level, the majority of revenues will remain in China.

Fixed prices, especially at a time in which EU ETS market liquidity for post-2012 CERs is still low, are often used by some bidders to take speculative positions. The position is not hedged and the fixed price is generally too high for the market level at that point. This fixed price is used to secure the project and will generally only be paid if the market conditions allow doing so. When market prices are low the speculative buyer may simply exit from the commercial agreement, leaving the project owner in a very difficult position and with no achievement of emission reductions. Similar cases have occurred already in this market, which could be mitigated by allowing floating price structures.

The EU ETS is by far the biggest end market for Chinese CERs and it represents, currently, the only post-2012 demand. Reflecting this strong link in the origination regulatory and contractual framework will ultimately maximise the volume and value of Chinese CERs and lower the default risk in commercial agreements.

**Recommendation**

- Clarify the post-2012 regulatory process for the CDM, including the process (commitments and pricing structures) for obtaining a post-2012 LoA
- Allow flexible pricing structures post-2012 linked to the secondary CER market price, which could include an indicative price based on flexible pricing structure linked to the secondary CER market price

3. Provide Clarity on Domestic Greenhouse Gas Emissions Reduction Mechanisms in China and the Role of the Private Sector

**Concern**

It remains unclear what specific roles regulatory entities, emissions trading platforms, and other stakeholders will play in the design and implementation of Chinese domestic emission reduction schemes, particularly in the early stages of scheme design to facilitate investment and prevent any risk of market fragmentation. Moreover, it is important to understand what kind of role the private sector (either domestic or international) is expected to and can play at each design stage.

**Assessment**

During last year there were several key political developments in China towards the implementation of domestic GHG emission reduction mechanisms. Within the timeframe of the 12th Five-Year Plan, which for the first time in such a Plan sets a Carbon Intensity Target in addition to an Energy Efficiency Target, several pilot schemes, such as the five provinces and eight cities selected by NDRC for Low Carbon pilot projects, might emerge at the provincial and municipal levels. While policy movement towards implementing domestic schemes has been rapid, it is necessary to be careful when establishing schemes and clarifying scheme structures in order to ensure that they are sustainable and robust.

A country as diverse as China will face many challenges when implementing future Emission Trading Schemes (ETSs), whether they are voluntary or mandatory. The marginal cost of abatement will show huge variations across sectors and provincial boundaries. Balancing these challenges should be taken into account from the design stage of any scheme and it will be key to the successful development of trading systems for environmental products in China.
Section Three: Trade in Goods

From an economic perspective, in order for a market to operate efficiently there needs to be a high degree of liquidity brought about by trading homogeneous products. For the carbon market, this means that the differing products created by standards traded on divergent platforms will affect the liquidity of the market and the cost effectiveness of GHG mitigation efforts. In this context, it is important that domestic linking mechanisms are considered at the earliest stage of the design of such schemes.

Defining interactions between municipal and provincial schemes will allow for a solidified national approach to mitigate climate change. The option to link or not link domestically or with other schemes is the decision of the Chinese government, but this should be considered when designing individual schemes so that unwanted fragmentation in the market is minimised. Homogeneity of environmental products regardless of which municipal or provincial scheme they come from will further attract private sector finance and engagement in them.

There is a wealth of experience in the carbon markets from businesses in China, such as those represented in this WG, that have worked on the development of GHG mitigation projects under the CDM and voluntary markets, as well as those that have been actively involved in the development of domestic trading schemes in the United Kingdom and European Union. The WG would like to offer its expertise in the development of pilot GHG mitigation schemes in China.

Recommendation

- Clarify the role of pilot voluntary schemes in the context of establishing a mandatory pilot ETS in China, particularly if participation (as an emitter or trader) is voluntary
- Explore the complementary role, if any, between future renewable energy credit/energy savings (e.g. white certificate) scheme and GHG ETSs
- Create a regulatory body that plays an overarching role, linking different pilot domestic schemes under a national approach nationally with the goal of managing GHG emissions and mitigating climate change impacts
- Clearly define metrics for carbon and energy intensity targets defined under the 12th Five-Year Plan in order to measure the effective implementation of its targets over time
- Clarify the roles of and relationships between different market players and stakeholders in the design of the carbon market schemes
- Share experiences and knowledge from EU stakeholders, including the private sector, regarding the design and operation of domestic schemes, with Chinese counterparts
- Engage the private sector in the design of domestic schemes

4. Promote Mechanisms Complementary to the CDM to Scale up Greenhouse Gas Emissions Management and Reductions in China

Concern

The scaling up of GHG emission reductions is needed to further mitigate climate change impacts. The CDM has been successful in reducing emissions, however due to continued growth in global emissions and the CDM’s project-specific nature, its contributions are limited. GHG mitigation mechanisms complementary to the CDM, such as standardised baseline approaches (mentioned in point 1 above) and PoA under the Programmatic CDM (PCDM), along with new mechanisms, should be enhanced or developed to expand the scope of GHG emissions management and scale up emission reductions over the global economy in a cost-effective manner.

The private sector is willing and ready to engage in activities that go beyond the CDM, but investment in and development of such activities hinge upon appropriate mechanism design, which must clarify key elements, such as institutional and operational structure, eligibility and predictability, incentives and investment uncertainty. New mechanisms at the domestic, bilateral and multilateral levels need to be carefully designed in order to incentivise private sector engagement, transfer low-carbon technologies, and deliver scaled-up emission reductions.

Assessment

Development of standardised baselines and expansion of PoA under the CDM and development of new market-based mechanisms at the domestic, bilateral, and multilateral levels will expand the scope of GHG emissions management and scale-up emission reductions beyond what the traditional CDM is delivering.

Standardised Baselines

In Cancun (2010), the concept of standardised baselines was introduced under the CDM.\(^5\) Their application, defined as a baseline established for a country or a group of
countries to help determine emission reductions and additionality for the CDM project activities, could clearly simplify approach to emission reduction calculations and define clearly of what project activities are additional. This gives more certainty to investors in developers of project types applying standardised baselines while maintaining environmental integrity. Standardized baselines could also be applied as a tool to further incentivise activity in under-represented project types and regions and scale up emission reductions.

Since the EB deliberations in April 2011, high-level guidance is being developed within which standardised baseline methodologies can be submitted.

Programme of Activities

PoA under the CDM allows a multitude of project-based activities to be developed under an overarching framework. It also allows the combination of several methodologies under one single PoA and is one means of scaling up emission reductions complementary to “traditional” project-based CDM, but is not yet widely applied.

There are recent positive signs regarding PCDM: the number of PoAs that started the public comments period is almost more than double to the current 81 since the PCDM guidelines were last revised at the 55th meeting of the CDM EB (EB55) in July 2010; PoAs started being developed in new countries, and energy efficiency / demand side management project types are taking the lead. It seems that as market players become more familiar with the “architecture” of PCDM it starts fulfilling its intended role, but in order to scale up emission reductions, further simplification and operationalisation of PCDM guidelines are needed.

In early 2011 there was a call for public input7 from stakeholders looking for possible alternative concepts for a PoA, and barriers and gaps in the current rules should be included.

According to an information note from the EB8 based on a summary of the input received, the EB agreed to provide guidance9 to the Secretariat highlighting priority areas and specific expectations to be addressed in the context of the deliverables contained in the CDM Management Plan 2011 such as:

a) Providing stakeholders with guidance on the demonstration and assessment of additionality at the programme level, in particular policy-driven programmes.

b) Enhancing the flexibility of the regulatory framework in a manner that facilitates the development of programmes applying multiple emission reductions measures or technologies in a coordinated fashion, noting that it is likely that such programmes may need to apply multiple approved methodologies.

c) Providing clarity with regard to the expectations for eligibility criteria for the inclusion of Component Project Activities (CPAs).

d) Continue enforcing the procedures to avoid potential liabilities arising from erroneous inclusion of CPAs10.

The work towards improvement of procedural framework for PoAs should progress in conjunction with the consolidation of project cycle rules and requirements into clear standards and procedures including those for:

a) Development and operation of a PoA, which should include standards for the coordination of programmes applying multiple emission reduction methods.

b) Development of eligibility criteria for the inclusion of CPAs.

c) Demonstration of additionality of a PoA.

d) Sampling.

e) Revised procedures to address, and certainty regarding liability for, the erroneous inclusion of CPAs.

A PoA Stakeholder Workshop as part of the plans above was convened by the Secretariat in May 2011.

New Mechanisms

The Cancun Agreements state that the CDM and other flexible mechanisms should continue to be available to
developed countries to meet their targets. In Decision 1/CP.16, the Parties agreed that the establishment of one or more market-based and one or more non-market-based mechanisms shall be considered at the 17th Conference of Parties to be held in Durban, South Africa in December 2011. Proposals for new mechanisms by governments and stakeholders have been developed in light of the need to scale up emission reductions beyond what the CDM is capable of delivering. Proposals for market-based mechanisms include ETSs, no-lose sectoral targets / crediting, sectoral crediting and nationally Appropriate Mitigation Actions (NAMAs) crediting.

In developing new mechanisms and ultimately an overarching architecture for global emissions management, it is critical to recognise that national circumstances vary, and that different sectors within a country may be at different levels of development. Therefore, any market-based mechanism or basket of approaches should be designed to accommodate these variances. Different countries and sectors can be managed by different mechanisms, and over time sectors can improve their infrastructure such that a transition to a more advanced GHG management approach or reduction mechanism can be applied.

While country and sector circumstances should be recognised, basic elements should be integrated into the fundamental design of market-based mechanisms regardless of the levels they are applied at. Basic elements of a market-based mechanism that will ensure mobilisation of private sector finance and engagement, transfer and deployment of low carbon technologies, and delivery of GHG emission reductions across a greater portion of the global economy are:

- **Demand:** whether it be a cap or target or mandatory or voluntary nature, the overall goal must be clear and ambitious in order to shape the market over the long term.
- **Incentives:** new incentives for low carbon activities that have previously been deemed unattractive.
- **Certainty:** regulatory certainty and stability over the lifetime or crediting period of the activity is needed to maintain investors’ confidence in the market.

**Institutional Structure:** develop transparent, efficient and professional institutional structures to allow for good governance.

**Fungibility:**
- **Accounting and assessment:** create means for measuring, reporting and verifying emission reductions and actions to ensure a high value and fungibility of the resulting emission reduction in a global carbon market.
- **Environmental Integrity:** maintain a balance between cost effectiveness and environmental integrity to ensure that activities result in real and unique GHG emission reductions (i.e., no double counting) which are then fungible.

Outside of the multilateral process at the UNFCCC, individual governments are pursuing GHG emission reduction initiatives at the domestic and/or bilateral levels, e.g. EU and Japan with China. Many of the current domestic and bilateral approaches are at the initial design stages where the structure of the approach has yet to be determined, as is the role of the private sector. The above basic elements should also be considered in the design of domestic and bilateral approaches, especially if the private sector is expected to play a role in financing, developing and implementing GHG mitigation activities.

A basket of new market-based mechanisms that build upon and work in parallel to existing mechanisms and recognize differences in national and sector circumstances can be created at various levels to scale up GHG emission reductions in a cost-effective and efficient manner. The interaction between the mechanisms applied at various geographic levels is the decision of each country involved in them; however, application of fungible units across mechanisms (common currency) and shared Measurable Reportable and Verifiable (MRV) principles will provide greater incentive to the private sector to engage in those mechanisms.

**Recommendation**

- Encourage the UNFCCC to develop high level guidance for standardised baseline proposals as soon as possible.
so project proponents in China can put forward new proposals
- Urge the EC and/or individual Member States through bilateral agreements could accept into Phase III of the EU ETS credits from all PCDM/ specific types of PCDM projects even if they are registered post-2012
- Urge China to press the EC for clarity on the eligibility of CERs from CPAs included post-2012 into PoAs registered pre-2013
- Develop a basket of new market-based mechanisms complementary to the CDM that recognise differences in national and sector circumstances (“common but differentiated responsibilities”) in order to scale-up emission reductions globally, and allow the private sector to work with policymakers on the design
- Recommend to climate change country representatives that new market-based mechanisms should have clear and ambitious goal(s) to shape, drive and create market demand
- Urge country representatives to clarify the interaction (or lack thereof) between each mechanism, while recognising that the decision of how existing and new mechanisms at various levels interact is up to each country involved

Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CAAC</td>
<td>Civil Aviation Administration of China</td>
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<td>CATA</td>
<td>China Air Transportation Association</td>
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<td>CDM</td>
<td>Clean Development Mechanism</td>
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<td>CER</td>
<td>Certified Emission Reduction</td>
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<td>CME</td>
<td>Coordinating Managing Entity</td>
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<td>CO₂e</td>
<td>Carbon dioxide equivalent</td>
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<td>CPA</td>
<td>CDM Programme Activity</td>
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<td>DNA</td>
<td>Designated National Authority</td>
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<td>DOE</td>
<td>Designated Operational Entity</td>
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<td>EB</td>
<td>Executive Board</td>
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<td>EC</td>
<td>European Commission</td>
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<td>ETS</td>
<td>Emission Trading Scheme</td>
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<td>EU</td>
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<td>EU ETS</td>
<td>European Union Emission Trading Scheme</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GHG</td>
<td>Greenhouse Gas</td>
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<td>LDC</td>
<td>Least Developed Country</td>
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<td>LoA</td>
<td>Letter of Approval</td>
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<td>MRV</td>
<td>Measurable, Reportable and Verifiable</td>
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<td>NAMAs</td>
<td>Nationally Appropriate Mitigation Actions</td>
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<td>NDRC</td>
<td>National Development and Reform</td>
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<td>PCDM</td>
<td>Programmatic CDM</td>
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<td>PoA</td>
<td>Programme of Activity</td>
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<td>UNFCCC</td>
<td>United Nations Framework Convention on Climate Change</td>
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<td>USD</td>
<td>US Dollar</td>
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<td>VER</td>
<td>Voluntary Emission Reduction</td>
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<td>WG</td>
<td>Working Group</td>
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Key Recommendations

1. Revision of Cosmetics Hygienic Management Rules (CHMR)
   - Speed up the revision of the CHMR and establish a unified, coordinated, highly efficient and sound cosmetics regulation system to protect consumer safety and encourage industry innovation and development.

2. Multiple Regulations
   A. Dual Licensing for Production Companies
      - Unify and streamline the specific roles and responsibilities of the SFDA and AQSIQ in cosmetics manufacturing.

   B. Overlapping Issues Between the Cosmetics Standards Committees
      - Coordinate by the State Council the various standards committees, similar to the Food Safety Law’s streamlining of the standards system, and define product safety as the key direction of cosmetic standardization.

   C. Dual Compulsory Cosmetics Hygiene Standards
      - Streamline cosmetics hygiene standards through coordination between MOH/SFDA and AQSIQ.

3. Evaluation of Cosmetic Risky Substances
   - Establish cosmetics safety evaluation guidelines based on the model adopted for food safety assessment; define the organisation responsible for the evaluation of hazardous substances in cosmetics and its work plan.
   - Publish and update regularly the list of hazardous substances and their quality and safety requirements to enhance cosmetics safety regulation.

4. Product Registration
   A. Simplify the Imported Non-Special Purpose Cosmetics Filing Process
      - Simplify imported non-special purpose cosmetics filings by including only type-approval by the SFDA Acceptance Centre (without technical review or administrative approval). A filing certificate should be issued at the site or within five working days, providing documents are complete.
      - Until the technical review is removed, establish a “Further Document Needed” process for the import of non-special purpose cosmetics registration.

   B. Examination and Approval of Domestic Special-Purpose Cosmetics
      - Remove the provincial manufacturing capability review and replace it with the submission of a faxed copy of the Cosmetics Manufacturing Hygienic Licence in the application materials.
      - Remove the pre-requisite of the manufacturing capability review as cosmetics administrative licensing testing.

   C. Approval and Administration of New Ingredients for Cosmetics
      - Release detailed requirements on the new ingredients technical review based on the newly released Cosmetics New Ingredients Application and Review Guideline.
      - Eliminate the registration of cosmetics new ingredients or at least limit it to a few types of special purpose ingredients, i.e. preservatives, colorant, sun screen and hair dye based on experiences from areas such as the EU.
      - Include all the ingredients which are/were used in cosmetics in the Chinese market, if a list of used cosmetic ingredients is to be developed.
D. Improvement of Cosmetics Administrative Licensing Procedure and Requirements

- Allow the signature of legal representatives for domestic manufacturers when applying for domestic special-purpose cosmetics in accordance to Article 63 of the General Rules of Civil Law.
- Simplify the approval process to shorten approval time for non-safety-related update, cancellation, and termination applications.
- Allow parallel applications of new products and the cancellation of existing products for “same-name application” where the formula has been changed but the product name remains the same, like the practices for pharmaceutical and medical devices.
- Establish regular training and communication with the Food Licensing Department of the SFDA, Acceptance Center, Review Center and reviewing experts.

E. Technical Evaluation Guidelines for Baby and Pregnant Women Products

- Issue related technical guidelines as soon as possible so that product registration can be resumed.

5. Animal Alternative Testing (AAT)

- Accept data that is acquired by AAT methods in cosmetics and new ingredients registration.
- Encourage the application of AAT to reduce testing on animals.

6. Business Related Issues

A. Enterprise Income Tax

- Grant a 30% pre-tax deduction to all cosmetics enterprises, considering the heavy reliance of the cosmetics enterprises on advertising and service promotion.

B. Consumption Tax on Cosmetics and Perfume

- Decrease the high consumption tax on cosmetics and perfume products, considering that cosmetics have already become an essential part of the lives of many Chinese consumers.

C. Advertising Regulation

- Specify the applicable laws and regulations that apply to cosmetics advertising and are practised by SAIC as well as its local branches and clarify the principles for handling any overlap between laws and regulations.

D. Online selling of Cosmetics

- Lift the threshold for e-commerce entities, i.e. only a market entity that is licensed by the SAIC can engage in selling cosmetics online.
- Strengthen relevant procedures for these entities to protect the consumer.

7. Sun Protection Factor (SPF) Labelling 50+

- Allow the SPF labelling limit to be changed to SPF 50+ with re-evaluation by Chinese experts to ensure better sun protection and improved choice of sun protection products for consumers (especially for people highly sensitive to the sun and/or undertaking constant outdoor/sun-exposed activities).
Introduction to the Working Group

In 2011 the Cosmetics Working Group consists of more than 50 registered members of different business models, including industry leaders firmly established in the Chinese market. The majority of the members have established research and development (R&D) and production facilities in China. Their expertise in the field is widely recognized by consumers and has made a significant contribution to China’s cosmetic industry’s development. Their presence has acted as a catalyst for other major industries, such as fine chemicals, packaging, logistics and advertising industries.

The Cosmetics Working Group’s objectives are to:

- Represent the interests of European cosmetics companies and facilitate information exchange among members, professional associations and regulatory bodies.
- Promote an efficient, fair and transparent regulatory environment in the cosmetics field by encouraging greater dialogue between members and the Chinese authorities.
- Protect consumers safety together with the various stakeholders.

Recent Developments

The Chinese cosmetics market has continued to develop rapidly, becoming the world’s second largest. Fuelled by rising disposable income and an increasing propensity to consume, products previously considered luxury items are increasingly becoming daily consumables. Overall the cosmetics market is expected to grow at around 12% from 2011 to 2014 (China).

During the past 12 months, a significant number of new regulations have further strengthened the market. From April 2010 to April 2011, the State Food & Drug Administration (SFDA) alone issued 46 specification documents and called for comments on 24 draft regulations.

Currently, there are two other major pieces of legislation being revised: 1) the renewal of the Hygiene Standard for Cosmetics (last updated in 2007) is being reviewed by the Cosmetics Standard Committees of the Ministry of Health (MOH) and the SFDA; and the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) is revising the Regulation of Enforcement for Cosmetic Product Production Permit and Regulation of Inspection for Cosmetic Product Production Permit.

Also, the Cosmetics Import & Export Inspection and Quarantine Management Rules are undergoing WTO/TBT public consultation, with an expected release by the end of 2011.

The Cosmetics Working Group greatly appreciates the open attitude of SFDA, MOH, and AQSIQ and their relevant call for comments from the industry on various issues. However, given the significant number and importance of new regulations, the industry is at times concerned by the insufficient short consultation times offered for comments on draft legislation and “grace periods” for implementation. In order for the Working Group to effectively comment on such drafts in a constructive and coordinated manner, normally a minimum of 10 working days is required.

The Working Group also notes that a number of ongoing regulatory issues that remain unresolved. For example,

- multiple cosmetics standards and standards committees still exist;
- no substantial progress has occurred regarding lifting the Sun Protection Factor (SPF) upper limit.
- a multiple approval procedure is still compulsory, leading to extensive waste of government administration resources and unnecessary delays in bringing the product to market, which is unfavourable to the fast and healthy development of the cosmetics industry.

The Working Group requests that relevant government organisations, based on the successful practices of the Food Safety Law such as the streamlining of manufacturing licences, transparent risk assessment and communication on risk, make product manufacturers the major party responsible for product safety; establish a scientific and reasonable safety assessment system and, by removing pre-market registration, promote an efficient, scientific unified market surveillance system to safeguard product safety.
Key Recommendations

1. Revision of Cosmetics Hygienic Management Rules (CHMR)

Concern
Given the rapid development of the cosmetics industry, the current CHMR cannot meet the urgent need for a cosmetics regulation system reform.

Assessment
- The current CHMR is based on a model from the 1980s planned economy. In today’s market economy there are large discrepancies between the fast-moving consumer goods industry (FMCG) and the 1980s cosmetics industry. It is widely held by the industry, regulators and experts that the CHMR can no longer meet the regulatory needs for the industry’s healthy development.
- Despite CHMR’s goal of ensuring product safety, the reality is that CMHR’s excessive emphasis and dependency on pre-market registration neither ensures product safety nor makes product safety primarily the manufacturer’s responsibility. Product safety can only be achieved through scientific safety assessment, risk communication and risk management.
- The current CHMR manages the market through multiple regulators including AQSIQ and SFDA, causing duplication. Only through revising CHMR can the regulation system be streamlined and coordinated.
- The CHMR is hampering innovation, the lifeline of the cosmetics industry. As global leader of many manufacturing industries, China can, through CHMR revision, increase the cosmetics industry’s productivity and scientific development.

Recommendation
- Speed up the revision of the CHMR and establish a unified, coordinated, highly efficient and sound cosmetics regulation system to protect consumer safety and encourage industry innovation and development.

2. Multiple Regulations

A. Dual Licensing for Production Companies

Concern
Currently, cosmetics manufacturers must acquire two licenses: SFDA’s Cosmetics Manufacturing Hygienic License and AQSIO’s Cosmetics Manufacturing Production License. The dual-licensing system’s additional burden to companies consequentially results in higher costs for consumers.

Assessment
Despite the emphasis of one on hygiene and the other on quality, the two licences’ ultimate goal is industry regulation and the ensuring of product safety through factory inspection with similar inspection items.

Recommendation
- Unify and streamline the specific roles and responsibilities of the SFDA and AQSIQ in cosmetics manufacturing.

B. Overlapping Issues Between the Cosmetics Standards Committees

Concern
Due to a lack of coordination between various cosmetics standard committees and overall planning, a number of repetitive standards projects have emerged and their quality varies.

Assessment
At present, there are at least five national industrial standard committees that regulate the cosmetics industry. At the national level they are:
- The National Fragrance Flavour Cosmetics Standards Committee under the SAC of AQSIQ;
- MOH Cosmetics Standards Committee;
- National Quality Supervision Key Product Assessment Methods Technical Committee;
- Entry-Exit Inspection and Quarantine Bureau Standards Committee under AQSIQ, and
- SFDA Cosmetics Standards Committee.

It is very difficult for companies to comply with the uncoordinated standards drafted by multiple standards committees that are repetitive and inadequately planned.

Recommendation
- Coordinate by the State Council the various standards committees, similar to the Food Safety Law’s streamlining of the standards system and define product safety as the key direction of cosmetic standardization.
C. Dual Compulsory Cosmetics Hygiene Standards

Concern
Currently, the cosmetics industry must comply with two different sets of cosmetics standards: the 2007 “Hygiene Standard for Cosmetics” issued by MOH and the “Cosmetics Hygiene Standard” (GB 7916-87) issued by AQSIQ in 1987.

Assessment
The Cosmetics Hygiene Standards, released in 1987, includes technical specifications that cannot guarantee consumer safety and are not in accordance with industry development and regulatory requirements. Some clauses even contradict the Hygiene Standards for Cosmetics issued in 2007.

Recommendation
• Streamline cosmetics hygiene standards through coordination between MOH/SFDA and AQSIQ.

3. Evaluation of Cosmetic Risky Substances

Concern
The issue of the safety of hazardous materials in cosmetics has already become a major and complex regulatory problem. The establishment of appropriate evaluation and communication processes is urgently needed.

Assessment
At present, there is no formal mechanism for the evaluation and communication of key cosmetics hazardous substances (i.e. traces of ingredients that are prohibited). Even when an appropriate assessment is done, there is still a lack of transparent, public communication and risk management systems. Therefore, the result is these evaluations are not implemented in product safety regulation. When there is an event that causes public/media concern, consumers are not given the proper and timely guidance on issues relating to traces of banned substances.

Recommendation
• Establish cosmetics safety evaluation guidelines based on the model adopted for food safety assessment; define the organisation responsible for the evaluation of hazardous substances in cosmetics and its work plan.
• Publish and update regularly the list of hazardous substances and their quality and safety requirements to enhance cosmetics safety regulation.

4. Product Registration

A. Simplify the Imported Non-Special Purpose Cosmetics Filing Process

Concern
The current filing process for importing non-special purpose cosmetics, which includes a technical review, does not allow a second chance for the provision of additional information, causing a complicated and long process even compared with special purpose cosmetics.

Assessment
The Working Group welcomes SFDA’s Notification on Further Simplification of Non-Special Purpose Cosmetics Filing Process4. However, we believe that a comprehensive simplification should start from the filing process itself so that companies can truly file the application.

Recommendation
• Simplify imported non-special purpose cosmetics filings by including only type-approval by the SFDA Acceptance Centre (without technical review or administrative approval). A filing certificate should be issued at the site or within five working days, providing documents are complete.
• Until the technical review is removed, establish a “Further Document Needed” process for the import of non-special purpose cosmetics registration.

B. Examination and Approval of Domestic Special-Purpose Cosmetics

Concerns
The new licensing rules require a two stage procedure for domestically manufactured special-purpose cosmetics. A provincial-level manufacturing capability review (provincial review) must occur prior to the relevant tests and application submission to the SFDA. The process is complicated and redundant.

Assessment
The provincial review’s purpose is to affirm that the products correspond with those in the Cosmetics Manufacturing Hygienic Licence and that the necessary equipment and production line is assembled. A copy of the Cosmetics Manufacturing Hygienic Licence is required.

• During the manufacturing hygienic licensing process, these

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items have already been reviewed and licensed. The provincial review is therefore an unnecessary, repetitive process.
• In practice, the provincial review might take around one or two months, which means an additional month on top of the lead time for the cosmetics administrative licensing process.

Recommendation
• Remove the provincial manufacturing capability review and replace it with the submission of a faxed copy of the Cosmetics Manufacturing Hygienic Licence in the application materials.
• Remove the pre-requisite of the manufacturing capability review as cosmetics administrative licensing testing.

C. Approval and Administration of New Ingredients for Cosmetics

Concern
Clause 9 of CHMR defines new ingredients in the manufacture of cosmetics as those natural or synthetic ingredients that are used domestically for the first time in cosmetics manufacturing. The use of new ingredients must be approved by the State Council Hygienic Administrative Organization. According to the SFDA’s explanation, all new materials used since CHMR’s implementation, which was on Jan 1, 1990 are considered new ingredients. The Working Group believes this explanation is unreasonable and impractical.

Assessment
• Unlike food and pharmaceuticals, cosmetic ingredients and products carry low human safety risk because they are applied to the skin and involve low exposure. Substantial amounts of cosmetic ingredients emerged during the last 30 years of rapid industry growth, the majority having traceable safety records after long-term usage. The current definition of new ingredients and the registration system, together with the establishment of a positive list of cosmetic ingredients, will hamper industry innovation and sustainable development.
• Meanwhile, in more mature markets such as the European Union (EU), United States (US) and Japan, no definition or registration requirements for cosmetics new ingredients similar to CHMR exists.

Recommendation
• Release detailed requirements on the new ingredients technical review based on the newly released Cosmetics New Ingredients Application and Review Guideline.
• Eliminate the registration of cosmetics new ingredients or at least limit it to a few types of special purpose ingredients, i.e. preservatives, colorant, sun screen and hair dye based on experiences from areas such as the EU.
• Include all the ingredients which are/were used in cosmetics in the Chinese market, if a list of used cosmetic ingredients is to be developed.

D. Improvement of Cosmetics Administrative Licensing Procedure and Requirements

Concern
Within the current cosmetics administrative licensing system, some procedures and requirements are not safety-related.

Assessment
The simplification of the registration process under the circumstances of ensuring product safety and truthful application can improve administrative efficiency, eliminate the burden of enterprises and is the future direction for reform.

Recommendation
• Allow the signature of legal representatives for domestic manufacturers when applying for domestic special purpose cosmetics in accordance to Article 63 of the General Rules of Civil Law.
• Simplify the approval process to shorten approval time for non-safety-related update, cancellation, and termination applications.
• Allow parallel applications of new products and the cancellation of existing products for “same-name application” where the formula has been changed but the product name remains the same, like the practices for pharmaceutical and medical devices.
• Establish regular training and communication with the Food Licensing Department of the SFDA, Acceptance Center, Review Center and reviewing experts.

E. Technical Evaluation Guidelines for Baby and Pregnant Women Products

Concern
Product registration relating to baby and pregnant-women products has been pending for more than 12 months, since April 1, 2010.
Assessment
According to the Cosmetic Administrative Licensing Application and Acceptance Rules, cosmetic products used by pregnant women, lactating women, children or babies must provide documents including product safety-based formula design principles, raw-material selection criteria, technology and quality control requirements, etc.

However, as the SFDA did not issue related technical evaluation guidelines, review experts were not able to proceed with the document evaluation and approval. Consequently, registration of all the aforementioned product has been on hold until now.

Recommendation
- Issue related technical guidelines as soon as possible so that product registration can be resumed.

5. Animal Alternative Testing (AAT)

Concern
China is the only country that requires compulsory animal testing for administrative licence applications for cosmetics new ingredients and finished products.

Assessment
- From March 2009, animal testing for cosmetics ingredients was banned in the EU. Marketing of cosmetic products that have been tested on animals has also been prohibited. As of March 2013, repetitive toxicology, reproductive toxicology and Acta toxicology animal testing will also be banned.
- After nearly 20 years of research, there are many mature AAT methods that are adopted in the EU. By the end of 2010, 13 methods including skin corrosion, metamorphosis and phototosity have been accepted by the OECD and were gradually put into use.
- Since 2000, Chinese experts have made great achievements to Reduce, Refine and Replacement (3R) of animal testing. Four test methods were released as standards in 2008 and 2009. They included eye irritation, developmental toxicology, phototosity and metamorphosis. In April 2009, three methods (eye irritation, phototosity and acute oral absorption) were approved by the Cosmetics Standards Committee of the MOH. The Import and Export Food Safety Bureau also released Good Lab Practice for AAT labs. Therefore, on the technical side, China is ready for AAT. However, since AAT data is not accepted by the SFDA’s cosmetics and new ingredients registration,

AAT in China is still in the process of scientific research with limited implementation. In April 2011, a successful international forum was held by the SFDA in Beijing. The industry expects solid policy as forward action of this forum.
- Compulsory animal testing is negatively affecting China’s export to the EU and its international image.

Recommendation
- Accept data that is acquired by AAT methods in cosmetics and new ingredients registration.
- Encourage the application of AAT to reduce testing on animals.

6. Business Related Issues

A. Enterprise Income Tax

Concern
On 31 July, 2009, the Ministry of Finance and the State Administration Taxation (SAT) jointly issued the Pre-tax Deduction of Certain Industry’s Advertisement and Promotion Fee [Cai Shui [2009]72]. According to Tax Notice [2009] 72, advertisement and business-promotion expenses for the manufacture of cosmetics, pharmaceuticals and beverages (excluding wine) within the 30% of sales income are allowed to be deducted. The excess part is allowed to be transferred to future tax years for deduction. However, this notice only applies to cosmetics manufacturing enterprises. For other enterprises such as companies involved only in cosmetics selling, the cap remains at 15%, which is unfair.

Assessment
In most international markets, enterprises can choose the deduction of advertisement and promotional fees depending on their own market judgement and revenue targets. Based on the development of industries at home and abroad, advertisement and promotion is still the key driver for performance growth. Enterprises’ expenditure in these areas far exceeds 15%. At the moment most of the cosmetics enterprises adopt a business model that separates manufacturing and sales. The two units belong to one company, with the sales sector covering the advertising and promotion fees. The manufacturing facility abroad or the parent company will not cover any advertisement or promotion fee occurring in China. Therefore, the industry believes that so long as the cosmetics companies are only engaged in selling the products produced by their parent company, no matter whether they are made in China or abroad, the [2009]72 Notice should apply. Different treatment of
domestic manufacturers and overseas manufacturers is contradicting the principle of fairness.

**Recommendation**
- Grant a 30% pre-tax deduction to all cosmetics enterprises, considering the heavy reliance of the cosmetics enterprises on advertising and service promotion.

**B. Consumption Tax on Cosmetics and Perfume**

**Concern**
In 1994 China started levying consumption tax on cosmetics and perfume products as luxury goods. The current consumption tax on luxury products is 30%.

**Assessment**
The consumption levels and attitudes of Chinese citizens have changed dramatically since 1994. Considering that cosmetics and perfume products such as lipsticks have already become a daily consumable in the lives of many Chinese consumers, classifying cosmetics as luxury goods and continuing to levy high consumption taxes on consumers will decrease the consumption level of cosmetics. It could also affect the development of the cosmetics industry in China. Moreover, with increasing numbers of Chinese citizens travelling abroad and purchasing cosmetics overseas, a considerable amount of the purchasing power has been diverted away from the Chinese market toward competing markets, causing the Chinese government to lose a large sum of value-added tax income.

**Recommendation**
- Decrease the high consumption tax on cosmetics and perfume products, considering that cosmetics have already become an essential part of the lives of many Chinese consumers.

**C. Advertising Regulation**

**Concern**
Multiple regulations concerning advertising by the cosmetics industry have resulted in enterprises facing varying punitive measures because law enforcement officials are often left to interpret and enforce the regulations based on their own personal understanding of the situation.

**Assessment**
At present, the domestic cosmetics industry is subject to the following four laws and regulations regarding advertising; the 1995 Advertising Law, the 1993 Measures on Administration of Cosmetics Advertising, the 2005 Measures on Administration of Advertisements on Printed Matters and the 1993 Law Against Unfair Competition. These laws and regulations tend to overlap in some provisions, including punitive provisions on a given advertising action and are rather vague in the expression of certain conceptual provisions. Different local State Administration for Industry and Commerce (SAIC) authorities often differ in their interpretations of the laws and regulations, leaving space for these authorities to freely interpret the regulations. This causes various law enforcers to have different judgments toward the same case.

**Recommendation**
- Specify the applicable laws and regulations that apply to cosmetics advertising and are practised by SAIC as well as its local branches and clarify the principles for handling any overlap between laws and regulations.

**D. Online selling of Cosmetics**

**Concern**
With the rapid development of e-commerce, internet cosmetics transactions are flooded with fake products, smuggled products and un-authorized selling activities. The proper rights of the consumers and cosmetics enterprises operating legally cannot be protected.

**Assessment**
It was estimated that the annual sales of on-line cosmetics exceeded 7 billion RMB in 2010. Due to delayed regulation and difficulties in managing the industry, online selling of fake and smuggled products is rampant. Being safety-related, the cosmetics business is strictly regulated in China. However, these regulations do not cover online sellers of cosmetics.

The Working Group is glad to see that on 1 June, 2011, the SAIC released the Order 49 to strengthen e-commerce regulation. We believe that the identification system that was introduced by this order laid the legal foundation to push forward the standardization of e-commerce.
Recommendation

- Lift the threshold for e-commerce entities, i.e. only a market entity that is licensed by the AIC can engage in selling cosmetics online.
- Strengthen relevant procedures for these entities to protect the consumer.

7. Sun Protection Factor (SPF) Labelling 50+

Concern

Since 2003 the Chinese legislation on Sun Protection Factor (SPF) labelling sets a limit of 30+ for sun protecting products with an SPF above 30. Other regulatory bodies, such as the US Food and Drug Administration (FDA) and EU regulators, have adopted a limit of 50+ for products with sun protection with an SPF above 50.

Assessment

China, like European countries and the US, sets limits on SPF labelling in its cosmetics regulations. The EU, US and China share a similar concept where the SPF rating cannot exceed certain limits. During the past seven years, sunscreen products have greatly improved in terms of ingredients, formulation and form. The current maximum of SPF30+ in China seriously lags behind the technical advancement. According to relevant studies conducted by experts from the EU and other countries, products with SPF30+ do not offer sufficient sun protection during outdoor activities.

This difference reduces the technical competitiveness of China’s domestic cosmetics industry in sunscreen products. While the SPF labelling on sunscreen products imported from many other countries is SPF 50+, the Chinese label can only claim an SPF of 30+. This not only confuses consumers, but also the regulator itself.

Recommendation

- Allow the SPF labelling limit to be changed to SPF 50+ with re-evaluation by Chinese experts to ensure better sun protection and improved choice of sun protection products for consumers (especially for people highly sensitive to the sun and/or undertaking constant outdoor/sun-exposed activities).

Abbreviations

AQS IQ General Administration of Quality Supervision, Inspection and Quarantine
CAFFCI China Association of Fragrance Flavour and Cosmetics Industries
CIQ China Entry-Exit Inspection and Quarantine Bureau
EC European Commission
ECVAM European Centre for the Validation of Alternative Methods
EEC European Economic Community
EU European Union
FDA Food and Drug Administration
GB Guo Biao (National Standard)
MOH Ministry of Health
OECD Organisation for Economic Co-Operation and Development
PRC People’s Republic of China
R&D Research and Development
SAC Standardisation Administration of China
SAIC State Administration for Industry and Commerce
SAT State Administration of Taxation
SFDA State Food and Drugs Administration of People’s Republic of China
SPF Sun Protection Factor
US United States
Key Recommendations

   - Clarify the margin structure for refining, wholesale and retail through transparent and fair price calculation methods that cover all ranges of possible crude oil prices, most particularly when crude prices go beyond USD 130/bbl
   - Stabilise the oil products retail and wholesale market through a more flexible price-adjustment structure that would prevent speculation
   - Provide incentives for high quality clean fuels and fuel additives and encourage the development of modern refineries with best engineering and process technologies as well as energy saving and emission reduction programmes
   - Reform the gas pricing policies to:
     1) Align prices of domestic gas with imported gas
     2) Allow third-party access to gas infrastructure (pipelines, LNG terminals and storage facilities) in order to remove overt and covert discrimination against private and foreign companies from accessing the gas market
     3) Create a gas trading market in which the price of gas from different sources can be ultimately determined by the market
   - Set a clear timetable for gas pricing reform and introduce third-party access to gas pipelines and LNG terminals
   - Eliminate the conflicts of coal price and power tariff through further reform of the electricity market, particularly via the establishment of a regional competitive power market

2. Create Conditions for Rapid Gas Market Development
   - Encourage exploration and development of upstream unconventional gas (CBM, tight gas, shale gas) through cooperation with foreign companies, enhancing the regulatory framework and granting preferential policies
   - Promulgate gas infrastructure regulations to enable open and non-discriminatory access by third parties
   - Extend the standard PSC terms for unconventional gas from 30 to at least 40 years
   - Grant more foreign cooperation licences for CBM to Chinese state-owned and private companies
   - Facilitate the appraisal and swift development of shale gas reserves by enacting a favourable regulatory system and fiscal incentives for investment

3. Ensure a Safe and Successful Implementation of the Chinese Nuclear Programme
   - Establish a clear legal and regulatory framework for the development of civil nuclear activities in China beginning with the promulgation of the awaited Atomic Energy Law (AEL) which should reflect in particular the internationally accepted principles regarding Nuclear Third Party Liability (NTPL)
   - Strengthen the power of the Chinese National Nuclear Safety Authority (NNSA) and of its supporting entity Nuclear Safety Centre (NSC), in terms of administrative independence, technical expertise and human resources. Further promote exchanges between the NNSA and major foreign nuclear safety authorities in order to take full benefit from lessons learnt from Fukushima events
   - Leverage the experience and knowledge of the European nuclear industry through the establishment of joint ventures (in the fields of nuclear plant operations, engineering and design, and heavy components manufacturing)
   - Ensure that the Chinese NNSA qualification criteria for joint ventures established in the China market in the
Introduction to the Working Group

The Energy Working Group (WG) comprises more than 70 member companies with a combined total cumulative investment in 2010 of around EUR 26 billion, and collective employment of more than 150,000 people in China. The largest European energy and equipment manufacturing companies as well as industrial energy consumers are active members of the WG.

The WG seeks to establish an effective and constructive dialogue on energy policies with appropriate Chinese authorities, 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;
- Promote the development and integration of clean and renewable energies.

In addition, in 2009 a Sub-Working Group on renewables was created and, in early 2010, a Sub-Working Group on Smart Grid was also established.

Recent Developments

2010/11 was the transition year from China’s 11th Five-Year Plan (FYP) to the 12th one. The energy sector continues to attract high level attention and has been filled with the following major events:

- Energy saving: As the deadline approached for the country to achieve the target of 20% energy intensity reduction over the 11th FYP, some local authorities resorted to cutting power supplies as a desperate measure to meet their respective targets. Overall, China declared it had achieved a 19.1% reduction.
- On 1 June, 2010, China raised well-head prices of natural gas by an average of 25%.
- On 10 October, 2010, China’s State Council published the Decision on Accelerating the Cultivation and Development of New and Emerging Strategic Industries. Energy saving and environmental protection, new energies and new energy vehicles are among the seven industries (the other four are new generation of information technology, biology, high-end equipment manufacturing and new materials) that are pinpointed as new and emerging strategic industries for priority growth from now to 2020, supported by various incentives. Altogether, these industries are expected to account for 8% of China’s Gross Domestic Product (GDP) by 2015 and 15% by 2020, from the current base of around 3%.
- Chinese National Oil Companies (NOCs) continued their aggressive overseas acquisition strategy with a total of USD 30 billion of investment during 2010.
- On 14 March, 2011, China’s National People’s Congress (NPC) concluded its annual session and approved the “Outlines for the 12th Five-Year Plan for Economic and Social Development”. The following energy-related targets were set:
  - Non-fossil fuels: increase the share of non-fossil fuels in the primary energy mixture from the current 8.3% share to 11.4% by 2015 as a stepping stone toward China’s international commitment of 15% by 2020.
  - Energy efficiency: reduce GDP energy intensity by 16% below the 2010 level.
  - Carbon reduction: reduce carbon intensity of GDP 17% below the 2010 level by 2015 as an intermediate step toward achieving 40 - 45% carbon intensity reduction target by 2020.
  - Major pollutant reduction: reduce chemical oxide demand and SO₂ emissions by 8%, Ammonia Nitrogen...
and NOx by 10% below 2010 levels.

- On 16 March, 2011, in the wake of the Fukushima incident in Japan, the State Council (SC) decided to enhance the safety control of all existing nuclear power plants, including those already in operation and those under construction, suspend the approval of any new nuclear power plants, and refine and adjust the country's mid to long-term nuclear power development programme.

- In March 2011, the SC's Legal Affairs Office put forward a draft version of the new “Catalogue for Foreign Investment Industries” for public comment.

- In April 2011, the National Development and Reform Commission (NDRC) issued an urgent notice to cool down the overheated development of coal conversion projects. This was the third time the NDRC had issued such a notice, the first one dating back to 2007.

- In April 2011, three key energy-related ministries, National Energy Administration (NEA), Ministry of Industry and Information Technology (MIIT) and State-owned Assets Supervision and Administration Commission (SASAC), saw their leadership change. An important reshuffle was also made to the top leadership of major Chinese oil companies (Sinopec and CNOOC).

The Working Group noted these developments and has the following general concerns:

- Foreign investment catalogue: while the list of restricted industries for foreign investment is getting shorter, more clarity is needed on the incentives for foreign investment in the “encouraged” category.

- Non-fossil fuel target: to achieve the 2015 target of 11.4% and 2020 target of 15%, China needs not only to promote the nuclear energy and renewable energy sectors, but also to reduce total energy demand. Greater attention needs to be paid to the safety aspect of the Chinese nuclear power programme. For renewables, while more investment is needed in installed capacity, what is equally important is to get the maximum effective power output from those installations. Foreign investment in the renewable sector could help China in achieving more renewable energy output, but it remains unclear on just how welcome foreign investment really is (see Renewable Sub-Working Group paper).

- Oil market: the new pricing regime installed in 2009 still operates within a market dominated by the domestic duopoly, with an occasional price adjustment by the NDRC following the movement of international crude oil prices. A sound oil market requires diversity in market players and more channels of oil supply.

- Smart Grid: the Smart Grid continues to draw high level attention. However significant technical, commercial and regulatory uncertainties exist and need to be addressed (See Smart Grid Sub-Working Group paper).

These and other issues will be explained in more details in this position paper.

**Key Recommendations**


**Concern**

The prices of main energy products (oil, gas and electricity) continue to be regulated by the NDRC with the NEA only playing an advisory role. This reduces the role of the NEA in formulating a sound energy policy given the critical importance of energy pricing as a policy instrument.

The current oil pricing regime has two major problems: on the one hand, it reduces refinery investors’ confidence when the basket crude oil prices are above USD 80/bbl and, on the other, it invites speculative stockpiling and creates frequent supply shortages.

The lack of a coherent natural gas pricing policy has put domestic production at a disadvantage to gas imports, which may discourage upstream investment in China and slow down the development of the gas market.

The distorted electricity pricing regime is one of the main causes of the power supply shortages which affect business operations in China, including those of European Chamber member companies.

**Assessment**

1) Assessment on Oil Pricing Policy:

The new oil product pricing regime effective May 8th, 2009, uses a cost-plus approach to determine domestic product prices and refining margins based on a basket of internationally traded crude oils. It provides a reasonable refinery margin when international crude prices are below
$80/bbl, but lacks transparency and fairness when crude prices go beyond this level. On the refinery side, no clarification has been published as to the margin protection or fiscal arrangements particularly in the USD 105/bbl to USD 130/bbl range and above the USD 130/bbl price environment.

On the refinery side, no clarification has been published to address: 1) the margin protection or fiscal arrangements for refiners when international crude oil prices are above USD 80/bbl, particularly beyond USD 130/bbl; and 2) the structure and the operational mode of the so-called compensation mechanism that has been conceived to compensate refiners when international crude oil prices go beyond USD 130/bbl. More clarity on the pricing mechanism in a high oil price environment would strengthen investors’ confidence for investing in advanced, modern but capital-intensive refinery projects.

On the retail and wholesale side, product prices are adjusted by the NDRC when the basket of international crude oil prices increase or decrease by 4% over a period of 22 days. This system invites speculative stockpiling by wholesalers, retailers and large customers, and long queues in front of petrol stations, shortly before the anticipated price adjustment. It also creates tension in the product market as wholesalers can pre-empt price hikes to reduce retailer’s margins, with cases of wholesalers refusing to supply shortly before a likely price hike. Shortening the fixed-price period would discourage retailers from stockpiling because the potential rewards would not be justified. The pricing mechanism in theory guarantees minimum margins for both wholesalers and retailers but it is not enforced in reality when pump prices are capped below the cost-plus levels (i.e. when crude oil is above USD 80/bbl).

No clear incentive is available for high quality clean fuels. Surcharges for fuel additives that protect the engine, improve the combustion and reduce tailpipe emissions were cancelled in 2010.

**2) Assessment on Gas Pricing Policy:**

Natural gas is priced following three different and disconnected pricing regimes:

- The price of domestic onshore gas is set by the NDRC with a cost-plus approach with published well-head prices for each gas field and transportation tariffs for each pipeline.
  - The price of imported Liquefied Natural Gas (LNG) is negotiated case by case and is passed to end-users with the government regulating the regasification fees and pipeline tariffs for LNG terminals.
  - The price for imported pipeline gas (currently only from central Asia) is also set through bilateral negotiations. The announced price at the Chinese border is much higher compared with domestically produced gas.

Reconciling these different prices into an inter-linked gas pricing system remains a significant challenge because it requires the break-down of the monopoly in pipeline operations, a change in the domestic gas pricing regime by taking into account prices of competitive fuels, and the streamlining of gas prices along the entire value chain that covers local distribution companies and gas end-users.

**Recommendation**

- Clarify the margin structure for refining, wholesale and retail through transparent and fair price calculation methods that cover all ranges of possible crude oil prices, most particularly when crude prices go beyond USD 130/bbl.
- Stabilise the oil products retail and wholesale market through a more flexible price-adjustment structure that would prevent speculation
- Provide incentives for high quality clean fuels and fuel additives and encourage the development of modern refineries with best engineering and process technologies as well as energy saving and emission reduction programmes
- Reform the gas pricing policies to:
  1) Align prices of domestic gas with imported gas
  2) Allow third-party access to gas infrastructure (pipelines, LNG terminals and storage facilities) in order to remove overt and covert discrimination against private and foreign companies from accessing the gas market
  3) Create a gas trading market in which the price of gas from different sources can be ultimately determined by the market
- Set a clear timetable for gas pricing reform and introduce third-party access to gas pipelines and LNG terminals

**3) Assessment on Electricity Pricing Policy:**

Due to a lack of real progress in the reform of the electricity market, China’s NDRC continues to set on-grid prices for power generation. Given that 80% of Chinese power is produced from coal, failure to pass through the rising coal
prices to the grid and end-users leads to losses for power generators and to power shortages.

At the end of 2004, the NDRC put in place “The Coupled Coal-Electricity Price Mechanism” in order to solve the conflict of coal and electricity prices. Since then, China’s coal prices continue to rise while on-grid electricity prices were only adjusted twice according to this mechanism (four price adjustments were made in total), which could hardly reflect the real costs of power generation.

As of April 2011, more than ten Chinese provinces experienced power shortages and the situation is worsening. Such shortages are not due to lack of power production capacity but because the generators’ power-selling price to the grid is too low to cover the production cost. As such, they had to stop operations or claim overhaul/maintenance was necessary.

As electricity consumers in China, European Chamber members companies’ operations also suffer from power shortages.

Recommendation
· Eliminate the conflicts of coal price and power tariff through further reform of the electricity market, particularly via the establishment of a regional competitive power market

2. Create Conditions for Rapid Gas Market Development

Concern
Entry barriers set up by the de facto NOC monopoly coupled with the lack of a coherent regulatory framework restrict participation by foreign investors in domestic unconventional gas exploration and production, thereby undermining China’s gas supply security and growth of its gas industry.

Assessment
China has set an ambitious target to double the share of natural gas in the energy mixture from 4% now to 8% in 2015. Chinese domestic gas reserves are abundant, particularly unconventional gas resources, which could be developed to support this ambitious goal. However, recurrent gas shortages cast some doubts on the reliability of gas supply and adversely affect its attractiveness for existing and new customers.

Several ways are available to improve gas supply security. They include a more systematic approach to opening up and/or expanding upstream access by experienced foreign companies, granting additional foreign cooperation licences to Chinese NOCs for coal bed methane (CBM) exploration, accelerating the administrative process for block opening-up and Production Sharing Contract (PSC) approvals, putting in place the right commercial structure and terms for unconventional gas resources such as CBM and shale gas, taking steps to progressively allow open and non-discriminatory access to gas infrastructure and, finally, reforming the gas pricing policies to reflect the true market value of natural gas.

The PCS is the current business model for foreign participation in the Chinese upstream sector. The contract term is usually 30 years (with an additional limitation on the production period), whereas the production profiles of unconventional gas (CBM, shale gas) are much longer (more than 40 years). In North America where unconventional gas was successfully developed, the tax and royalty system does not limit the production period so that investors can maximise their production and returns from a gas development. In comparison, the short PSC term in China reduces the economic value for potential investors given that gas development requires significant investment but production and sales are limited by the contract period.

Access to gas infrastructure is a major issue for developers of unconventional gas as they face pipeline access restrictions and lack of bargaining power with pipeline owners on gas selling prices. This damages their economic returns especially in locations where the regulated gas price is significantly low. As far as LNG is concerned, lack of third-party access to terminals and storage results in wasted opportunities to secure competitive LNG or potentially redundant infrastructure projects in the same demand area.

Recommendation
· Encourage exploration and development of upstream unconventional gas (CBM, tight gas, shale gas) through cooperation with foreign companies, enhancing the regulatory framework and granting preferential policies
· Promulgate gas infrastructure regulations to enable open and non-discriminatory access by third parties
· Extend the standard PSC terms for unconventional gas from 30 to at least 40 years
· Grant more foreign cooperation licences for CBM to
Section Three: Trade in Goods

Chinese State-owned and private companies
- Facilitate the appraisal and swift development of shale gas reserves by enacting a favourable regulatory system and fiscal incentives for investment

3. Ensure a Safe and Successful Implementation of the Chinese Nuclear Programme

Concern
Events that took place recently in Fukushima, Japan, call for the absolute necessity of uncompromising safety in nuclear operations. As China pursues its ambitious nuclear power programme, it requires a legal framework, a rapid development of technical and human capabilities, the adherence to the best safety practices of the International Atomic Energy Agency (IAEA) and the mobilisation of international experience and resources.

Assessment
Chinese has today 13 nuclear reactors in operation for an installed capacity of 11GW. In order to achieve the 4 - 5% target by 2020, a nuclear production capacity of up to 80 to 100GW would be required, depending on the projections of total electricity-installed capacity. This requires the mobilisation of a tremendous amount of industrial resources and the implementation of a large number of projects in parallel.

Although China has several decades of Research & Development (R&D) experience and has operated commercial nuclear installations for almost 20 years, its construction experience in large size nuclear reactors is still developing. The Chinese nuclear programme today is characterised by its very large size and its execution is almost entirely “local”, i.e. by and under the responsibility of Chinese companies. These two characteristics place a significant burden on all the Chinese nuclear players (power companies, engineering companies, suppliers as well as supervisory bodies), who face the important challenge of having to mobilise large amounts of resources within a short period of time. Meanwhile, no less than 28 nuclear reactors are under construction. A key element to the safe and successful completion of these projects will be a superior level of technical expertise and a strong appreciation and adherence to stringent nuclear safety conditions.

While reacting quickly and appropriately to the events in Fukushima, the Chinese authorities face a huge task to establish increasingly sophisticated nuclear safety rules while not jeopardizing their target in terms of future installed nuclear capacity.

Recommendation
- Establish a clear legal and regulatory framework for the development of civil nuclear activities in China beginning with the promulgation of the awaited Atomic Energy Law (AEL) which should reflect in particular the internationally accepted principles regarding Nuclear Third Party Liability (NTPL)
- Strengthen the power of the Chinese National Nuclear Safety Authority (NNSA) and of its supporting entity Nuclear Safety Centre (NSC), in terms of administrative independence, technical expertise and human resources. Further promote exchanges between the NNSA and major foreign nuclear safety authorities in order to take full benefit from lessons learnt from Fukushima events
- Leverage the experience and knowledge of the European nuclear industry through the establishment of joint ventures (in the fields of nuclear plant operations, engineering and design, and heavy components manufacturing)
- Ensure that the Chinese NNSA qualification criteria for joint ventures established in the China market in the nuclear sector recognise the Europe-based experience of European companies (and not only the joint ventures in-China experience)

4. Create an Integrated Industry Value Chain around the Carbon Capture, Utilization and Storage (CCUS)

Concern
Due to heavy fossil fuel dominance in its energy mixture, China’s ability to reduce its CO2 emissions will ultimately depend on reducing emissions from coal CCUS can play a key role in reducing CO2 emissions from both existing and new-build coal-burning facilities. The development of CCUS requires a sound policy and regulatory framework that enables an integrated approach to align a variety of industries (including power generation, industries, coal chemical, transportation and oil and gas).

Assessment
At this stage, China’s CCUS activities focus on technology development, capacity building, and knowledge sharing through a number of demonstration projects (Huaneng, CPI, Shenhua, Sinopec and Petrochina) and international cooperation. Until now, China has not elaborated a national policy to promote the development and deployment of CCUS. The implementation of those demonstration
projects could put China in the leading position on the deployment of the CCUS technologies in the future, and it is time for China to formulate an appropriate policy and regulatory framework.

Like many other emerging technologies, CCUS demonstration projects are not financially viable without any financial support from the government. A combination of financial incentives including grants, carbon financing, special electricity tariffs, loan guarantees, low-interests loans and favourable tax treatment, is essential to make investment in CCUS projects financially attractive to both public and private investors.

A comprehensive policy and regulatory framework supporting the integrated approach of the CCUS industry value chain could facilitate the cooperation among stakeholders for the successful development of CCUS in China. Such a framework should cover CO₂ capture, transport and storage, and address site selection, standards, Intellectual Property Rights (IPR), safety and liability issues.

To achieve large absolute volume CO₂ reduction, CO₂ emission from the existing fossil fuel-burning facilities (especially power plants) may need to be dealt with in the future when CCUS technology is mature and economically viable for large deployment. Considering the potential of Carbon Capture and Storage (CCS) retrofit in the future, the notion of “CCS ready” needs to be adopted in the project planning stage for new fossil fuel power plants. This is the prudent and cost effective way of planning that will prevent the building of a huge number of carbon-stranded assets.

**Recommendation**

- Create a policy and regulatory framework covering CO₂ capture, utilization, transport and storage, and address issues of standards, liability, monitoring system, IPR protection, CCS ready, etc.
- Provide financial assistance to CCUS R&D and demonstration projects. Promote the use of a carbon-finance mechanism under the framework of international and bilateral agreements to support CCUS projects
- Encourage cooperation with European industries for capacity building, knowledge sharing, technology advancement and joint demonstration project development

**Abbreviations**

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<thead>
<tr>
<th>Abbreviation</th>
<th>Meaning</th>
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<tr>
<td>AEL</td>
<td>Atomic Energy Law</td>
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<td>CBM</td>
<td>Coal Bed Methane</td>
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<td>CCS</td>
<td>Carbon Capture and Storage</td>
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<td>CCUS</td>
<td>Carbon Capture, Utilization and Storage</td>
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<td>EUR</td>
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<td>FYP</td>
<td>Five-Year Plan</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>IAEA</td>
<td>International Atomic Energy Agency</td>
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<td>IPR</td>
<td>Intellectual Property Rights</td>
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<tr>
<td>LNG</td>
<td>Liquefied Natural Gas</td>
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<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
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<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<td>NOC</td>
<td>National Oil Company</td>
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<td>NPC</td>
<td>National People’s Congress</td>
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<td>NTPL</td>
<td>Nuclear Third Party Liability</td>
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<td>NNSA</td>
<td>National Nuclear Safety Authority</td>
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<td>NSC</td>
<td>Nuclear Safety Centre</td>
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<tr>
<td>PSC</td>
<td>Production Sharing Contract</td>
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<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
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<tr>
<td>SASAC</td>
<td>State-owned Assets Supervision and Administration Commission</td>
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<tr>
<td>SC</td>
<td>State Council</td>
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<tr>
<td>SOE</td>
<td>State - owned Enterprise</td>
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<td>USD</td>
<td>US Dollar</td>
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<td>WG</td>
<td>Working Group</td>
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Key Recommendations

1. Simplify Pre-Market Review Processes (SFDA, AQSIQ, SC)
   1.1 Classification
   - Follow the four class rules-based classification scheme recommended by GHTF to ensure predictability for manufacturers and reviewers.
   - Adopt a risk-based approach to classification and specify regulatory control proportional to the level of risk.
   - Downgrade the risk classification of many forms of IVD devices and imaging equipment, as well as other medical devices including syringes, needles, IV catheters and adapters to reflect their relatively lower risk and the well-established technical characteristics of these devices.
   - Establish a procedure so that industry can formally apply for product re-classification by providing technical and scientific supporting documents.
   - Provide necessary training to evaluators, with only those passing examinations given by experts being certified as evaluators.
   - Establish an evaluation team consisting of highly experienced experts within the CMDE to mediate disputes which arise.

   1.2 Standardisation
   - Build on and refer to the GHTF guidance document on “Essential Principles of Safety and Performance of Medical Devices”, the “Role of Standards in the Assessment of Medical Devices” and the “Principles of Conformity Assessment” as the basis for regulatory requirements of medical devices.
   - Timely adopt unaltered international standards for medical devices (i.e. without national deviations), taking into account reasonable transition periods and the structure of the series of standards, and eliminate any special GB/YY standards that are in conflict with international standards.
   - Establish a project to transfer a batch of international standards into GB/YY Standards as a priority in the next one to three years, for instance the IEC 60601-1 3rd edition as a priority, including its related particular and collateral standards.
   - Allow flexibility in the current system by accepting evidence of compliance to latest versions of international standards as the basis of demonstrating the safety and efficiency of products, instead of requiring compliance to the current Chinese standard that is built on a superseded version of an international standard.
   - Strengthen China’s communication with and participation in international standards organisations, especially IEC and ISO, and accept standard guidance issued by ISO and IEC as the authoritative technical interpretation.
   - Harmonise medical device standard requirements among different government institutions (SFDA, AQSIQ), testing and inspection centres and eliminate the deviation among different standards (GB, YY, JJG).

   1.3 Clinical Trials
   - Accept foreign clinical data where there is no evidence that ethnic variations in intended populations may affect the effectiveness and safety of the device.
   - Exempt new Class II (GHTF Class B) medical devices and IVDs from clinical trial requirements based on re-classification by risk or adoption of GHTF guidance.
   - Produce certain criteria or a list of special products that require clinical trial, and/or accept other research data instead of clinical trials in China, such as performance evaluation reports or scientific literature.
   - Exempt foreign clinical data requirements for products that will have clinical trials conducted in China from the Provisions for Clinical Trials of Medical Devices.
2. Develop a Comprehensive Post-Market Surveillance (PMS) Regulatory Framework (SFDA, AQSIQ, SC)
   - Encourage an AE (vigilance) reporting system, based on GHTF guidance documents, through scientifically-based considerations to ensure public safety.
   - Establish advanced labelling systems via UDI to assist with the creation of a harmonised tracing and coding system.
   - Enhance staff training for provincial FDA supervision teams to ensure universal supervision standards throughout the country.
   - Adopt GHTF guidance on UDI when established, and ensure that hospitals, clinics, and other user facilities have appropriate resources to apply UDI information when implemented.

3. Allow Fair Market Competition to Determine Price in Payment and Tendering Systems (NDRC, MOH, SC, MOFCOM)
   - Avoid cost-based price interventions, especially those that are prejudiced against imported products.
   - Recognise the difference between drugs and devices. Adopt a value-based approach and fair market competition to allow pricing to reflect the technology value, overall investment, provision of training and lifetime technical services.
   - Engage industry in any changes to medical payment system, be it the possible short term case-payment system or the long term DRG-PPS, and avoid ruling out the use of medical technology.
   - Maintain orderly and structured tender purchases through the issue of comprehensive guidelines for good tendering practices.
   - Encourage the MOH to lead the promotion of and regulation of best practices in tendering policies and procedures for local tendering officials.
   - Avoid medical price ceilings or maximum bid prices that restrict competitive bidding processes in tenders or centralised purchases.
   - Regulate the collection of tendering or centralised purchase service fees.
   - Assure all pricing and tendering processes are transparent and non-discriminatory with respect to country of origin.

4. Strengthen the Timely Inclusion of Medical Technology in Reimbursement (NDRC, MOH, MOHSS, SC)
   - Strengthen policies and procedures for assessing and evaluating in a timely and consistent manner the inclusion of medical technology under reimbursement coverage based on the value it brings.
   - Re-evaluate the mechanism to allow for regular review of existing reimbursement rates to bring them into alignment and up-to-date with advancements in technology.
   - Re-evaluate the reimbursement approach for chronic diseases whereby therapies and/or diagnoses are often conducted in non-clinical settings.
   - Engage industry, along with other interested parties, regarding changes to the medical payment system, be it the possible short-term case-payment system or the long term DRG-PPS, and avoid ruling out the use of medical technology.
   - Explore the possibility of establishing a platform where industry can regularly update officials (such as MOHSS) on technology advancements in order to foster understanding of the relative value of the technology and correspondingly facilitate market access.

5. Draw on International Expertise and Resources to Assist in Implementing the “3521” National Strategy for eHealth in the 12th Five-Year Plan (MOH, NDRC, MOHSS, SC)
   - Further define the vision of eHealth laid out in the “3521” plan at the national, provincial and municipal levels.
   - Foster international standards and profiles for eHealth interoperability at the national level and leverage self-
declaration of interoperability performance based on IHE processes.

- Work with the industrial associations to develop an information-sharing platform that brings together healthcare IT pilot project owners in China with international best practices and expertise, to document and disseminate the benefits and to understand technology effects through evidence-based analysis.
- Develop a more international profile by participating in major international conferences on eHealth and through establishing international forums and workshops bringing together Chinese and international stakeholders to discuss major issues such as interoperability and standardisation.
- Establish dialogue on eHealth between key officials in China and those of other major markets, including the European Commission.
- Achieve legal certainty and set up a framework to support cross-stakeholder and cross-provincial care services; and address citizen’s data privacy and security requirements in a coordinated manner across China through the creation of a standardised Security Model which determines rights of information access and Internet information exchange.
- Foster an open, fair and competitive healthcare IT market environment which removes administrative, financial, legal and technical barriers and which encourages international trade and non-discriminatory treatment to ensure a continuous and effective growth of the eHealth market.

6. Introduce Remanufactured Large Medical Imaging Equipment and Regulate the Market (SFDA, MOFCOM, MIIT, AQSIQ, GAC)

- Build and strengthen public awareness and understanding of the main differences between safe and effective remanufactured medical imaging equipment, versus second-hand equipment of unknown quality.
- Establish a pilot program for remanufactured CT/X-Ray equipment, so as to investigate the benefits of good OEM remanufacturing including safety, energy saving and resource utilisation.
- Accelerate the development of a regulation for remanufactured medical equipment.
- Work with industry on defining standards for remanufacture, thereby ensuring the authenticity of remanufactured equipment.

Introduction to the Working Group

European Chamber Healthcare Equipment Working Group member companies deliver indispensable life-saving and disability-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. To enhance international cooperation, the Working Group has established contacts with the major medical technology industry associations based in Europe, COCIR\(^1\) and Eucomed\(^2\) since 2007.

Two other factors are crucial in furthering the goal of promoting safety, increasing efficiency, and reducing costs of healthcare services. First and foremost is the need for a transparent and predictable regulatory environment that has international credibility. The second factor is harmonisation of regulations and standards for medical devices with those of major trading partners. Ensuring that market forces determine prices would also increase efficiency and reduce costs.

The Working Group wishes to engage in a continuous and constructive dialogue with all relevant departments to develop the current unwieldy regulatory framework into one that is friendly to innovation. The group therefore strongly supported the EU-China Medical Device Expert Roundtable (MDER)\(^3\) project and is committed to continuing this engagement in another series of Medical Device Expert Roundtables in 2011.

Recent Developments

Since the announcement of the Healthcare Reform Plan, various regulations have been promulgated to restructure

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the healthcare industry in China. With reassurance from the central government to fight continually against protectionism and promote equal treatment for all companies, the Working Group is confident that the ongoing reform will increase access to high-quality healthcare, at the same time as it increases resource efficiency and creates more investment opportunities.

Since the publication of the European Chamber 2010-2011 Position Paper, two major developments have taken place. Foremost is the release of the 12th Five-Year Plan. The Working Group shares and supports the goals of the Plan, such as utilising public healthcare services as the major host to provide primary healthcare services; to improve healthcare insurance schemes and resource utilisation and investment; to improve the operations of healthcare institutions and enhance healthcare training for healthcare professionals; and to progressively promote information technology. The Working Group is devoted to making continuous efforts to engage with the relevant government departments to improve the effectiveness of the healthcare mechanism overall.

In September 2010, the Legislative Affairs Office of the State Council (SCLAO) released the Regulation on the Supervision and Administration of Medical Devices (Amended Draft). The Working Group is happy to see that the SCLAO has incorporated some of the recommendations provided by industry in 2007. Many of the principles in the State Council amended draft are consistent with Global Harmonisation Task Force (GHTF) guidelines, including the principles of risk-based classification, exemption criteria from clinical trials and production based on the principles of Good Manufacturing Practice (GMP)/Quality Management System (QMS) requirements. In respect to market access, the realisation of a single administrative authority will greatly improve efficiency.

The draft regulation also clearly puts forward the need for the SFDA to ask for public opinion to collect advice from manufacturers and other experts when adjusting related legislation. The Working Group looks forward to more exchanges with regulatory officials and kindly urges the SFDA to adopt more constructive recommendations from industry and to provide trainings to industry upon the issuance of regulations to ensure understanding and appropriate implementation.

However, there are still some aspects of the regulation which concern European industry. These include the provision that manufacturers should submit a self-audit report, questions whether foreign clinical trial data can be accepted and the Centre for Medical Device Evaluation’s (CMDE) review time for technical review.

Overall Assessment
The Working Group applauds the continuous efforts made by government to increase communication with the industry over the past years. Most notable improvements include:

- Increased CMDE resources that have resulted in a shortened product registration time.
- Increased regulatory transparency that has improved both mutual understanding between government and industry as well as regulatory compliance.
- Increased attention to suggestions from industry that has produced beneficial results for patients, industry and officials.

While still faced with many pressing issues, most notably the lengthy and burdensome registration process, the Working Group continues to promote the adoption of a comprehensive regulatory framework for medical devices in China that is geared towards international best practices as advocated by GHTF and the Asian Harmonization Working Party (AHWP) guidelines. An overhaul of current regulations is needed to establish a framework that incorporates key elements like essential principles, quality management systems, product risk management, risk-based classification rules, notified bodies/conformity assessment bodies and clinical evaluation. Members call upon regulators to implement this vision into the base regulation on the supervision and administration of medical devices, which is currently under revision and due for release.

Key Recommendations
1. Simplify Pre-Market Review Processes

1.1 Classification

Concern
Chinese officials have announced to implement rules, regulations and notices that are consistent with GHTF and AHWP guidance documents. However, China is much more stringent on classification than other major regulators. Manufacturers are thus challenged with deviating regulatory control of their products in China,
apparently without a sound scientific basis.

Evaluation centres in China also implement different procedures and requirements for the same type of products. These discrepancies not only bring additional burden to manufacturers, but also significantly extend the amount of time needed by technical reviewers.

Assessment
The amount of registration documentation required to demonstrate the safety and effectiveness of medical devices depends on classification, based on the level of risk. Manufacturers of medical devices classified as having a higher level of risk are required to submit more detailed documentation.

Manufacturers are faced with a situation whereby different classification schemes exist globally. Compared to the systems used in other major markets, or with recommendations from the GHTF and AHWP, it can be discerned that China uses a catalogue-based classification (Class I to III), whereas the GHTF and AHWP recommend a rule-based system (Class I to IV). The majority of countries and territories including the EU, Australia, Mercosur5-countries and Canada have for decades adopted the rule-based system that allows for more flexibility and predictability and which considerably reduces the time to make new technology available to patients. The rules-based system also accommodates new technologies not foreseen at the time the ‘catalogue’ is developed.

Other than the Chinese market, no other market requires a comparable set of technical documentation to be prepared by the manufacturer for lower risk class devices and devices which have already existed in the global market for many years, thus putting additional burden on the manufacturer with respect to process implementation costs and resources. Owing to the higher classification and resulting increases in registration requirements such as clinical studies (see 2.3 Clinical Trials), costs for medical device registration also rise. These costs will eventually burden the healthcare system. Moreover, these additional requirements make little or no improvements for product safety or efficiency.

The most pertinent example is for in-vitro diagnostic medical devices. In recent years, the SFDA has even raised the classification of some special IVD products into higher levels of risk, rather than aligning classification with global practices. Examples include flow cytometry reagents, tumour-related reagents, allergen, drug abuse and tumour markers that are all now Class III in China.

Case Study 1: IVD Reagent Classification
In China, more than 100 IVD reagents are classified as Class III, accounting for 20% of all IVDs sold in China. Most tumour markers, gene or pathogen testing and drug abuse detection reagents are classified as Class III. In the EU and US, these products are not regulated as high risk. Under most other medical device regulatory systems worldwide, IVD products are generally categorized as low-risk devices. For example, only some 20 devices are listed in the Annex II list A and B of IVDD (98/79/EC), e.g. high risk classification, accounting for only 5% of all IVDs.

In addition, technical evaluation centres in China do not adopt consistent evaluation principles and guidelines for the same types of products. Evaluation relies on evaluators’ own subjective judgments. The lack of knowledge of many evaluators often leads to unreasonable supplementary requirements. These cause great confusion to enterprises, particularly foreign manufacturers.

Recommendation
- Follow the four class rules-based classification scheme recommended by GHTF to ensure predictability for manufacturers and reviewers.
- Adopt a risk-based approach to classification and specify regulatory control proportional to the level of risk.
- Downgrade the risk classification of many forms of IVD devices and imaging equipment, as well as other medical devices including syringes, needles, IV catheters and adapters to reflect their relatively lower risk and the well-established technical characteristics of these devices.
- Establish a procedure so that industry can formally apply for product re-classification by providing technical and scientific supporting documents.
- Provide necessary training to evaluators, with only those passing examinations given by experts being certified as evaluators.
- Establish an evaluation team consisting of highly experienced experts within the CMDE to mediate disputes which arise.

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1.2 Standardisation

Concern
China’s regulatory requirements for the safety and performance of medical devices rely on mandatory standards, many of which are not stringently linked to the intended use of the medical device or to dedicated risk management to ensure safe application. In addition, some of China’s national standards (GB) and medical industry standards (YY) differ from international standards. The most up-to-date international standards must wait an inordinate amount of time before adoption in China, and when they are adopted, they are sometimes unreasonably altered. Furthermore, discrepancies in the standards and tests in China’s own registration system create unreasonable hurdles for product registration and technology innovation.

Assessment
GHTF promotes that essential requirements be fulfilled by all medical devices and the use of voluntary standards that facilitate fast adoption of state-of-the-art technologies. China, by implementing its often outdated standards on a mandatory basis, allows much less flexibility. Manufacturers therefore have to comply with outdated Chinese requirements could not offer more state-of-the-art technology to Chinese healthcare providers and patients.

China has expressed its intention to follow the international standardization work of IEC and ISO. However, in practice there seems to be no clear plan on how or when China will adopt these standards. Many standards in China, originating from superseded versions of international IEC or ISO standards, are still being used to test products that have been manufactured using a more recent version of that international standard. (see Standardisation and Conformity Assessment Position Paper, Case Study PAGE NO on IEC 60601-1, page PAGE NO).

It is commonplace that some standards have been promulgated and implemented in some parts of China, but that the official text has not yet become publicly available (either online or a copy sent to all regulatory bodies and manufacturers).

SFDA testing centres and medical device inspection centres sometimes do not have sufficient time to learn and to reach a harmonised implementation approach for newly-issued product standards.

China will need a strong internationally-aligned standardisation framework and system if it wishes to develop its domestic medical technology industry and innovation and thus place Chinese manufacturers in a more competitive position in the global marketplace.

Case Study 2: Example of inconsistent standardisation practices
While most IEC standards are transformed into national GB standards (however using a different indexing method), others are transposed or even independently developed as YY standards. The IEC collateral safety standard on electromagnetic compatibility, e.g., IEC 60601-1-2:2001, has been transformed into YY 0505-2005 instead of into the GB 9706 series as with other parts in the IEC 60601 family.

Recommendation
- Build on and refer to the GHTF guidance document on “Essential Principles of Safety and Performance of Medical Devices”, the “Role of Standards in the Assessment of Medical Devices” and the “Principles of Conformity Assessment” as the basis for regulatory requirements of medical devices.
- Timely adopt unaltered international standards for medical devices (i.e. without national deviations), taking into account reasonable transition periods and the structure of the series of standards, and eliminate any special GB/YY standards that are in conflict with international standards.
- Establish a project to transfer a batch of international standards into GB/YY Standards as a priority in the next one to three years, for instance the IEC 60601-1 3rd edition as a priority, including its related particular and collateral standards.
- Allow flexibility in the current system by accepting evidence of compliance to latest versions of international standards as the basis of demonstrating the safety and efficiency of products, instead of requiring compliance to the current Chinese standard that is built on a superseded version of an international standard.
- Strengthen China’s communication with and participation in international standards organisations, especially IEC and ISO, and accept standard guidance issued by ISO and IEC as the authoritative technical interpretation.
- Harmonise medical device standard requirements among different government institutions (SFDA, AQSIQ), testing and
inspection centres and eliminate the deviation among different standards (GB, YY, JJG).

1.3 Clinical Trials

Concern
Increasing requirements for clinical trials in China are causing great concern for industry. Local clinical trials in China for product registration purposes do not further improve the safety and effectiveness of medical devices. Instead, they increase burden on industry and authorities and lengthen time to market for potentially life-saving medical devices.

Assessment
In China, clinical trials are mandatory in the registration application for certain Class II and Class III products. Although the draft SCLAO revision of the “Regulation for the Supervision and Administration of Medical Devices” provides exemption criteria for clinical trials, a list of products that can be exempt has not been developed due to the inability to update corresponding SFDA decrees, such as SFDA Order 5 ‘The Provisions for Clinical Trials of Medical Devices’ before the SCLAO draft is released.

Due to the trend towards higher classification of medical devices, many products in a low-risk category under other regulatory systems, including the EU and the US, may fall into Classes II or III in China, thus causing the need for a local clinical trial. Repeated local clinical trials in China do not provide increased evaluation of safety or efficiency, but simply increase costs and required resources. The SFDA also requires the submission of foreign clinical trial data for products classified as low-risk in other countries although no such clinical trial requirements exist abroad, meaning no overseas clinical data is reasonably available.

Effective administrative measures and manufacturers’ social responsibilities are essential for medical device safety. Intensive regulatory requirements that lack scientific consideration do not improve product safety. Cost-benefit analysis needs to be taken into consideration when considering the regulations for pre-market approval. This facilitates innovation and technical improvement, allowing new technology to be more speedily adopted and thus better serving patients and protecting public health.

Recommendation
- Accept foreign clinical data where there is no evidence that ethnic variations in intended populations may affect the effectiveness and safety of the device.
- Exempt new Class II (GHTF Class B) medical devices and IVDs from clinical trial requirements based on reclassification by risk or adoption of GHTF guidance.
- Produce certain criteria or a list of special products that require clinical trial, and/or accept other research data instead of clinical trials in China, such as performance evaluation reports or scientific literature.
- Exempt foreign clinical data requirements for products that will have clinical trials conducted in China from the Provisions for Clinical Trials of Medical Devices.

2. Develop a Comprehensive Post-Market Surveillance (PMS) Regulatory Framework

Concern
The supervision of medical devices, post-market, is inadequate due to an underdeveloped PMS regulatory framework, and the lack of both implementing guidance as well as expertise within provincial Food and Drug Administration (FDA) agencies.

Assessment
It is essential to develop a science-based attitude and scientifically-valid written guidance to develop a comprehensive PMS analysis system. Adverse Events (AE) regulation is one of the great developments in the medical device regulatory framework in China. Since the trial regulation of medical device AE monitoring and re-evaluation was published in 2009, the majority of multinational medical device manufacturers have submitted reports to the SFDA on schedule. However, AE reports from domestic manufacturers can hardly be found on the relevant websites or in hospitals. This is not only unfair to the foreign manufacturers submitting AE reports,
but is also non-transparent for the public as it may lead to misleading comparisons between similar products. Regulators must collect and publish all relevant information and lead the drafting of analysis reports to ensure that the public understands AE occurrence trends.

An arbitrary ‘AE or not’ barrier set in pre-market approval probably will be regarded as punishment for properly reporting AE, and thus will discourage manufacturers or clinicians from reporting AE cases, or will push out those manufacturers or clinicians who strictly comply with regulations. For re-registration, manufacturers should be allowed to evaluate AE occurrences to analyse if the AE was caused by uncontrolled risk. Those reported AE which are caused by residual risk should not count as negative evidence towards re-registration.

On 16th June 2011, MOH and SFDA jointly issued the “Measures for Administration on Medical Device Recall (Trial) (MOH No. 82 [2010])”. This is a great step forward in the effort to complete the regulatory framework of PMS. The Measure is substantially harmonized with regulations in other countries in terms of recall purpose, recall measures and report/notification content. However, the Working Group would like to raise 2 major concerns:

- Overseas Recall Notification: The Measure requires registered devices that are recalled overseas should also be reported to SFDA. Reporting recall action not affecting domestic market would create significant administrative costs for multinational companies, as well as increasing SFDA workload. The Working Group suggests that it should be made clear that such reports should only be required if the extraterritorial field safety corrective action involves or is relevant to medical devices marketed or in use in China.

- Patient Compensation: The Appendix of the Measure stated that patient can claim compensation toward distributor/health care institute/manufacturer. The Working Group suggests the compensation shall not be within the scope of a recall regulation but would be covered in other laws and regulations, such as the consumer protection law. The Working Group recommends taking common practices established in recall regulations for other industrial sectors and international practices. Including a provision stating “Undertaking a recall action does not waive any legal responsibility” should achieve the desired objective.

To ensure universal supervision standards, the SFDA must enhance staff training for provincial medical device supervision teams and issue guidelines. A lack of experience and training has caused bias in the interpretation of SFDA regulations and has resulted in different supervision standards throughout China. In a unified regulatory framework, inconsistent interpretations and execution place an unnecessary burden on enterprises to comply with the divergent practices. The situation could be improved significantly by providing more staff training and issuing more post-market guidance. Currently, most guidance is related to pre-market approval. The Working Group would welcome the opportunity to assist the SFDA in providing trainings and creating guidance.

UDI systems utilise harmonised tracing and coding systems outlined in GHTF guidance (when published), both of which are important aspects of the PMS framework. UDIs are a hot topic worldwide as a tool to facilitate post-market surveillance. In light of SFDA surveys on the feasibility of establishing a China UDI system, European industry would like to encourage the adoption of a UDI system utilising a harmonised tracing and coding system, not only to lower trade barriers in China, but also to help domestic products smoothly interface with the world. The Working Group would be willing to provide experts and comments if needed.

**Recommendation**

- Encourage an AE (vigilance) reporting system, based on GHTF guidance documents, through scientifically-based considerations to ensure public safety.
- Establish advanced labelling systems via UDI to assist with the creation of a harmonised tracing and coding system.
- Enhance staff training for provincial FDA supervision teams to ensure universal supervision standards throughout the country.
- Adopt GHTF guidance on UDI when established, and ensure that hospitals, clinics, and other user facilities have appropriate resources to apply UDI information when implemented.

**3. Allow Fair Market Competition to Determine Price in Payment and Tendering Systems**

**Concern**

Medical devices continue to be a target of administrative price controls. National Development and Reform Commission (NDRC) and some of its provincial arms are
on the edge of releasing some universal administrative control measures to restrict prices of certain kinds of medical devices based on a cost-plus approach. Ignoring value-based pricing and applying across-the-board mark-ups for devices of different associated services and costs would promote inefficiency, unfairness and suffocate innovation. Similar price restriction mechanisms in tendering and in new payment systems, be they the case-payment or Diagnosis Related Group-Prospective payment system (DRG-PPS), would result in similar deficiencies.

Assessment
The Chinese government is concerned by rising medical expenditures, especially with the role of the State as the payer of medical services through the rapid development of social medical insurance. To cope with the increasing demand for medical services, enlarged coverage and improving reimbursement rates, NDRC and its provincial arms are chartered to control the prices of drugs and medical devices. Officials are adopting the cost-based approach inherited from the era of the planned economy, which is not in alignment with the development of a market economy in China.

This approach ignores the core difference between drugs and devices, e.g. the associated technical training, services and costs in applying the devices to patients by a wide range of surgical and procedural means. These costs are admittedly high and wide-ranging for different kinds of devices and required procedures. Any across-the-board measure that commoditises devices and underestimates the requirements of technical training and services and the costs involved would drive out physician and patient choice and stifle innovation.

Under the Chinese healthcare reform, NDRC, the Ministry of Health (MOH) and the Ministry of Human Resources and Social Security (MOHRSS) are also examining the introduction of alternative payment systems such as case-payment and DRG-PPS to supplement its current, by-and-large, fee-based approach. The success of any new payment systems must provide reasonable recognition of medical technology and its associated costs, applying both market competition and a value-based approach.

The setting of price ceilings or similar price restrictions in the tendering process, especially those that attempt to ignore technological content, innovation and the value of the therapy or diagnosis of the products, carry similar deficiencies. This is exacerbated by issues of inconsistent and unreasonable tendering practices, high tendering service fees and sometimes even duplicative tenders.

The Working Group very much encourages reforms that build on the principles laid down in the China Health Reform Plan, for example to “…promote the formation of orderly competition…raise the standard of care and quality…[and] satisfy the different demands in healthcare and medical treatment.”

Recommendation
- Avoid cost-based price interventions, especially those that are prejudiced against imported products.
- Recognise the difference between drugs and devices. Adopt a value-based approach and fair market competition to allow pricing to reflect the technology value, overall investment, provision of training and lifetime technical services.
- Engage industry in any changes to medical payment system, be it the possible short term case-payment system or the long term DRG-PPS, and avoid ruling out the use of medical technology.
- Maintain orderly and structured tender purchases through the issue of comprehensive guidelines for good tendering practices.
- Encourage the MOH to lead the promotion of and regulation of best practices in tendering policies and procedures for local tendering officials.
- Avoid medical price ceilings or maximum bid prices that restrict competitive bidding processes in tenders or centralised purchases.
- Regulate the collection of tendering or centralised purchase service fees.
- Assure all pricing and tendering processes are transparent and non-discriminatory with respect to country of origin.

4. Strengthen the Timely Inclusion of Medical Technology in Reimbursement

Concern
High-value medical technology is often seen as a burden and not a solution. The social medical insurance regime has a tendency to limit the coverage of high-value medical technology under reimbursement based on its absolute price, instead of its comparative value and improved safety and efficacy. The system does not allow an effective, efficient and timely mechanism to embrace technological advancement in the reimbursement coverage, resulting in a situation whereby many therapies or diagnoses must be
paid solely out-of-pocket by patients, or are undervalued with a low reimbursement value based on outdated technology and costs.

Assessment
The central level guidelines for reimbursement issued by MOHRSS stipulates a negative listing that states which therapies, diagnoses or devices are not covered, or which are only partially covered by social medical insurance. This guideline or negative listing in essence does not disallow the introduction of medical technology. However, when applied by local social medical insurance regulators and when it is sometimes developed further into positive listings, some medical technology is typically excluded from coverage based solely on its absolute high value and/or insufficient understanding of its medical value. The requirements, procedures and timelines for assessment and evaluation differ widely between and within provinces.

There is often an absence of a clear mechanism to update the list of reimbursable medical procedures or products, resulting in a lot of uncertainties over the timing for inclusion under reimbursement. If this happens at all, it is usually long after the procedures or products have been approved by the SFDA for introduction into China.

For those reimbursement rates that are based on absolute values instead of percentage rates, it is not uncommon to find that there is no effective and efficient mechanism to regularly and scientifically review the rates against advancements in technology, therapy value and changes in associated costs.

Reimbursement policy does not appear to recognise the characteristics of chronic diseases whereby diagnoses and therapy can be carried out in a non-clinical setting, for example at patients’ homes. With the reimbursement system built basically on ambulatory and inpatient settings, reimbursement coverage basically rules out the many required therapies or diagnostic procedures that are administered in non-clinical settings.

Recommendation
- Strengthen policies and procedures for assessing and evaluating in a timely and consistent manner the inclusion of medical technology under reimbursement coverage based on the value it brings.
- Re-evaluate the mechanism to allow for regular review of existing reimbursement rates to bring them into alignment and up-to-date with advancements in technology.
- Re-evaluate the reimbursement approach for chronic diseases whereby therapies and/or diagnoses are often conducted in non-clinical settings.
- Engage industry, along with other interested parties, regarding changes to the medical payment system, be it the possible short-term case-payment system or the long term DRG-PPS, and avoid ruling out the use of medical technology.
- Explore the possibility of establishing a platform where industry can regularly update officials (such as MOHRSS) on technology advancements in order to foster understanding of the relative value of the technology and correspondingly facilitate market access.

5. Draw on International Expertise and Resources to Assist in Implementing the “3521” National Strategy for eHealth in the 12th Five-Year Plan.

Concern
The recently published “352” National Strategy for Health Informatisation during the 12th Five-Year Plan represents a major step forward, providing the first clear national strategy for the important project of eHealth deployment in China. However, significant challenges remain in ensuring coordination between various government departments involved, funding, standard setting, cross-region and cross-system interoperability, information security and personnel training. EU countries are going through a similar process of health informatisation and the European Chamber provides a platform to promote exchanges and the transfer of technical expertise between the EU and China.

Assessment
In the complex world of new medical developments, information load and rapid change, health information and communications technology (ICT) and eHealth solutions have been identified as major tools to improve the safety, quality, accessibility and efficiency of healthcare. Regional and rural health information networks and increased cooperation between urban hospitals and community healthcare centers through information networks will improve both coverage and efficiency of healthcare services. Implementing standardised Electronic Medical Record (EMR) systems linked to regional health
The importance of eHealth has been recognised by the Chinese central government, which has outlined an ‘energetic promotion of healthcare informatisation’ as one of the major points of the healthcare reform. The European Chamber strongly advocates the development and deployment of eHealth solutions, but notes that clearly articulated, coordinated and planned national policies and investment strategies are required to ensure that the enormous potential benefits of eHealth are fostered in China.

In recent years, the Chinese government has begun investing heavily in various eHealth initiatives, including public health records, electronic medical records and telemedicine. Although these initiatives are important, the approach to their implementation has often been scattered and uncoordinated. Without a clearly articulated, overarching national strategy and comprehensive national standards to guide the adoption of healthcare information technology, these projects bear the risk of leading to problems in connectivity throughout the country and between provinces and municipalities. As funding is highly fragmented, mostly between provinces and municipalities, a coordinated national strategy that emphasises interoperability between the various relevant central level and sub-central level government officials is required to ensure that eHealth solutions can be introduced and can achieve optimum benefits.

Recommendation

- Further define the vision of eHealth laid out in the “3521” plan at the national, provincial and municipal levels.
- Foster international standards and profiles for eHealth interoperability at the national level and leverage self-declaration of interoperability performance based on IHE processes.
- Work with the industrial associations to develop an information-sharing platform that brings together healthcare IT pilot project owners in China with international best practices and expertise, to document and disseminate the benefits and to understand technology effects through evidence-based analysis.
- Develop a more international profile by participating in major international conferences on eHealth and through establishing international forums and workshops bringing together Chinese and international stakeholders to discuss major issues such as interoperability and standardisation.
  - Establish dialogue on eHealth between key officials in China and those of other major markets, including the European Commission.
  - Achieve legal certainty and set up a framework to support cross-stakeholder and cross-provincial care services; and address citizen’s data privacy and security requirements in a coordinated manner across China through the creation of a standardised Security Model which determines rights of information access and Internet information exchange.
  - Foster an open, fair and competitive healthcare IT market environment which removes administrative, financial, legal and technical barriers and which encourages international trade and non-discriminatory treatment to ensure a continuous and effective growth of the eHealth market.

6. Introduce Remanufactured Large Medical Imaging Equipment and Regulate the Market

Concern

China is just one of five countries in the world to forbid by law the import of remanufactured medical devices. In addition, there is no clear regulation in place to supervise and regulate remanufactured medical equipment in China. The lack of such a regulatory framework denies Chinese healthcare providers access to affordable and advanced medical technology from an earlier generation, and also creates an unregulated grey market involving second-hand equipment of questionable quality which may endanger the safety of citizens.

The resources consumed in the research and development, production and maintenance of large medical imaging devices are too great to leave idle such equipment before it reaches the end of its planned service life. Such practices result in a waste of resources and work against the principles of a recycling economy and the

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7 The remanufacture referred to herein this position paper means, in simple terms, through a standard Remanufacturing Process, to resume the performance of a product to the state when it was originally shipped out of factory. Remanufacture combines actions such as repair, rework, updating and replacing based on the premise of not changing the original product design from its original market introduction and ensuring that the remanufactured equipment has the same safety and efficiency as the equipment or systems at the time of its original market introduction. All actions shall be performed in a manner consistent with product specifications and service procedures, defined by manufacturer for that equipment.

8 The US Department of Commerce issued a report on ‘Global Import Regulations for Pre-owned (Used and Remanufactured) Medical Devices’ in 2006 using data collected from 105 countries and regions. Of these, 84 countries and regions are completely open for the import of pre-owned and remanufactured medical devices; 16 countries are open but restricted; and just 5 countries (including China) forbid by law the import of pre-owned and remanufactured medical devices.
Assessment

The remanufacture of medical devices combines actions such as repair, rework, updating and replacing based on the premise of not changing the original product design from its original market introduction and ensuring that the remanufactured equipment has the same safety and effectiveness as the equipment or systems at the time of its original market introduction.

Remanufacture is a globally well-established process in which hospitals upgrading to newer generational technologies return the older equipment to the original equipment manufacturer (OEM). Remanufacture supports China’s efforts to expand quality healthcare access, optimise resources, and recycle and reduce waste. Remanufacture also works to combat the grey market for pre-owned medical devices that has developed from large hospitals discarding old or used medical devices.

The remanufacture of medical devices is in line with the goals of healthcare reform through the business model of old-for-new services, which assists with equipment renewal and technology upgrades. In today’s global medical fields, owing to continuous development in medical science and technology, the innovation cycle of equipment is far ahead of the life cycle.

Old-for-new services assist healthcare providers by ensuring that they can possess the latest and most advanced medical technology at reasonable costs. High-quality devices sold by top-tier hospitals are remanufactured to safety, quality and technical standards as new and sold to next cycle hospitals at lower costs than new equipment of similar specifications. Unlike grey market refurbished devices, devices remanufactured by the OEM also typically include a warranty.

According to an article published on the website of the Chinese Association of Medical Device Industry (CAMDI), it is estimated that about 80% of clinics and 70% of all hospitals in China need to upgrade medical devices that have already reached their normal end of service life. The availability of quality remanufactured medical equipment could accelerate the upgrading of the infrastructure in China’s medical institutions.

Remanufacturing allows the re-utilisation of pre-owned medical imaging equipment by those with less investment capital. Putting high-quality, safe remanufactured equipment into the market is a widely recognized method by both the EU and the US to re-allocate and utilise existing resources, which helps reduce environmental degradation. For example, remanufactured X-ray medical equipment is processed with 73% less energy on average, compared with the manufacturing of new X-ray equipment of a similar type.

Remanufacture also works to inhibit the grey market of pre-owned medical equipment. As procurement personnel from mid-sized and small hospitals have not been professionally trained to identify good remanufactured devices from bad pre-owned devices, this can result in safety and market risks. The different economic states of differing regions result in different levels of medical devices, whereby devices discarded from large hospitals enter into the next market cycle through different channels, forming a pre-owned device market. Despite this, China has not yet developed related laws to effectively monitor and regulate this market.

In response to the increasing demand of healthcare providers for affordable equipment, industry leaders have established the Good Remanufacturing Practice (GRP) Guidance, enabling the delivery of safe and effective remanufactured medical equipment. In Europe and the US, remanufacture has been practiced for more than 10 years, addressing considerable demands for affordable, high-quality equipment. Regulations and standards such as GRP for remanufactured medical equipment could pave the way for Chinese patients to gain access to high-quality medical technology and, at the same time, address issues such as the grey market for unregulated second-hand equipment and assist with the goals of the recycling economy.

Recommendation

- Build and strengthen public awareness and understanding of the main differences between safe and effective remanufactured medical imaging equipment, versus second-

9 For example, just one original equipment manufacturer factory carrying out MRI remanufacturing in 2006 saved over 730k Kilograms of raw material only from magnets, including copper, iron, stainless steel, low carbon steel, NbTi and glass fiber, amongst other materials.


hand equipment of unknown quality.

- Establish a pilot program for remanufactured CT/X-Ray equipment, so as to investigate the benefits of good OEM remanufacturing including safety, energy saving and resource utilisation.
- Accelerate the development of a regulation for remanufactured medical equipment.
- Work with industry on defining standards for remanufacture, thereby ensuring the authenticity of remanufactured equipment.

Abbreviations

<table>
<thead>
<tr>
<th>AE</th>
<th>Adverse Events</th>
<th>IHE</th>
<th>Integrating the Healthcare Enterprise</th>
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<tr>
<td>AHWP</td>
<td>Asian Harmonization Working Party</td>
<td>ISO</td>
<td>International Organisation for Standardisation</td>
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<tr>
<td>AQSIO</td>
<td>General Administration of Quality</td>
<td>IT</td>
<td>Information Technology</td>
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<tr>
<td>CAMDI</td>
<td>Chinese Association of Medical Device Industry</td>
<td>IV</td>
<td>Intravenous</td>
</tr>
<tr>
<td>CFR</td>
<td>Code of Federal Regulations</td>
<td>IVD</td>
<td>In-vitro Diagnostic</td>
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<tr>
<td>CMDE</td>
<td>Centre for Medical Device Evaluation</td>
<td>IVDD</td>
<td>In-vitro Diagnostic Directive</td>
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<tr>
<td>COCIR</td>
<td>European Coordination Committee of the Radiological, Electromedical and healthcare IT Industry</td>
<td>JJJG</td>
<td>Jiliang Jianding Guicheng (China regulation of meteorological verification)</td>
</tr>
<tr>
<td>CT</td>
<td>Computed Tomography</td>
<td>MDER</td>
<td>Medical Device Expert Roundtable</td>
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<tr>
<td>DRG-PPS</td>
<td>Diagnosis-related Group – Prospective-payment System</td>
<td>Mercosur</td>
<td>South American Common Market</td>
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<tr>
<td>EC</td>
<td>European Commission</td>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
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<tr>
<td>EMR</td>
<td>Electronic Medical Record</td>
<td>MOH</td>
<td>Ministry of Health</td>
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<tr>
<td>EU</td>
<td>European Union</td>
<td>MOHRSS</td>
<td>Ministry of Human Resources and Social Security</td>
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<tr>
<td>Eucomed</td>
<td>European Voice of the Healthcare Technology Industry</td>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>FDA</td>
<td>Food and Drug Administration</td>
<td>OME</td>
<td>Original Equipment Manufacturer</td>
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<tr>
<td>GB</td>
<td>Guo Biao (China medical device standards are classified as national standards)</td>
<td>PMS</td>
<td>Post Market Surveillance</td>
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<tr>
<td>GHTF</td>
<td>Global Harmonization Task Force</td>
<td>QMS</td>
<td>Quality Management System</td>
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<tr>
<td>GMP</td>
<td>Good Manufacturing Practice</td>
<td>SCLAO</td>
<td>Legislative Affairs Office of the State Council</td>
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<td>GRP</td>
<td>Good Refurbishment Practice</td>
<td>SFDA</td>
<td>State Food and Drug Administration</td>
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<tr>
<td>ICT</td>
<td>Information and Communications Technology</td>
<td>UDI</td>
<td>Unique Device Identifier</td>
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<tr>
<td>IEC</td>
<td>International Electrotechnical Commission</td>
<td>US</td>
<td>United States</td>
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<td>YY</td>
<td>Yi Yao (China medical device standards are classified as industry standards)</td>
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Key Recommendations

1. Trade Barriers for Certification in China
   1.1 Encourage the Rapid, Broad Scale Introduction of Condensing Boilers
      • Issue implementation rules for GB 20665 to encourage the introduction of energy efficient technology.
      • Test condensing boilers under real working conditions.
      • Encourage the rapid adoption of energy efficient technologies that are already in use overseas, which
         have the potential to lower heating costs in China.
      • Encourage the use of high efficiency boilers through tax rebates.

   1.2 Wall-Hung Boilers Testing Should be Standardised
      • Remove the issuing authority of local certification wherever this procedure is redundant (e.g. Beijing,
        Shanghai, Nanjing and the majority of other cities in China).
      • Make CGAC certification sufficient for sales of wall-hung boilers in China.
      • Specify all the cities where specific kinds of gas are used, which cannot be tested in CGAC national
        testing centres, and ensure their testing conforms to standard CJ/T228-2006.

2. Reduction in Emissions Should Follow Industry Best Practices
   • Implement testing standards for boilers which measure NOx levels.
   • Consider collaboration with European companies so as to achieve emission reduction targets.

3. Efficiency Test for Large Boilers (Standard TSG G0002-2010)Should be Partly Revised
   • Implement TSG G0002-2010 nationwide such that there are no regional differences, additionally provide
     clear information on the timeline of the implementation.
   • Revise the technical and economical feasibility of TSG G0002-2010.

Introduction to the Working Group
The Heating Working Group is mainly comprised of members from the Association of the European Heating
Industry (EHI), an organisation that was founded in 2002. In China, the European heating industry is heavily involved
in discussions relating to European and Chinese regulatory frameworks, as well as global industry issues. The Working
Group brings together the majority of European heating manufacturers to investigate market needs from the point
of view of industry. Working Group 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 Working Group seeks to:

   • promote European technology relating to eco-friendly heating and hot water systems.
   • strengthen the dialogue with Chinese authorities for domestic standards and certifications.
   • assist in China’s efforts to implement the highest international standards in the heating sector.
   • contribute to sustainable development via appropriate technological training.

Recent Developments
In recent years, energy saving and the reduction of Carbon Dioxide (CO₂) emissions have been a top priority for the
European heating industry. The industry has not only invested massively in research and development (R&D),
but has also established many service, after-sales and training centres in China. These centres contribute to the understanding and correct usage of all types of heating technology available on the market. These technologies range from individual heating solutions such as gas-fired, wall-hung boilers and gas-fired, floor-standing boilers to heating and hot water systems drawing on renewable energies. The centres also provide training and education for specialists for commercial and industrial heating solutions.

Over the past five years, the EHI has worked very closely with Chinese standards associations. It has also greatly contributed to the drafting of the new Chinese standards for gas-fired domestic heating boilers.

Producing publications on industry-related technologies, regulations, and energy-efficient heating systems also fall under the remit of the Working Group. In order to promote advanced European technology to China, the China section of the EHI publishes a bilingual magazine that offers an overview of the latest trends and developments of the industry.

Almost all big European players in the heating industry are currently active in the Chinese heating market or operate manufacturing plants in China. European heating technology manufacturers have been able to gain a strong foothold in the market for individual heating products, as well as for commercial and industrial applications.

China is rapidly moving towards a much more sustainable model of development. In order to meet the targets for energy preservation and pollution reduction that China has set for itself, the highest international standards for energy consumption will have to be adopted and enforced.

In the recently adopted China’s 12th Five-Year Plan (FYP), the Chinese government focuses heavily on environmental protection and sustainability. This is one of the three main policies that the Chinese government will carry out over the next five years. In order to achieve the ambitious goals China has set for itself, among which a 2.2% of China’s Gross Domestic Product (GDP) expenditure on R&D by 2015, the highest international standards and technologies will need to be introduced and promoted. Moreover, the FYP provides for more urban housing in a grand scale. This will all result in more chances for active participation by European manufacturers. The European heating industry, now widely represented across China, hopes to continue its partnership with the Chinese authorities. The Working Group strives to demonstrate the value of European heating best practices to Chinese consumers and legislative bodies.

Key Recommendations

1. Trade Barrier for Certification in China

1.1 Encourage the Rapid, Broad Scale Introduction of Condensing Boilers

Concern

In this sector of the industry, a lack of relevant standards for condensing boilers makes it difficult to bring new energy efficient technology to China.

Assessment

Foreign heating companies and system suppliers can significantly contribute their expertise in energy-saving technology for condensing boilers. Such boilers can help to save 15% of primary energy without loss of comfort or energy output. When considering an improvement in energy savings relating to fossil fuel consumption, more attention should be given to condensing boilers. This is why the lack of standards is such a handicap, in that it acts as a barrier to the adoption of the latest condensing boiler technology, which would lower heating costs in China.

Recommendation

- Issue implementation rules for GB 20665 to encourage the introduction of energy efficient technology.
- Test condensing boilers under real working conditions.
- Encourage the rapid adoption of energy efficient technologies that are already in use overseas, which have the potential to lower heating costs in China.
- Encourage the use of high efficiency boilers through tax rebates.

1.2 Wall-Hung Boilers Testing Should be Standardised

Concern

Both imported and domestic boilers are required to be tested at the national level by the China Quality Supervising and Test Center for Gas Appliances (CGAC). Additionally, there is an unnecessary duplicative request to test these products at the local level in order to obtain local sales approvals. Local (city level) Quality Testing Centres may request additional tests, even if the product has already been tested and certified at the national level.
Assessment

In the past, the type of gas used both domestically and in industry varied regionally. Local testing centres were necessary to test wall-hung appliances using different grades of gas, when piped to different cities or localities. Presently, natural gas is widely used across China and supplies 80% of the market, which obviates the need for most of the local testing centres.

The wall-hung boiler market has been evolving rapidly in recent years, and the whole industry co-operated with the CGAC in order to design the new standard for this category: GB25034-2010. The CGAC testing and certification (product type examination) process is mandatory and has national validity, as their laboratories are equipped to conduct tests on all kinds of wall-hung boilers. For this reason, additional local testing should not be required. Yet not only do local testing centres insist on repeating tests already carried out at the national level, but sometimes they deny approvals because of improper testing methodology or because they lack the correct equipment to conduct tests.

The uncertainty of manufacturers concerning unpredictable local testing policies affects their operations, causes confusion and slows down development of new boilers and adds to costs.

Recommendation

- Remove the issuing authority of local certification wherever this procedure is redundant (e.g. Beijing, Shanghai, Nanjing and the majority of other cities in China).
- Make CGAC certification sufficient for sales of wall-hung boilers in China.
- Specify all the cities where specific kinds of gas are used, which cannot be tested in CGAC national testing centres, and ensure their testing conforms to standard CJ/T228-2006.

2. Reduction in Emissions Should Follow Industry Best Practices

Concern

The lack of an industry standard relating to emissions for the heating industry makes it difficult bring European heating technology to the market in China. This is important for a number of reasons, mainly since nitrous oxides (NOx) are poisonous and are a major cause of acid rain.

Assessment

The applicable testing standard for boilers is GB25034-2010, which assesses safety and various technology standards. However, GB25034-2010 does not measure NOx levels. A related standard, GB25034-2010, assesses the efficiency of boilers; however, like GB 6932-2001, it does not assess emission levels for NOx. Emission levels could be regulated by a norm equivalent to the internationally recognised 'Blue Angel,' with NOx levels lower than 60 mg/kWh (milligrams per kilowatt hour); and carbon monoxide (CO) levels lower than 50 mg/kWh. NOx levels of lower than 35mg/kWh are possible using existing technologies.

Recommendation

- Implement testing standards for boilers which measure NOx levels.
- Consider collaboration with European companies so as to achieve emission reduction targets.

3. Efficiency Test for Large Boilers (Standard TSG G0002-2010) Shoud be Partly Revised

Concern

The TSG G0002-2010 standard will be implemented by different provincial agencies. Unfortunately, implementation by these regional agencies is not standardised. This leads to uncertainties for manufacturers, trade partners, customers and the industry as a whole.

Of special concern are regional differences as far as the timeline and testing procedures are concerned.

Assessment

The Working Group welcomes and encourages all efforts by the Chinese government to increase boiler efficiency and thus conserve natural resources as well as protect the environment. However, the implementation of new standards such as TSG G0002-2010 with a potential impact on a plethora of different industries should be centrally coordinated. The uncertainties created by provincial and regional differences in implementing TSG G0002-2010 are not only harmful to the heating industry, but to all industries that rely on industrial heating equipment. Increasing boiler efficiency has been one of the central goals of the European heating industry for decades and the implementation of official standards is a proven tool to achieve efficiency targets. Notwithstanding these ambitious goals, the technical feasibility and economic
impact on the industry as a whole should be taken into consideration when drafting standards.

Recommendation

- Implement TSG G0002-2010 nationwide such that there are no regional differences, additionally provide clear information on the timeline of the implementation.
- Revise the technical and economical feasibility of TSG G0002-2010.

Abbreviations

CGAC  China Quality Supervising and Test Center for Gas Appliances
CO    Carbon Monoxide
CO₂   Carbon Dioxide
EHI   Association of the European Heating Industry
FYP   Five-Year Plan
GB    Guo Biao (National Standard)
GDP   Gross Domestic Product
NOₓ   Nitrous Oxide
R&D   Research and Development
Lighting Working Group

Key Recommendations

1. Recycle of Waste Lighting Electronic Equipment
   - Conduct a feasibility study with the aim of developing WLP-specific collection and recycling legislation
   - Introduce financial incentive policies to aid the collection and recycling of lamps

2. China Restriction of Hazardous Substances (RoHS)
   a. The Catalogue
      - Be more transparent on the formation and working mechanism of the Expert Advisory Committee (EAC) who drafts The Catalogue. By sharing a timetable on future releases of The Catalogue products, the industry will have sufficient time to react and prepare
      - Include in The Catalogue only products which are ‘technically and economically feasible’
      - Start with the components industry followed by the finished products industry to ensure the proper flow of data and conformity
      - Adopt exemption levels in accordance with prevailing international standards and regulations for hazardous substances and review and update the exemption levels regularly

   b. Dissembling and Testing
      - Adopt internationally harmonised standards for dissembling and testing, or convert them into identical Chinese standards
      - Simplify testing requirements of China RoHS certification by developing a ‘risk based assessment’ process which adopts different test requirements for components which carries different level of risks
      - Recognise test reports produced by both Chinese and foreign laboratories
      - Avoid repetitive testing for single units

   c. Post Market Surveillance
      - Improve the consistency of enforcement and market surveillance by encouraging central government agencies to carry out more training and education for its local affiliates
      - Ensure all companies, irrespective of whether they are domestic or foreign invested, be treated equally in accordance with the laws and regulations

3. Semi-Conductor Lighting
   - Prioritize in-door lighting over road lighting
   - Conduct an interchangeability study for road lighting products and encourage large international and domestic players to participate

4. Energy Labelling
   - Revise the Energy Labelling Management Rules on the basis of thorough studies of international practices
   - Invite industry comments on what and how to include lighting products into the product catalogue
Introduction to the Working Group

The Lighting Working Group was established in November 2008. Members of the Lighting Working Group are leading international lighting equipment (lamps, control gears, luminaries) providers who are active in China. They have established manufacturing facilities in China, supplying both the local and international market. The expertise of the members in the lighting field is widely recognised by Chinese consumers and has contributed to the development of the lighting sector in China.

The objectives of the Working Group (WG) are to promote efficient lighting practices for the benefit of the global environment, human comfort, health and safety of consumers as well as to represent the interests of member companies and to promote the exchange of information between members, professional associations and regulatory bodies. In particular, the Working Group aims to promote a fair and transparent regulatory environment in the lighting field by furthering the dialogue between member companies and Chinese officials.

Recent Developments

Global demand for electrical lighting is predicted to increase at a rate of 4.5% to 2014\(^1\) (reaching EUR 26.7 billion). Emerging markets will provide the main driving forces of sales growth, propelled by strong economic growth, continued industrialisation, growing secondary sector (manufacturing) output and rising living standards. China will individually account for 47% of global additional product demand to 2014\(^2\), cementing its position as the largest global lighting market.

On 8th September 2010, the National Development and Reform Commission (NDRC), Ministry of Environment Protection (MEP) and Ministry of Industry and Information Technology (MIIT) jointly published the first batch of catalogue products that included televisions, refrigerators, washing machines, air conditioners and personal computers.\(^3\) On 1st January 2011 the “Regulatory Articles on Recycle and Disposal of Waste Electrical and Electronic Equipments” (China WEEE) came into effect.\(^4\) The European Chamber welcomes the China WEEE regulation. However the need for clarification on the articles and the consideration of the uniquely fragile characteristics of lighting products will be essential to the lighting industry’s further development in China.

Another development includes the revised Electronic and Electric Products Pollution Control Management Rules (China RoHS) which will be released in the second half of 2011 and be put into effect in the second half of 2012. After the release of the revised China RoHS, the Key Catalogue for the Control of Pollution Caused by Electronic Information Products will be renamed as Electronic and Electric Products Pollution Qualified Products Catalogue due to change of scope. The WG is concerned by the uncertainties of China RoHS; these issues, raised by the affected industries, include the composition of an expert committee, “basis for inclusion” and high costs brought about by compulsory certification.

Besides these environment-related laws and regulations, the government is also pushing forward the development of energy efficiency-related rules and standards such as further implementation of energy labelling rules and encouraging the growth of the domestic Light Emitting Diode (LED) sector. In the 12th Five-Year Plan, the emphasis on energy efficiency will have great impact for the LED sector. Also, programs such as the ‘10 Cities with 10,000 Lights’\(^5\) highlight the government’s commitment towards fostering this emerging field. As with any other young industry which enjoys high growth, the LED industry can only enjoy prosperous and sustainable growth by adopting proper industry and standards policies.

The recognition of the lighting industry’s characteristics is exceedingly important for the development of the sector, and the WG is positive about the openness and cooperation of the Chinese officials and is seeking further positive change within the lighting industry in China.

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Key Recommendations

1. Recycle of Waste Lighting Electronic Equipment

Concern
On a global scale the lighting industry supports the reduction of the waste stream and is willing to take responsibility to collect and recycle their Waste of Lighting Products (WLP) in order to contribute to a more sustainable society. According to experience and lessons learned from leading lighting companies in other countries, collection and recycling of WLP is rather different from the collection and recycling of other Electric and Electronic Equipments (EEEs). Therefore, China has the opportunity to learn from both the best and the worst practices in other countries resulting in a more efficient and sustainable implementation procedure.

Assessment
The experience gained in other countries regarding collection and recycling of WLP is quite different from the collection and recycling of other EEEs for many reasons.

First, WLP usually has a very low monetary value although lighting products are widely used in large regions and vast quantity.

Second, the end users are often unaware of the environmental damage caused by improper disposal and recycling of WLP. Therefore, a collection system needs to include an additional incentive policy supported by the government in order to retrieve WLP from end users.

Third, the cost of storage and transportation of WLP is comparatively higher than the collection and recycling of other EEEs. This is due to: the bulkiness of some lighting products, the fragile characteristics of glass which require additional special treatment, and the associated transportation costs brought on by the wide geographical coverage from which lighting products need to be collected. Considered together, the disposal cost of collecting and recycling of WLP far exceeds the dollar value the recycled material can eventually generate.

Finally, the cost of collecting and recycling WLP, e.g. lamps, can be as high as 50-100% of the original products retail price. This is very different if compared to other WEEEs, where the cost only represents a few percent of the price and can sometimes even result in a positive cash flow for the manufacturers. (Please refer to the Graph 1 below).

Graph 1: Percentage of End-of-Life Product Disposition Fees over Product Prices

End-of-life lamps are fundamentally different from the other categories of end-of-life EEEs in various aspects; therefore the WG proposes not to include WLP in the scope of the WEEE legislation, but to develop specific legislation to properly organise the collection and recycling of WLP. Lamp producers are willing to cooperate and take responsibility for the management of lamps containing mercury at their end-of-life.

Therefore the following approach is suggested:

1. Carry out a feasibility study leading to specific WLP legislation:

a) Develop a set of practical scenarios on how to organise the collection and recycling of WLP in an efficient and effective way in China. This will take into account all aspects including environmental objectives, financial scenarios and obligations
of the respective parties, operational parameters, social and economic environment, information and communication dimensions, geographical growth, infrastructure, and reporting. Please refer to Graph 2.

b) Ensure that both the feasibility study and any proposed legislation resulting from the study be carried out in cooperation and consultation with the relevant lamp producers.

2. Based on the feasibility's findings, set up and implement pilot projects to be carried out in different areas.

3. Based upon the experience gained from the pilot projects, revise and optimise the plan.

4. Based upon the optimised plan, stipulate an eventual WEEE policy for lighting.

Development of a specific and feasible legislation for lighting would better serve the interests of all stakeholders involved: the government, the environment, the society and the producers.

Considering the high cost of the collection and recycling of lamps at their end-of-life in relation to their value (see again Graph 1), to avoid additional costs being transferred to consumers, government financial incentive policies should show willingness and support to manufacturers for carrying out this exercise.

The Working Group is extremely committed to bringing in the required expertise and knowledge gained by lamp producers abroad to develop an effective and sustainable solution for China.

From the information available, the infrastructure for the recycling of WLP is far from adequate, especially in China, where it is almost absent. Consequently, plenty of time is needed to build up such infrastructure; it is therefore crucial to start the feasibility study as soon as possible.

Recommendation

- Conduct a feasibility study with the aim of developing WLP-specific collection and recycling legislation
- Introduce financial incentive policies to aid the collection and recycling of lamps

2. China Restriction of Hazardous Substances (RoHS)

a. The Catalogue

Concern

The Catalogue for Priority Control of Pollution Caused by Electronic Information Products6 (The Catalogue) plays a crucial role in providing the lighting industry with a fair and transparent operating environment. Clear and applicable procedures for The Catalogue formulation are essential for the success of the lighting industry in China.

Assessment

In Article 3 of “Procedures for Formulating the Priority Administrative Catalogue for the Control of Pollution Caused by Electronic Information Products”, it is stated that the procedures for creating The Catalogue will be undertaken in an open and transparent manner, mainly conducted by government in conjunction with the proactive participation and consultation of various stakeholders. Transparency here is vital, to allow lighting manufacturers to react to the implementation of hazardous materials control limits on a timely basis, all the while providing opportunities for relevant officials and manufacturers to thoroughly understand the current status and future developments. This is necessary to assess “technical and economical feasibilities,” and to create a reasonable list of regulated products and relevant exemption limits.

China is the world’s biggest producer and exporter of lighting products. Harmonising China’s exemption limits on harmful materials with the prevailing international levels would improve manufacturers’ ability to conform to often complex and varying limits, while simultaneously enabling officials more effective monitoring. Alongside technological development and product replacement, it is necessary to review and update exemption levels regularly in order to reduce the usage of hazardous materials, or even eliminate them.

Recommendation

- Be more transparent on the formation and working mechanism of the Expert Advisory Committee (EAC) who drafts The Catalogue. By sharing a timetable on future releases of The Catalogue products, the industry will have sufficient time to react and prepare

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- Include in The Catalogue only products which are ‘technically and economically feasible’
- Start with the components industry followed by the finished products industry to ensure the proper flow of data and conformity
- Adopt exemption levels in accordance with prevailing international standards and regulations for hazardous substances and review and update the exemption levels regularly

b. Dissembling and Testing

Concern
Dissembling and testing of the material in components is a significant burden.

Assessment
A large number of components are often included in a simple Electronic Information Product (EIP) such as electronic watches and these components contain many kinds of substances. According to the current regulation, every component is required to be tested for 6 potential hazardous substances and test results from foreign labs are not recognized by Chinese authorities. As a result, testing requirements for China RoHS certification is relatively demanding. This further significantly increases costs for business.

Recommendation
- Adopt internationally harmonised standards for dissembling and testing, or convert them into identical Chinese standards
- Simplify testing requirements of China RoHS certification by developing a ‘risk based assessment’ process which adopts different test requirements for components which carries different level of risks
- Recognise test reports produced by both Chinese and foreign laboratories
- Avoid repetitive testing for single units

c. Post Market Surveillance

Concern
Working Group members are concerned over the inconsistency in China RoHS market surveillance by different provinces and municipalities.

Assessment
The WG frequently experiences difficulties in complying with the same set of policies in different regions, due to the great discrepancy in interpretation and implementation throughout the country.

Recommendation
- Improve the consistency of enforcement and market surveillance by encouraging central government agencies to carry out more training and education for its local affiliates
- Ensure all companies, irrespective of whether they are domestic or foreign invested, be treated equally in accordance with the laws and regulations

3. Semi-Conductor Lighting

Concern
In the absence of relevant standards, the LED road lighting sub-sector is overheating.

Assessment
Due to various government support programs, the semiconductor lighting industry in China has advanced rapidly. One of the key areas is road lighting. However, due to a low entrance threshold and the un-coordinated standardization work of each province, the market was in disorder.

After the first phase of ‘10 Cities with 10,000 Lightings’, governments and manufactures are now able to rationally study the situation and refocus the emphasis on in-door lighting during the “Semi-conductor Lighting Products Application Demonstration Project” in late November 2010.

The Working Group supports such a transition from road lighting to in-door lighting due to the following reasons:

- In-door lighting products are more lucrative than road lighting. Therefore, industry development is more sustainable without government subsidies.
- The socket and holder that are the basis for interchangability are consistent with traditional lighting.

Recommendation
- Prioritize in-door lighting over road lighting
- Conduct an interchangeability study for road lighting products and encourage large international and domestic players to participate.

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4. Energy Labelling

Concern
Under the current Energy Labelling Management Rules, manufactures are experiencing unnecessary cost and difficulties in compliance.

Assessment
The Energy Labelling Management Rules were implemented on 1st March 2005. Article 8 specifies the content of energy labels and the Energy Labelling Implementation Rules for a variety of products illustrated below.

Until now, all the labels specified are in colour while the formats remain largely consistent. The graph below shows the format and specification for Compact Compulsory Lamp (CFL) energy labelling. The labels for other products are similar.

Graph 3: Energy Label for CFL

However, for some products, it is not necessary to comply with the adhesive graphic labels. For example, High Pressure Sodium Lamps (HPSLs) are a professional product. The users are professional enough to understand the energy index without the colourful information. The additional cost resulted by colour printing eventually is passed on to end-users. For these types of product, there are more mature methods practiced in other countries or regions.

Recommendation
- Revise the Energy Labelling Management Rules on the basis of thorough studies of international practices
- Invite industry comments on what and how to include lighting products into the product catalogue

Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>AQSIQ</td>
<td>General Administration of Quality Supervision, Inspection and Quarantine</td>
</tr>
<tr>
<td>CCC</td>
<td>China Compulsory Certification</td>
</tr>
<tr>
<td>CFL</td>
<td>Compact Fluorescent Lamp</td>
</tr>
<tr>
<td>CFL-I</td>
<td>Self-ballasted Lamps for General Lighting Service</td>
</tr>
<tr>
<td>CFL-NI</td>
<td>Compact Fluorescent Lamps without Integrated Ballast</td>
</tr>
<tr>
<td>CNCA</td>
<td>Certification and Accreditation Administration of People’s of Republic of China</td>
</tr>
<tr>
<td>EAC</td>
<td>Expert Advisory Committee</td>
</tr>
<tr>
<td>EC</td>
<td>European Commission</td>
</tr>
<tr>
<td>EEE</td>
<td>Electrical and Electronic Equipment</td>
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<tr>
<td>EIP</td>
<td>Electronic Information Product</td>
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<tr>
<td>EMC</td>
<td>Electromagnetic compatibility</td>
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<tr>
<td>EoL</td>
<td>End-of-Life</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>FL</td>
<td>Fluorescent Lamp</td>
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<tr>
<td>GLS</td>
<td>General Lighting Service</td>
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<tr>
<td>HID</td>
<td>High Intensity Discharge</td>
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<tr>
<td>HPSL</td>
<td>High Pressure Sodium Lamp</td>
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<tr>
<td>IECQ</td>
<td>International Electrotechnical Commission Quality Assessment System for Electronic Components</td>
</tr>
<tr>
<td>ISO</td>
<td>International Organization for Standardization</td>
</tr>
<tr>
<td>LED</td>
<td>Light Emitting Diodes</td>
</tr>
<tr>
<td>MEP</td>
<td>Ministry of Environment Protection of People’s Republic of China</td>
</tr>
<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
</tr>
<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
</tr>
<tr>
<td>PRC</td>
<td>People’s Republic of China</td>
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<tr>
<td>RoHS</td>
<td>Restriction of Hazardous Substances</td>
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<tr>
<td>SSL</td>
<td>Solid State Lighting</td>
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<tr>
<td>XRF</td>
<td>X-Ray Fluorescence</td>
</tr>
<tr>
<td>WEEE</td>
<td>Waste Electrical and Electronic Equipment</td>
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<tr>
<td>WG</td>
<td>Working Group</td>
</tr>
<tr>
<td>WLP</td>
<td>Wasted Lighting Products</td>
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<tr>
<td>WTO</td>
<td>World Trade Organisation</td>
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</table>
Key Recommendations

1. Promoting the Secondary Metal Industry
   1.1 Scrap Metal Recycling
   - Restructure the scrap collection and pre-processing sector in China to make it transparent and compliant with market rules.
   - Ensure effective and uniform enforcement of environmental, health and safety rules in recycling practices across regions.
   - Eliminate export restrictions relating to scrap in order to integrate the Chinese scrap market into the global recycling economy.

   1.2 China Waste Electrical and Electronic Equipment (WEEE)
   - Establish clear-cut divisions of responsibilities among various regulators and streamline cross-ministerial administrative procedures for regulating WEEE recycling.
   - Issue a set of detailed implementation guidelines based on timely public consultation of the various stakeholders, so as to better prepare the industry for the enforcement of regulations.
   - Clearly classify and regulate the pre-processed powder from waste PCBs as hazardous waste, and enforce more stringent hazardous waste management regulations as needed.
   - EPBs should implement clear standards and a transparent system, to ensure the permit system for hazardous waste treatment operates fairly and in accordance with its original purpose.
   - Enhance cooperation between the central government and all relevant governmental agencies to ensure: (1) the formal sector can survive and develop; (2) the informal sector is rapidly restructured and integrated into the open market.
   - Set up a representative national trade association under the guidance of relevant central government agencies to provide a necessary platform for industry (both domestic companies and Foreign Invested Enterprises) to better communicate with authorities.

2. Overcapacity
   - Further stimulate domestic consumption and investment on the basis of market requirements and profitability.
   - Establish a systematic national and industrial standard for high-valued products which adopts and efficiently utilizes NFM in areas of manufacturing, application and inspection etc.
   - Make investment decisions in regards to market demand, and improve the enforcement of industry entrance requirements.
   - Include the local governments in the assessment of overcapacity problems, and increase their accountability.

3. Metal Hedging
   - Accelerate the development and opening up of the Chinese metals futures market and adopt international metals hedging practices.
   - Allow hedging on LME with free movement of capital in USD cross-border for closing or rolling over such hedges.
4. Metal Commodity Exchange
- Remove the existing restrictions on non-Chinese membership and trader-clients, to allow free access to the SHFE for any interested party.
- Adopt international practices for SHFE operating rules and mechanisms, specifically with reference to those of the LME, which is in the leading global metal Commodity Exchange.
- Enable the free and unrestricted in-and-out flow of financial funds to allow daily margining.
- Establish unrestricted imports and exports of metals and metal raw materials, free of influence from customs duties, export taxes, etc.
- Allow foreign Commodity Exchanges (such as the LME) to run licensed bonded warehouses in China.

5. Cooperation within the Chinese NFM Industry
- Allow membership of the China Non-Ferrous Metals Industry Association (CNIA) to foreign companies and joint-ventures established in this sector in China.
- Permit foreign companies to apply for financial support from national development funds.

Introduction to the Working Group

The Chinese non-ferrous metals (NFM) industry has developed spectacularly over the last few years and now ranks as one of the largest and most important in the world. Despite the size of the Chinese NFM industry, only a limited number of European Union (EU) companies have entered the Chinese NFM industry.

The Non-Ferrous Metals (NFM) Working Group was established in 2006 in Beijing with the support of The European Association of Metals (Eurometaux), to enable NFM industry members to exchange information and opinions on key horizontal or vertical issues relating to their activities in China. The NFM Working Group is represented by major European players who are active in different sub-sectors of the Chinese NFM industry. These European companies in China have focused on specific high-end market segments and on high value-added products. In doing so, the companies are greatly contributing to the development of the Chinese NFM sector by transferring expertise and know-how.

Since its establishment, the NFM Working Group has been active in policy dialogue/development with key government stakeholders in China, i.e. National Development Reform Commission (NDRC), Ministry of Industry and Information Technology (MIIT), Ministry of Environmental Protection (MEP), the General Administration of Customs (GAC), the State Council (SC) and Shanghai Future Exchange (SHFE).

The objective of the NFM Working Group is to contribute, on behalf of member companies, to the development of a healthy NFM industry in China, and to see to its harmonious integration in the international market.

Recent Developments

Since the announcement of the Stimulus Plan for the Non-Ferrous Metal Industry\(^2\) in 2009, the government has promulgated a series of regulations to promote the sustainable development and growth of the Non-Ferrous Metal industry. Government objectives include further developing secondary metal, increasing resource efficiency, reducing overcapacity, optimising industrial layout, and promoting industrial re-organization by using legal, financial and administrative measures and by promoting advanced technology and management measures. The NFM Working Group applauds the great efforts made by the national government to guide the healthy growth of the industry.

As a capital-intensive industry, the NFM industry needs policy stability. To achieve the long term development goals and expedite investment and transfer of technology and management systems, the NFM Working Group supports the Chinese Government to continuously improve the transparency, predictability and consistency of legal and regulatory framework, to ensure the sufficient transitional periods for implementing various policies and to further reduce local protectionism. Over the past 3 years, China


significantly and repeatedly adjusted VAT refund rates, restrictions on processing trade, and import-export tariffs. It has as revised or adopted many measures on external trade. Moreover, the status and operating conditions in free trade zones (FTZ) have worsened over the past few years. Such instability can cause companies to become unprofitable overnight and may lead to the failure of several projects that would have been beneficial for local development.

China is the biggest world supplier of certain raw materials, and also a key economic and political power. In view of this, the European Chamber welcomes measures taken by the national and local Governments that are conducive to greater policy stability, transparency, industrial sustainability, and are in line with international rules.

1. Promoting the Secondary Metal Industry

1.1 Scrap Metal Recycling

Concern
The highly fragmented, unregulated and widespread operation of informal scrap collection and pre-processing circuits in China leads to a market that lacks transparency and makes sustainable integration of the Chinese recycling sector in the global recycling economy difficult. Not only does this discourage investment in state-of-the-art facilities in China, but also it gives rise to trade tensions with the international scrap market whose participants -- operating according to market rules and environmentally sound management principles -- find it impossible to compete at arm’s-length with these informal circuits in China. In addition, the Chinese scrap market is a one-way market, sheltered from external competition by export restrictions.

Assessment
China’s pursuit of sustainable development, notably in the raw material sector, was highlighted by the focus placed on recycling in the 11th Five-Year Plan for National Economic and Social Development of the People’s Republic of China, and confirmed in the 12th Five-Year Plan.

China’s metal scrap collection market was established years ago but this sector still operates with a large number of informal networks that manually or with rudimentary technologies collect and pre-process scrap. Such methods may cause considerable material losses, health hazards and pollution. Local protectionism and inconsistent enforcement of national rules facilitate pervasive and continually fraudulent behaviour whilst discouraging the development of a sound domestic recycling sector. As a result, prospects for reasonable return on investments with more sophisticated technologies and more responsible management are undermined.

Additionally, this situation produces a number of detrimental effects to the efficient operation of a global recycling economy and China’s smooth integration into the global recycling economy. Indeed, the international scrap market has become a very attractive source of feed supplies for China’s informal recycling networks and an important source of material for the fast growing needs for raw materials by the Chinese NFM industry. Buying pressure, stirred up by the purchasing edge that Chinese operators derive from domestic informal networks and the protection of export taxes on scrap, has given rise to recurrent trade tensions on the international scrap market. It has also created serious and unfair imbalances between market players, in and out of China, who operate according to market rules and the principles of environmentally sound management.

The NFM Working Group appreciates the government’s efforts to lead the recycling sector in China towards transparent trade practices, sound environmental management and increased efficiency. The Working Group members are convinced that strict and uniform enforcement of the rules, particularly in the field of customs and environment, would benefit the recycling sector. The Working Group also believes that the Chinese recycling sector would benefit from exposure to international competition that naturally triggers technological progress and efficiency.

The NFM Working Group is willing to work constructively with MEP, MIIT, NDRC, GAC and AQSIQ to develop mutually satisfactory solutions to ensure the development of a transparent recycling sector in China and a level international playing-field in regards to operating conditions for recycling and access to scrap.

Recommendation
- Restructure the scrap collection and pre-processing sector in China to make it transparent and compliant with market rules.
- Ensure effective and uniform enforcement of environmental, health and safety rules in recycling practices across regions.
• Eliminate export restrictions relating to scrap in order to integrate the Chinese scrap market into the global recycling economy.

1.2 China Waste Electrical and Electronic Equipment (WEEE)

Concern
A large number of regulators – without clear distinctions of responsibilities among them – are involved in Waste Electronic and Electrical Equipment (WEEE) recycling. Yet detailed implementation guidelines regarding the regulation on WEEE, to be implemented from 1 January 2011, are not available. Furthermore, the classification of Polychlorinated biphenyls (PCB) dismantled from End-of-Life WEEE (EoL-WEEE) lacks clarity. A large number of recyclers physically pre-process waste PCBs into powder and sell the powder as non-hazardous waste to downstream processors. In addition, a large number of licensed recyclers do not have end-processing capabilities, while rampant questionable practices by the huge informal sector seriously jeopardizes the survival of the formal sector. This situation exists in a climate where no trade association specifically represents the WEEE recycling industry in China.

Assessment
The numerous different regulators and a lack of clarity for divisional responsibility produce enforcement inefficiencies in some areas, and over-regulation in others. While the enforcement of regulations on WEEE is imminent, implementation processes are unknown, including those regarding licenses (e.g. collection, transportation, pre-processing and end-processing, fund collection and usage, etc.).

It is clear that scrap PCBs from the production side shall be classified as Hazardous Waste and shall, therefore, be managed as such. But the lack of forceful regulation for waste PCBs dismantled from EoL WEEE is resulting in a large number of unlicensed players engaging in collecting, trading and disposing of waste PCBs dismantled from EoL WEEE.

The rampant practice of pre-processing waste PCBs into powder and selling the powder as non-hazardous waste without the proper supervision of hazardous waste management, results in secondary pollution and the loss of precious metals at the pre-processing stage.

Permits for hazardous waste treatment should be issued only to qualified recyclers with sound and eco-friendly end-processing capabilities. However, a number of licensed recyclers in China operate without proper end-processing capabilities. Unless there is transparency in the process and standards ensuring that permits go to the best recyclers, widespread non-compliance of environmental protection will continue, thereby nullifying the original purpose of the permitting system.

As the WEEE recycling market in China is still developing, the availability of a representative trade association will be instrumental in ensuring appropriate and much needed communication between responsible authorities and the industry. Such communication is critical for the healthy development of the market in China. The WEEE recycling sector is still a niche market that has not received the deserved consideration given the huge impact on the environment if it is not dealt with properly.

Recommendation
• Establish clear-cut divisions of responsibilities among various regulators and streamline cross-ministerial administrative procedures for regulating WEEE recycling.
• Issue a set of detailed implementation guidelines based on timely public consultation of the various stakeholders, so as to better prepare the industry for the enforcement of regulations.
• Clearly classify and regulate the pre-processed powder from waste PCBs as hazardous waste, and enforce more stringent hazardous waste management regulations as needed.
• EPBs should implement clear standards and a transparent system, to ensure the permit system for hazardous waste treatment operates fairly and in accordance with its original purpose.
• Enhance cooperation between the central government and all relevant governmental agencies to ensure: (1) the formal sector can survive and develop; (2) the informal sector is rapidly restructured and integrated into the open market.
• Set up a representative national trade association under the guidance of relevant central government agencies to provide a necessary platform for industry (both domestic companies and Foreign Invested Enterprises) to better communicate with authorities.
2. Overcapacity

Concern
Overcapacity increases competitive pressures on domestic and global markets and spurs trade tensions between China and its major trading partners. One of the main reasons only a few global NFM companies are currently investing in China is that overcapacity results in unprofitable market prices and often unfair price competition.

Assessment
Overcapacity is not a new problem for China’s Metal industry, though the problem was exacerbated during the economic crisis due to the reduction of exports. The Chinese Government has clearly demonstrated that it understands the overcapacity problem. It has been active in eliminating obsolete capacities and encouraging structural changes in the industry. Various regulations have been promulgated by the SC, MIIT, and NDRC with specific implementation plans at local levels.

The Government is eager to create more high-end products by efficient usage of NFM, instead of exporting raw materials. Yet, overcapacity leads to unhealthy competition on prices, which is detrimental to the development of more value added products as companies are forced to cut costs in Research and Development (R&D) and skimp on technology upgrades. This promotes inefficient utilization of raw materials, threatens living conditions and causes huge resource waste.

The Working Group is concerned by local practices in the elimination of overcapacity. Easy access to technology and funding, and relatively low market entry levels for domestic players have attracted continuous investment projects. Under the influence of this trend at least two side effects are being felt: 1) the entrance level is artificially low due to easy access to loans and government subsidies; 2) local governments tend to focus on the short term economic benefits, sometimes in contradiction with national policies.

From a different perspective, China lacks clearly defined standards distinguishing high and low end products. In fact, overcapacity may not be applicable to high end products, but without clear standards, the products are labelled as “overcapacity” as the other low end products. Without adopting clear standards established for the high-end NFM products, the copy-cats (with bad quality, but look-likes) could enter the market easily. It would easily lead to unfair competitions and distort the market for high-end products.

Recommendation
- Further stimulate domestic consumption and investment on the basis of market requirements and profitability.
- Establish a systematic national and industrial standard for high-valued products which adopts and efficiently utilizes NFM in areas of manufacturing, application and inspection etc.
- Make investment decisions in regards to market demand, and improve the enforcement of industry entrance requirements.
- Include the local governments in the assessment of overcapacity problems, and increase their accountability.

3. Metal Hedging

Concern
Metal hedging is currently offered by several banks in China in CNY only. This causes exchange rate risks for hedging parties, since import purchases of metal for export are conducted in USD. Furthermore, companies are not allowed to hedge offshore, but need to do so via a bank in China, limiting the flexibility of hedging transactions.

Assessment
China has continuously reformed its financial market. However, NFM company’s operating practices subject them to potential losses from metal price fluctuations. It is normal for metal purchased to stay in “stock” (e.g., raw
material stockpile, work in progress (WIP) and finished goods) for a period of time between purchasing the raw material to delivery of finished goods to customers. Due to the pricing mechanism of processed NFM products to be sold, companies are subject to potential financial losses on the 'Imbalanced Stock' (I/S) during this period.

The correct way to remove this risk, and a common practice around the world, is to sell I/S open position in the metals future market and buy it back (close) upon maturity. The result of this operation is that, if metal prices fall/increase, the relevant losses/profits made from the total price received from the customer would always be offset by the relevant gain/loss from the metal hedging transaction in the futures market. Considering that the price for the export customer is based on the LME, removing the risk associated with these customers requires that the metal be hedged against the LME.

The problem faced by companies in China is that, under the current regulations, State Administration of Foreign Exchange (SAFE) divides foreign exchange transactions into two main categories: operational transactions and capital transactions. The latter is separated into two sub-categories: direct investments and indirect investments (such as financial derivatives). SAFE stipulates that capital transactions are restricted, i.e., capital is not allowed to flow freely, but the direct investments sub-category is partly liberalised through a more flexible interpretation of the regulation.

The transfer of funds in and out of China in order to settle the suspended balance associated with hedging transactions would be classified by SAFE as an indirect investment, making it impossible to carry out these transactions. SAFE has, however, pointed out that it would not have any objections to these transactions if a solution can be found that does not require funds being sent back and forth. However, this procedure leads to another problem, that the gain or loss cannot be closed, and contradicts generally accepted accounting principles.

SAFE acknowledges that legislation has not been modified to satisfy the manner in which most relevant enterprises operate, due to the fear of inflow and outflow of capital by speculators. Yet, in metals hedging transactions where the objective and justification are to mitigate the risk on customer contracts, there is no speculative purpose.

Recommendation

- Accelerate the development and opening up of the Chinese metals futures market and adopt international metals hedging practices.
- Allow hedging on LME with free movement of capital in USD cross-border for closing or rolling over such hedges.

4. Metal Commodity Exchange

Concern

NFM in China are normally traded on the Shanghai Futures Exchange (SHFE). In general, the SHFE property serves its purpose of being a trading platform for NFM in China. However, comparing the SHFE metals price levels over time with those of other international non-ferrous metal exchanges, shows major discrepancies exist. This reveals that the SHFE is not well-integrated in the international non-ferrous metal pricing mechanism. These discrepancies create concerns, especially for those non-ferrous metal companies who operate with a long term business plan, because they distort global metal and metal raw materials markets, making supplies to China attractive for speculators and creating unfair competition for market players outside of China. There is also a risk that such discrepancies encourage NFM companies to produce and do business in commodity-type products, rather than value-added products.

Assessment

In general, the SHFE follows price trends of international Commodity Exchanges. However, a detailed comparative analysis of international price levels (e.g., price developments on the LME) over time with the development of the SHFE price levels clearly shows periods of significant and lasting discrepancies. In a transparent global market, such as the NFM market, price differences between NFM Commodity Exchanges cannot vary to this extent. Indeed, independent Commodity Exchanges that grant free access to any user free of local policy influence, regardless of location, cannot show an arbitrage that exceeds normal shipment/financing cost between the warehouse locations of the different exchanges. A good example is LME compared with the New York Mercantile Exchange and Commodity Exchange, Inc (COMEX). The arbitrage is always small and limited, even in extreme market situations.

This is not the case with the SHFE. Significant and
lasting price differences with the LME encourage speculative behaviour, and thereby distort market forces that determine prices. This is a cause for concern for NFM companies with a long-term business plan, as it introduces unwarranted instability and unpredictability into the business environment. It encourages enterprises to operate on a short-term basis, either to limit their risks, or to take advantage of price discrepancies. In both cases, business decisions are skewed to metal price fluctuations rather than made in relation to an industrial project geared to developing customized products with a higher degree of technical content.

The European Chamber notes that the Shanghai Futures Exchange aims to open trading participation to foreign companies. The Working Group applauds this development and the continuous efforts made by the Shanghai Future Exchange. The Working Group members believe that a system which is fully integrated to the international pricing mechanism will result in an open Chinese market that will become an integral part of the global metals market. In the long run, it will also support competitiveness of domestic companies in China.

**Recommendation**

- Remove the existing restrictions on non-Chinese membership and trader-clients, to allow free access to the SHFE for any interested party.
- Adopt international practices for SHFE operating rules and mechanisms, specifically with reference to those of the LME, which is in the leading global metal Commodity Exchange.
- Enable the free and unrestricted in-and-out flow of financial funds to allow daily margining.
- Establish unrestricted imports and exports of metals and metal raw materials, free of influence from customs duties, export taxes, etc.
- Allow foreign Commodity Exchanges (such as the LME) to run licensed bonded warehouses in China.

5. Cooperation within the Chinese NFM Industry

**Concern**

Foreign companies established in China are not allowed membership in national industry associations which exist for their sector. They are, therefore, unable to exchange views on market and policy developments relating to their area of activity. In addition, foreign companies are not allowed to apply for financial support from national funds.

**Assessment**

The Chinese government has repeatedly stated that foreign invested companies in China are regarded and treated as Chinese companies. However, there are limited opportunities to exchange information and best practices between foreign and Chinese metals companies. There is also a limited opportunity as regards transparency and stakeholder consultation in policy development and the shaping of sectoral policy measures. Foreign companies established in the NFM sector in China are nevertheless an integral part of Chinese industry and contribute to its development. They should, therefore, be allowed to participate in the activities of their industry association, and reap the benefits in the same way as their Chinese counterparts.

In addition, many foreign companies have transferred important know-how from their respective parent companies to China. It is important not only to support the continued transfer of technology but also to encourage the development efforts of local foreign companies. Therefore, foreign companies should have the option to apply for financial support from national funds, particularly when they are working with Chinese companies in joint R&D programmes.

**Recommendation**

- Allow membership of the China Non-Ferrous Metals Industry Association (CNIA) to foreign companies and joint-ventures established in this sector in China.
- Permit foreign companies to apply for financial support from national development funds.

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5 Shanghai Future exchanges aims to open trade to foreign firms-exec 2011, Reuters, viewed in 2011, [http://af.reuters.com/article/metalsNews/idAFB9E7FQ01X20110521]
## Abbreviations

<table>
<thead>
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<tr>
<td>AQSIQ</td>
<td>General Administration of Quality Supervision, Inspection and Quarantine</td>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
</tr>
<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>COMEX</td>
<td>New-York Commodity Exchange, a Division of the New-York Mercantile Exchange (NYMEX) China Non Ferrous Metals Industry Association: CNIA</td>
<td>PCBs</td>
<td>Polychlorinated biphenyls</td>
</tr>
<tr>
<td>China WEEE</td>
<td>China Waste Electrical and Electronic Equipment</td>
<td>R&amp;D</td>
<td>Research and Development</td>
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<td>EoL</td>
<td>End-of-Life</td>
<td>SHFE</td>
<td>Shanghai Future Exchange</td>
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<td>EPB</td>
<td>Environmental Protection Bureau</td>
<td>SHME</td>
<td>Shanghai Metal Exchange</td>
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<td>EU</td>
<td>European Union</td>
<td>SME</td>
<td>Small and Medium-sized Enterprise</td>
</tr>
<tr>
<td>FTZ</td>
<td>Free Trade Zone</td>
<td>USD</td>
<td>US Dollar</td>
</tr>
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<td>GAC</td>
<td>General Administration of Customs</td>
<td>VAT</td>
<td>Value Added Tax</td>
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<tr>
<td>LME</td>
<td>London Metal Exchange</td>
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<tr>
<td>MEP</td>
<td>Ministry of Environment Protection of People’s Republic of China</td>
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</table>
Key Recommendations

1. Fully Open the Oil Product Import and Wholesale Markets
   - Abolish Regulation No. 38 and other obsolete regulations in order to render conditions of the December 2006 regulation applicable.
   - Retain transparent and open guidelines allowing foreign invested enterprises to qualify for import licences and to benefit from import quotas.
   - Adapt the existing wholesale licensing system to encompass business lines rather than legal entities, enabling integrated oil companies to qualify.

2. Exempt Naphtha from the Consumption Tax
   - Permanently remove the consumption tax for both imported and domestically purchased naphtha, in cases where it is used as raw material for ethylene and aromatic products.
   - At a minimum, extend the exemption of the consumption tax for domestically purchased naphtha and provide a direct exemption of the consumption tax for imported naphtha, where it is used as a raw material for chemical downstream products, such as ethylene, propylene, C4’s and aromatic products, etc.

3. Grant Government Approval for the Importation of Controlled Active Pharmaceutical Ingredients (APIs)
   - MOFCOM should approve the importation of samples of controlled APIs with the necessary restrictions on quantity and purpose of use.
   - Initiate cross-ministerial consultations to formulate and implement official regulations, guidelines and procedures on the approval of the importation of controlled APIs.

4. Enhance Transparency Regarding Expert Panel Reviews and Investment Decisions (previous fragment was not a recommendation)
   In order to improve the methodology in assessing major chemical projects, the Working Group recommends the government:
   - Define and formalize fair and transparent evaluation and scoring criteria, in line with the 12th Five-Year Plan and other industrial development orientations, policies and priorities, embracing all factors of sustainability.
   - Set procedures for each project stage (Pre-FS, PAR, FS, EIA, etc.) and timetable for review, enabling project owners to better prepare and respond to expert queries.
   - Ensure a formal approach in the selection of an expert panel, avoiding the involvement of direct competitors and extending it to foreign consultants to enhance expertise.

5. Transportation of Dangerous Chemicals
   - Adopt a standard for the transportation of dangerous chemicals. Establish nationwide applicable compulsory standards and criteria for transportation vehicles and their necessary affiliated equipments to meet technical qualifications.
   - Adopt international standards (ADR) that include quantitative exemptions. Allow smaller load capacity, certified vehicles to be used for transportation of limited quantities of dangerous chemicals.
   - Ensure legal compliance by strengthening professional administration and standardizing the supervision of the transportation vehicles for dangerous chemicals. The government should consider introducing qualified third-party agencies to assess logistics service providers and vehicles in order to ensure more effective enforcement of the regulations.
Introduction to the Working Group

The Petrochemicals, Chemicals and Refining (PCR) Working Group represents European manufacturers in this sector. PCR companies together with their joint venture (JV) cooperation partners are large investors in China. For example, new foreign investment in the Chinese chemicals industry in 2009 totalled USD 3,991,530,000. For years, the Working Group has enjoyed a close relationship with both Chinese and European authorities. With the launch of the 12th Five-Year Plan, the Working Group member companies are eager to contribute sustainably to the further development of China’s economy.

Recent Developments

The Working Group has continued the strategic dialogue with the Chinese government and relevant institutions, including high-level meetings with the Ministry of Commerce (MOFCOM), the Ministry of Environmental Protection (MEP), the China Petroleum and Chemical Industry Federation (CPCIF) and senior European Commission (EC) officials.

Through its close relationship with MEP, the Working Group contributed to the final drafting of a regulation for imports of small volumes of chemicals for R&D purposes. This was made easier starting from the fourth quarter of 2010. Furthermore, the Working Group participated in the preparation of implementing guidelines for the newly revised Regulation on the Registration of New Chemical Substances. Further improvement can be made for the process of registration of chemicals, such as by applying registration rules and fees equally, ensuring awareness and fair enforcement of the regulation and by further simplifying registration procedures to reduce costs and resources for chemical manufacturers, both Chinese and foreign.

Member companies of the PCR Working Group have sponsored a study that aims to provide recommendations for Chinese chemical clusters on energy management improvement for the 12th Five-Year Plan period. The study results show how important size, best practice sharing and targeted restructuring are to develop sustainable clusters. Another important topic in this respect is energy source optimisation. The PCR Working Group intends to discuss the outcome of this study with the National Development and Reform Commission (NDRC) to further contribute to a sustainable development of the chemical industry in China.

The PCR Working Group greatly appreciates both the constructive dialogue between European industry and the Chinese authorities and the market-driven orientation of much of the new domestic legislation. However, the Working Group is still concerned about a variety of issues, discussed in detail in the following section of this Position Paper. Additionally, the Working Group would like to stress a number of other issues, which are of concern for PCR companies operating in China:

Progress in registering chemical substances has been made (as mentioned above), but PCR member companies are concerned about striking a balance between creating transparency for the public and safeguarding confidential business information. A balance can only be achieved by establishing a reliable legal framework that protects the interest of all stakeholders.

Recently issued regulations on so-called “new cosmetic ingredients” lack a clear description of what is considered new. Moreover, the PCR Working Group suggests that the testing requirements for new ingredients for cosmetics should be better aligned with international practices recognized by the OECD. (For more information, please refer to the “Cosmetics” section of this Position Paper).

As one means to accelerate the process to transform China into an innovative nation, China expects companies worldwide to locate more of their R&D centres in China. However, China is still lacking a competitive funding system to encourage foreign companies’ R&D centres in China. Given the high importance that China gives to innovations in the chemical industry, the PCR Working Group recommends that China integrates multinational R&D activities in China in a way that all enterprises registered in China should be eligible to apply for R&D funding programmes with equal rights and the innovation ability as the only criteria for evaluation. Furthermore, it is recommended that China introduces an international conventional public funding system, which provides funds on the basis of targeted key national innovation projects.

In conclusion, this year’s key recommendations tackle concerns that, if addressed properly, would help both domestic and foreign companies continue to build a world-class, highly competitive and sustainable Chinese chemical and petrochemical industry. The PCR Working
Group is eager to continue constructive dialogues with all relevant ministries and institutions and to bring in relevant expertise in the area of best available techniques and latest technologies in both industrial practices and the regulatory framework.

Key recommendations

1. Fully Open the Oil Product Import and Wholesale Markets

Concern
Despite China’s commitment to open the oil products retail sector to foreign firms, regulations governing the issuance of import and wholesale licences do not constitute a move towards an open and competitive market. A lack of transparency in the awarding of import licences and the restrictions on legal entities qualifying for oil product depot ownership make it difficult for foreign invested enterprises (FIEs) to become effective players in this sector.

Assessment
Regulation 1999 (No. 38) of the State Council gave two major Chinese oil companies a de facto duopolistic position over the import and wholesale of oil products. According to the regulation, other refiners were forced to sell their production solely to these two companies. Consequently, all retailers were compelled to source their supplies from the same two companies that are also their main competitors.

The December 2006 regulation\(^2\) defining the conditions to obtain a wholesale licence gave access to foreign firms to the wholesale market, but did not cancel the provisions of Regulation No. 38. This ambiguity translates into the de facto control of the wholesale market by the two major oil companies.

The opening of the oil products import process, including the allocation of import quotas to non-state owned enterprises (SOEs), remains unclear, particularly its structure and application qualification process. This casts serious doubts over the ability of FIEs to qualify as possible importers. No FIE has applied for an import licence to date because securing a license at this stage remains useless, as all imported products have to be channelled through the two major Chinese oil companies.

In practice, the latest regulation, issued in December 2006\(^3\), for obtaining a wholesale licence excludes all FIEs. For example, one of the conditions is to own a refinery, which means owning 51% of its shares. Yet, refineries in China are considered strategic assets; therefore, foreign ownership is limited to 49%. In other words, it is impossible for a FIE to own a refinery in the sense needed for obtaining a wholesale license. Another condition is that the FIE must obtain an import licence, yet no FIE has ever been granted one. A third condition is that the FIE must secure a long-term (i.e. greater than one year) supply agreement with a wholesaler. Although this is theoretically possible, FIE’s seeking to secure long-term agreements have always failed to obtain it. Another condition is to own a depot. The restricting factor is that only legal entities qualify, whereas business lines of an integrated oil company would offer much better guarantees and financial means, if it were to qualify for licences.

The problems described with the wholesale and retail market supply demonstrate the duopolistic practices by the two major Chinese oil companies. Normal market conditions could be defined as being free to source supplies from any party (“freedom to buy”) and to have potential suppliers compelled to sell to all parties (“obligation to sell”). The Working Group recommends that the buying and selling of oil products on the market should always take place in a non-discriminatory environment, with all parties having the freedom to buy and an equal obligation to sell.

Recommendation
- Abolish Regulation No. 38, and other obsolete regulations in order to render conditions of the December 2006 regulation applicable.
- Retain transparent and open guidelines allowing FIE’s to qualify for import licenses and to benefit from import quotas.
- Adapt the existing wholesale licensing system to encompass business lines rather than legal entities, enabling integrated oil companies to qualify.

2. Exempt Naphtha from the Consumption Tax

Concern
If the Naphtha Consumption Tax (NCT) law remains unchanged, from 2011 on, NCT will become automatically payable at the higher level of CNY 1 per liter. The addition-
al NCT and the current handling of the NCT on imported naphtha would severely affect the petrochemical industry in China, including European petrochemical companies.

Assessment
Effective from April 2006, import or sale of Naphtha as feedstock to produce ethylene or downstream chemical products is subject to NCT. In accordance with Circular No. 19 and No. 168 issued by SAT and MOF, which is valid until the end of 2010, NCT is exempt, if domestically produced Naphtha is used as feedstock to produce ethylene or aromatic products and NCT paid on imported naphtha is refundable, if consumed to produce ethylene or aromatic products. If the NCT law remains unchanged, from 2011, NCT will become automatically payable at CNY 1 per liter.

NCT on imported naphtha at CNY 1.0 per litre (equivalent to USD 200 per ton) represents an additional 30% naphtha feedstock cost (e.g.: USD 700 per ton naphtha average cost in 1Q 2010.) The current tax refund application is complicated and time-consuming and requires approval from provincial and state-level authorities (including MOF, Customs and SAT). Some Working Group member companies are still waiting for NCT refunds that were imposed 12 months ago, despite its qualification as a tax-free product.

Taxation of a chemical feedstock is not in line with international practices. NCT (USD 200 per ton) jeopardises the viability of the Chinese petrochemical industry and makes China less attractive to petrochemical investments by foreign investors. The tax causes Chinese ethylene crackers to be the highest cost ethylene producers in the world and forces the closure of domestic facilities. This necessitates massive imports from nearby competing nations. The naphtha tax burden will force foreign investors to expand cracker capacities outside of China and export more downstream products into China. This means enormous losses for China's petrochemical industry in terms of investment opportunities, access to advanced technologies, especially for high-end downstream products, tax revenue and employment.

The "pay first, refund later" approach to imported naphtha places an enormous cash flow burden on the Chinese ethylene producers. It increases debt levels and associated financing costs. It reduces the competitiveness of the Chinese petrochemical industry, especially when compared to supportive and favourable fiscal and monetary policies for competing naphtha crackers in Singapore, South Korea and Japan.

Recommendation
• Permanently remove the consumption tax for both imported and domestically purchased naphtha, in cases where it is used as a raw material for ethylene and aromatic products.
• At a minimum, extend the exemption of consumption tax for domestically purchased naphtha, and provide a direct exemption of the consumption tax for imported naphtha where it is used as raw material for chemical downstream products, such as ethylene, aromatic products and other products.

3. Grant Governmental Approval for the Importation of Controlled Active Pharmaceutical Ingredients (APIs)

Concern
Chinese regulations currently allow FIEs to apply for import drug licences (IDL) for imports of APIs. However, for some controlled APIs, obtaining governmental approval for the importation of API samples is difficult, creating an impasse in the IDL approval process. One such case was presented in the 2009/2010 Position Paper and discussed in several follow-up meetings with MOFCOM and SFDA officials in 2010.

Assessment
In China, certain APIs, including those listed as Table I precursors under the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, are regulated by State Council Decree No. 445 and MOFCOM Decree No. 7, 2006. One such API has been widely used as raw material for the production of pharmaceutical formulations across the world. As China is a major producer and exporter of the concerned API, domestic consumption is currently 100% supplied by Chinese production with no authorised importer of the controlled APIs from overseas producers.

Prior to 1 May 2010, domestic distribution was handled by state-authorised distributors. According to directive No. 72 by MOH on 23 February 2010, regulation has been refined and adapted for pharmaceuticals, including allowing pharmaceutical companies to purchase the raw materials directly from the producers. However, no details have been provided in the new regulation about the importation of the specified pharmaceuticals.
Chinese authorities have tightened control on quality, environmental protection and public security since 2007. This has resulted in the above-mentioned API being in short supply in China. Consequently, domestic and international pharmaceutical manufacturers in China have suffered from price hikes and unstable supply of this raw material. Many international pharmaceutical manufacturers try to source API from outside China for the following reasons: 1) improved quality, 2) stable raw material costs (based on increased competition), 3) improved consistency and 4) increased competitiveness of the finished APIs in the export markets. European companies are allowed to apply for IDLs for all APIs, but a prerequisite for IDL approval is that imported API samples are product quality tested. However, in the case of the API discussed above, it is administered by several ministries. In 2010, as suggested by MOFCOM, SFDA was consulted. It is now understood that, in principle, SFDA does not oppose the importation of samples of such APIs, which is subject to the approval of MOFCOM.

Recommendation
· MOFCOM should approve the importation of samples of controlled APIs with the necessary restrictions on quantity and purpose of use.
· Initiate cross-ministerial consultations to formulate and implement official regulations, guidelines and procedures on the approval of the importation of controlled APIs.

4. Enhance Transparency Regarding Expert Panel Reviews and Investment Decisions for Large Chemical Projects

Concern
European companies are concerned about the lack of a formalised procedure in the selection of experts and the preparation and the evaluation criteria of expert reviews for the assessment process of large chemical projects by relevant authorities.

Assessment
The project approval process of NDRC, especially for large projects (with total investment above US$ 100 million) and projects in restricted categories (as defined in the foreign investment catalogue), often involves local consulting firms or expert panels to evaluate the project and advise the government on project viability, value creation and whether the project supports the development of China.

The whole assessment process by the expert panel has not been formalised in an appropriate regulatory or administrative format. The lack of regulatory environment negatively impacts the predictability and transparency of each step of the process.

The selection of experts and the process of choosing the firms and advisors is not transparent for a foreign investor. Occasionally, direct competitors to the applicant are requested to join an advisory panel, thereby gaining access to confidential and proprietary information submitted in application documents. The level of details required in the process is well beyond the information released during a similar process in OECD countries. Formalising the expert selection process, giving the project owners an opportunity to disregard competitors, and the possibility to involve foreign experts would guarantee transparency and expand the expertise to encompass areas such as best practices and sustainability criteria.

The stages, at which such expert review is required, has not been properly defined, i.e. it could be at pre-feasibility, feasibility, PAR or EIA stages of the project’s preparatory work and approval process.

Formalizing the timetable and sequence of reviews would allow the project owners to better plan and organise their work as well as assemble the relevant in-house expertise in order to better respond to technical queries from the expert panel.

Neither the evaluation criteria nor the scoring system is clearly defined. Developing and announcing the evaluation criteria for the expert panel review and establishing scientific and quantitative scoring system in line with national industrial development planning and policies would guarantee an objective, fair and transparent assessment methodology. Such evaluation system should balance factors of technology, process, capital expenditure, economics, environmental and social impact, while reflecting priorities of the authorities’ concerns. It would also allow foreign investors to understand the authorities’ orientations for the 12th Five-Year Plan and encourage them to bring their best technologies and expertise to support China’s development in a sustainable model.

The following recommendations are addressed to NDRC, MIIT, MEP, SAWS and other authorities involved in large project approvals:
In order to improve the methodology in assessing major
chemical projects, the European industry recommends the government:

- Define and formalise fair and transparent evaluation and scoring criteria in line with the 12th Five-Year Plan and other industrial development orientations, policies and priorities, embracing all factors of sustainability.
- Set procedures for each project stage (Pre-FS, PAR, FS, EIA, etc.) and timetable for review, enabling project owners to better prepare and respond to expert queries.
- Ensure a formal approach in the selection of an expert panel, avoiding the involvement of direct competitors and extending it to foreign consultants to enhance expertise.

5. Adopt Standards and Regulations for Transportation of Dangerous Chemicals

Concern
China lacks a nationwide applicable standard for the administration of vehicles and equipment used to transport dangerous chemicals. This raises safety issues and makes it difficult to fairly enforce related laws and regulations. Moreover, there are no different requirements for transportation of large or small quantities of dangerous chemicals in China.

Assessment
The transportation of dangerous chemicals in China is controlled by many laws and regulations and is supervised by a variety of government authorities. Regulations exist to administer the licence of the carrier, the transportation vehicle, the driver and the escorting person. However, current legislation is not applicable for nationwide technical standards of vehicles and equipments for transportation of dangerous chemicals. The quality of licensed vehicles vary greatly. Some inexpensive vehicles licensed for transportation of dangerous chemicals look the same, except for an indicating sign with an exclamation. But they are not equipped with the required facilities for transportation of dangerous chemicals, such as anti-leakage containment, fire extinguisher and absorption materials. Due to price differences between vehicles of varying quality, as much as 2-3 times, some companies choose to use lower quality and cheaper vehicles to transport dangerous chemicals. This makes the enforcement of related regulations ineffective. Moreover, accidents with such vehicles are extremely dangerous. This also adds additional cost for companies compliant with high industrial examination standards, which would only consign dangerous chemicals to not only licensed, but also properly qualified companies and vehicles for transportation.

In addition, the lowest load capacity of licensed tank vehicles is 5 tons. Small quantity exemptions for dangerous chemical transportation in China do not exist. This means compliant companies need to transport small quantities of dangerous chemicals. Small quantities of dangerous chemicals - samples or reagents are sometimes as small as 200–500ml - by using large load capacity trucks. For transportation of small quantities of dangerous chemicals, 100 kg for instance, using and paying for large vehicles is unreasonable. But some companies in China, in violation of these current regulations, already use smaller vehicles to transport small quantities of dangerous chemicals, in order to save cost. International best practices have adopted small quantity exemption, such as the International Air Transport Association, for various kinds of dangerous chemicals.

Recommendation
The following recommendations are addressed to AQSIQ, Ministry of Transportation, Ministry of Public Safety, State Administration of Work Safety and other authorities involved in the administration of dangerous chemical transportation:

- Adopt standards and for the transportation of dangerous chemicals. Establish applicable nationwide compulsory standards and criteria for the transportation vehicles and their necessary affiliated equipments to meet technical qualifications.
- Adopt international standards (ADR) that include quantitative exemptions. Allow smaller load capacity, certified vehicles to be used for transportation of limited quantities of dangerous chemicals.
- Ensure legal compliance by strengthening professional administration and standardizing the supervision of the transportation vehicles for dangerous chemicals. The government should consider introducing qualified third-party agencies to assess logistics service providers and vehicles in order to ensure more effective enforcement of the regulations.
## Abbreviations

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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>API</td>
<td>Active Pharmaceutical Ingredient</td>
<td>MEP</td>
<td>Ministry of Environment Protection of People’s Republic of China</td>
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<tr>
<td>AQSIQ</td>
<td>General Administration of Quality Supervision, Inspection, and Quarantine</td>
<td>MOF</td>
<td>Ministry of Finance</td>
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<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
<td>MOFCOM</td>
<td>Ministry of Commerce</td>
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<tr>
<td>CPCIF</td>
<td>China Petroleum and Chemical Industry Federation</td>
<td>MPS</td>
<td>Ministry of Public Security</td>
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<td>CRC</td>
<td>Chemical Registration Centre</td>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>EC</td>
<td>European Commission</td>
<td>OECD</td>
<td>Organisation for Economic Co-Operation and Development</td>
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<td>EIA</td>
<td>Environmental Impact Assessment</td>
<td>PCR</td>
<td>Petrochemicals, Chemicals and Refining</td>
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<tr>
<td>FIE</td>
<td>Foreign Invested Enterprise</td>
<td>PAR</td>
<td>Project Appraisal Report</td>
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<tr>
<td>GLP</td>
<td>Good Laboratory Practice</td>
<td>R&amp;D</td>
<td>Research and Development</td>
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<tr>
<td>IDL</td>
<td>Import Drug Licence</td>
<td>SAT</td>
<td>State Administration of Taxation</td>
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<tr>
<td>IECSC</td>
<td>Inventory of Existing Chemical Substances in China</td>
<td>SFDA</td>
<td>State Food and Drug Administration</td>
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<tr>
<td>JV</td>
<td>Joint Venture</td>
<td>SOE</td>
<td>State Owned Enterprise</td>
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Key Recommendations

1. Regulatory and Quality
   a. Regulatory
      • Harmonise the Clinical Trial Approval (CTA) process to international standards so that clinical trial approval is granted no more than 60 days from application date (versus the current 12 months).
      • Recognise and accept in China clinical trial data from other countries, except in cases where there is a clear medical rationale for additional specific clinical data for Chinese patients.
      • Allow the country of origin Certificate of Pharmaceutical Product (CPP) to be submitted in parallel during the course of the State Food and Drug Administration (SFDA) evaluation, rather than as a pre-condition of the initial regulatory application.
      • Ensure that changes to the Chinese Pharmacopoeia (ChP) are supported by a clear scientific rationale, are better planned in advance (including prior consultation with manufacturers) and acknowledge the international standards and timelines needed for transition of regulatory changes.
   b. Quality
      • Adopt and rigorously enforce internationally recognised standards of Good Manufacturing Practice (GMP) and Good Clinical Practice (GCP).
      • Ensure that the tender bidding processes include clear, consistent and transparent specifications on product quality so that price comparisons are fair and equitable.
      • Ensure that all regulations are consistent and harmonised nationally so as to avoid current regional differences in processes, interpretation and enforcement.

2. Innovation
   • Improve enforcement of Intellectual Property Rights (IPR) generally.
   • Improve protection of the originator’s confidential research and development (R&D) data, enforced by disallowing reliance on the original registration dossier when a copy product files for approval.
   • Implement effective ‘patent linkage’ whereby copy products cannot file for regulatory approval until after the patent has expired.
   • Take serious and effective action to eliminate counterfeit medicines.

3. Pricing, Re-imbursement and Patient Access to Medicines
   • Establish an improved dialogue between the National Development and Reform Commission (NDRC) and pharmaceutical manufacturers in order to develop a fair and more equitable pricing system and sustainable innovative pharmaceutical industry in China.
   • Recognise the principle of quality in the pricing (and bidding) system.
   • Update the National Reimbursement Drug List (NRDL) at least every two years in order to provide better access to modern medicines for Chinese patients.
   • Allow non-Essential Drug List (non-EDL) products to be sold in urban Community Health Centres (CHCs) and rural Health Centres.
Introduction to the Working Group

The Pharmaceutical Working Group represents European pharmaceutical manufacturing companies operating in China.

The European pharmaceutical industry is a major contributor to both European and Chinese economies and to the world pharmaceutical market. A large proportion of the world’s major multinational pharmaceutical companies are of European origin. European pharmaceutical companies represent a significant proportion of the global pharmaceutical market and contribute a large share of both total world pharmaceutical R&D spending and employment.

In China, European companies are significant contributors of Foreign Direct Investment. A typical large European pharmaceutical company employs 3,000 to 4,000 people in China and spends millions of euros on local R&D. A large proportion of all foreign pharmaceutical companies operating in China are of European origin and most of these are investing in both manufacturing and R&D in China. An improved operating environment as recommended in this Position Paper will increase and accelerate this investment trend.

In the European Union (EU) the pharmaceutical regulatory system is harmonised across all countries, thereby further encouraging innovation and investment.

This position paper describes the vision of European companies operating in China. The recommendations presented here aim to develop a healthy industry (for both international and domestic companies) in line with the Chinese government’s objectives and with patients at the core. Overall, China is lacking a proper mechanism to efficiently coordinate public health policies and the pharmaceutical industry’s needs. If China wants its rightful place on the ‘world map’ of the pharmaceutical industry in terms of real innovation (and not just copy products) it will need a shift of paradigm that enables all participants (both international and domestic) to work closely with the relevant authorities.

Recent Developments

1. New GMP and Regulations

In November 2010, the State Food and Drug Administration (SADA), Ministry of Industry and Information Technology (MIIT), and Ministry of Health (MOH) jointly promulgated the ‘Guidance on Accelerating the Structural Adjustment in Medical Industry’, which set a framework for the future development of the medical industry. The highlight of this was that China would pursue innovation-oriented development and encourage enterprises to conduct technology upgrading according to the Good Manufacturing Practices for Pharmaceutical Products (GMP) (Revised 2011).

One of the major developments in the pharmaceutical industry in 2010 was the implementation of the ‘Announcement on Electronic Supervision of All Varieties of Drugs’, which helps to ensure the quality of medicines and lay a foundation for a national basic medicine system.

In early 2011, after many failed attempts, the World Health Organisation (WHO) finally recognised China’s SFDA as meeting international standards for vaccine licensing. This will allow Chinese vaccine manufacturers to apply for WHO pre-qualification and ultimately participate in the export market for vaccines.

However, on the negative side, significant changes were made to the Chinese Pharmacopoeia (ChP) in October 2010 that did not allow foreign companies sufficient time to meet the implementation steps and transition periods mandated. This particularly adversely affected the European vaccine manufacturers and has resulted in interruption of supply to China of a number of vaccines, manufactured in Europe, that meet universally recognised global standards of quality, safety and efficacy.

2. Hospital Financing

China is promoting the reform of its medical and healthcare system and wants eventually to completely separate prescribing from dispensing and reduce commercial bribery. State-owned hospitals will revert to being public-benefit oriented. The proportion of medical expenditure in government spending has increased by 0.78% in the past three years. This brings both opportunities and challenges to pharmaceutical enterprises. For specific measures, the government has issued ‘Guidelines of Establishing and Regulating Government Procurement Mechanism for Essential Drugs in Primary Healthcare institutions’, which established the principle of centralised procurement and

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1 MIIT, http://www.miit.gov.cn/n11293472/n11293832/n11293907/n11368223/13476011.html
3 State Food and Drug Administration, 11th May 2010 http://www.sda.gov.cn/WS01/CL0053/49153.html
distribution of medicines.

3. Latest Round of Price Reductions Discourages Innovation and Quality
The Working Group welcomes the additional emphasis given to innovation but the reality is that current pharmaceutical pricing and re-imbursement policies in China are having a negative impact on innovation. Product quality is simply not taken into account as specific criteria in pricing and re-imbursement systems.

4. Essential Drug List (EDL) Implementation End-2010
The EDL implementation has been highly complex due to decentralisation and lack of funding. The introduction of the e-barcode is a good example by which some provinces have a very different interpretation from central government and try to implement earlier than the national regulation of February 2012.

5. Healthcare Reforms – Community Health Centres (CHCs)
The implementation of the ‘Social Insurance Law’ 5 will increase the coverage of basic medical insurance. The higher level of insurance and wider coverage will make medicines more available to the general population, and ongoing rapid urbanisation and population ageing will further increase demand for pharmaceutical products.

6. New Five-Year Economic Plan and Implications for the Pharmaceutical Industry
The bio-medical industry being classified as a strategic industry 6 should provide good opportunities for the pharmaceutical industry generally, especially enterprises that have strong R&D capability, provided that pricing and reimbursement policies in China adequately reward both innovation and quality.

7. Intellectual Property Rights (IPR)
IPR protection in the pharmaceutical industry has made some progress in 2010. For example, from October 2010 to March 2011, the SFDA launched a specific campaign 7 against the infringement of intellectual property and the production/marketing of counterfeit and poor quality medicines. However IPR needs to be more rigorously enforced if China is to develop a truly innovative economy (see recommendations below).

Key Recommendations
The following recommendations seek clarity, transparency and equality across the entire national pharmaceutical sector. European companies are investing ‘in China for China’ and simply seek fairness and equal treatment.

Following these recommendations would result in a pharmaceutical business environment in China that better encourages investment in innovation and quality and will help establish China as a major global centre for life sciences. This fits well with two of China’s key macro-economic policies of (a) focusing on innovation and (b) providing better health care coverage for the people.

1. Regulatory Process and Quality

a. Regulatory Process
Concern
The pharmaceutical regulatory process in China is lengthy, unnecessarily complex and discourages local innovation. Regulations are often changed at too short notice and without adequate prior consultation with manufacturers e.g. the October 2010 changes to the Chinese Pharmacopoeia (ChP).

Assessment
Pharmaceutical products must first be approved for sale in the country of origin and then clinical trials must be repeated in China, often unnecessarily, before a regulatory application in China can even be initiated. There is therefore a delay of several years, during which time Chinese patients are denied access to new and important innovative medicines.

The process for Clinical Trial Approvals (CTA) alone can take up to one year in comparison with 60 days in Europe. Even when Chinese clinical trials are completed the regulatory application cannot even be submitted to the SFDA until the product is actually licensed for sale in the country of origin and a Certificate of Pharmaceutical Product (CPP) is available from the source country.

Changes were made to the Chinese Pharmacopoeia in October 2010 that did not allow foreign companies
sufficient time to meet the implementation steps and transition periods mandated. This particularly adversely affected the vaccine manufacturers and has resulted in interruption of supply to China of a number of vaccines, manufactured in Europe, that meet global standards of quality, safety and efficacy.

**Recommendation**

- Harmonise the Clinical Trial Approval (CTA) process to international standards so that clinical trial approval is granted no more than 60 days from application date (versus the current 12 months).
- Recognise and accept in China clinical trial data from other countries, except in cases where there is a clear medical rationale for additional specific clinical data for Chinese patients.
- Allow the country of origin Certificate of Pharmaceutical Product (CPP) to be submitted in parallel during the course of the State Food and Drug Administration (SFDA) evaluation, rather than as a pre-condition of the initial regulatory application.
- Ensure that changes to the Chinese Pharmacopoeia (ChP) are supported by a clear scientific rationale, are better planned in advance (including prior consultation with manufacturers) and acknowledge the international standards and timelines needed for transition of regulatory changes.

Following these recommendations would actively encourage more R&D in China and allow Chinese patients faster access to new medicines. With its existing excellent clinical trial centres and medical infrastructure, China easily has the potential to fully participate in prestigious international clinical studies and become a world leader in pharmaceutical R&D.

The long term objective should be the adoption of a single ‘Marketing Authorisation’ process, as is used in most other countries, instead of the current local manufacturing or Import Drug Licence (IDL) routes. This will receive strong support from the European Chamber, the European Federation of Pharmaceutical Industries and Associations (EFPIA) and the EU authorities.

**b. Quality**

**Concern**

There have been several public scandals recently related to poor quality medicines. This, coupled with recent bad publicity in the food sector, has not been good for China’s overall quality image worldwide. There is therefore a vital need for quality to be given prominence in the overall planning for the pharmaceutical industry.

**Assessment**

The use of generic products in China is huge but too much focus on price alone has led to inconsistent product quality and over-capacity. It has forced many companies to reduce quality in order to lower costs and remain price-competitive. This ‘self-destructive’ process is counter-productive to the nation’s clear need for a sustainable industry. Until quality meets universally recognised international standards China will not secure its rightful place as a major world centre for life sciences.

**Recommendation**

- Adopt and rigorously enforce internationally recognised standards of good manufacturing practice (GMP) and good clinical practice (GCP).
- Ensure that tender bidding processes include clear, consistent and transparent specifications on product quality so that price comparisons are fair and equitable.
- Ensure all regulations are consistent and harmonised nationally so as to avoid the current regional differences in processes, interpretation and enforcement.

**2. Innovation**

**Concern**

China seeks to become a truly innovative economy by 2020 and the development of strong local biotech and pharmaceutical industries will be a key factor in achieving this goal. However the current complex regulatory process, lack of focus on product quality and weak enforcement of IPR do not encourage and support innovation.

**Assessment**

The long and unnecessary regulatory process and lack of consistency in quality (already discussed above) are actually significant disincentives to the development of true local innovation.

In addition, strong protection and enforcement of IPR is vital to the development of a sustainable pharmaceutical industry anywhere in the world. Despite rapid growth in the healthcare market in China, local pharmaceutical R&D expenditure represents less than 1% of global R&D spend in the sector, so the potential is huge for China if adequate policies are implemented and enforced to genuinely reward and promote innovation.
Patent laws have existed in China since 1993 so the issue really is lack of pro-active and consistent enforcement. In addition, China is a major global source of counterfeit medicines that, while presenting a serious health hazard, are not good for China’s overall image both domestically and internationally.

Recommendation
- Improve enforcement of Intellectual Property Rights (IPR) generally.
- Improve protection of the originator’s confidential research and development (R&D) data, enforced by disallowing reliance on the original registration dossier when a copy product files for approval.
- Implement effective ‘patent linkage’ whereby copy products cannot file for regulatory approval until after the patent has expired.
- Take serious and effective action to eliminate counterfeit medicines.

3. Pricing, Re-Imbursement and Patient Access to Medicines

a. Pricing

Concern
The current ‘cost-plus’ pricing system implemented by the National Development and Reform Commission (NDRC) does not encourage innovation for both European and domestic companies and does not take product quality into account.

The innovative industry has suffered several price cuts with even bigger reductions since the end of 2010. It is based on the wrong assumption that this is the best way to achieve cost containment and, importantly, it has direct negative impact on quality.

Assessment
It is important to understand that innovative drugs that are more effective and safer can actually generate real cost benefits by reducing the overall drug bill and by keeping people out of hospital. There are also significant indirect economic benefits, such as keeping people at work. A pricing system that rewards innovation and encourages consistent international quality standards would better serve the medical and patient needs in China and also accelerate China’s development to a more innovative economy.

Expenditure on pharmaceutical products in China accounts for only a limited share of the total healthcare budget, so driving down pharmaceutical prices is not the sole solution to managing overall healthcare expenditure. Furthermore, a large proportion of the total drug bill is accounted for by profit margins in the distribution channel, which are outside the control of the manufacturers. Pharmaceutical distribution in China is extremely fragmented, very inefficient and relatively expensive compared with the EU and the Unified States (US).

For products sold via the bidding process it is important to have a fully transparent and consistent specification of quality so that competitive bidding prices can be compared on an equal and fair basis. The adoption of international standards for GMP would encourage the development of a healthy, sustainable pharmaceutical industry in China that could also compete effectively in international markets and improve China’s image as a manufacturer of high quality, safe and effective products.

The implementation of the “single reimbursement price” for newly listed National Reimbursement Drug List (NRDL) drugs would mean that local generic drugs may be fully (100%) reimbursed while foreign drugs may be only partially reimbursed, thereby causing an uneven ‘playing field’.

Recommendation
- Establish an improved dialogue between the National Development and Reform Commission (NDRC) and pharmaceutical manufacturers in order to develop a fair and more equitable pricing system and sustainable innovative pharmaceutical industry in China.
- Recognise the principle of quality in the pricing (and bidding) system.

b. Re-imbursement

Concern
According to the Ministry of Human Resources and Social Security (MOHRSS) 1999 guideline, the NRDL must be updated at least once every two years. In reality the NRDL was last updated in November 2009, the first time in five years. Furthermore, numerous oncology and biological products have not been included in this update. This means that Chinese patients have been denied access to a significant number of modern medicines.
Assessment

The NRDL is the mechanism by which Chinese patients receive access to reimbursed medicines through the healthcare system.

The NRDL was last updated in November 2009, the first time in five years. The Working Group has continuously lobbied for more frequent updates to the NRDL. This would not only benefit patients by granting them access to newer and better medicines, but would also encourage more investment and development in the entire sector, including domestic manufacturers who account for more than 75% of all drug sales in China. Concretely the update of the NRDL had very little impact on the industry and the patient. Innovative drugs have not experienced a substantial increase in sales as a result of their entry into the medical insurance catalogue (and acquisition of the current reimbursement percentage). Therefore, they do not have too much of an impact on the overall medical insurance fund.

The actual implementation of the NRDL by individual provinces has been very slow and, since November 2009, the vast majority of the patients still cannot enjoy the benefits of the enlarged list of reimbursed drugs. The Working Group recommends that the whole process be studied by the national authorities with the objective of streamlining the process.

The MOHRSS 1999 NRDL guideline* actually states that the NRDL must be updated at least once every two years. Simply enforcing an existing regulation would be a major step forward in achieving this objective.

For example, according to statistics from the latest IMS data, in 2010, among the top-selling 100 synthetic drugs in the world, 57 of the drugs have been sold on the Chinese market as of now and only 35 of these drugs have been included in the state medical insurance drug catalogue since 1999.

Recommendation

- Update the National Reimbursement Drug List (NRDL) at least every two years in order to provide better access to modern medicines for Chinese patients.

c. Other ‘Access to Medicines’ Issues

Concern

The development of urban CHC and rural basic health centres is a key feature of the healthcare reform. Access of patients to quality pharmaceutical products in these centres is an issue.

Assessment

The creation of the Essential Drugs List (EDL) in 2010 and investment in basic health centres represent a very positive move to provide basic medical services and supply basic pharmaceutical products to the vast majority of China’s population.

Current implementation of this new policy is limited by a financing scheme that is not yet operational ‘on the ground’. In the long run, authorities may also limit the development of this basic system only to that segment of the population with very limited resources. The more affluent people who do not want to use the basic system will still prefer to go to the biggest hospitals.

From the Working Group point of view, it would be in the interests of both patients and the economic viability of the basic medical system to allow the sales of non-EDL products in urban Community Health Centres and rural health centres.

Recommendation

- Allow non-Essential Drug List (non-EDL) products to be sold in urban Community Health Centres (CHCs) and rural Health Centres.

* As stated in ‘Provisional Rules on Scope of Drugs used in Basic Medical Insurance for Urban Employees’, Decree of the MOHRSS, October 1999
### Abbreviations

<table>
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<tr>
<th>Abbreviation</th>
<th>Description</th>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CHC</td>
<td>Community Health Centre</td>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
</tr>
<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
<td>MOH</td>
<td>Ministry of Health</td>
</tr>
<tr>
<td>RMB</td>
<td>Renminbi</td>
<td>MOHRSS</td>
<td>Ministry of Human Resources and Social Security</td>
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<tr>
<td>CHP</td>
<td>Chinese Pharmacopoeia</td>
<td>NCE</td>
<td>New Chemical Entity</td>
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<tr>
<td>CPP</td>
<td>Certificate of Pharmaceutical Product</td>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>CTA</td>
<td>Clinical Trial Application</td>
<td>NRDL</td>
<td>National Reimbursement Drug List</td>
</tr>
<tr>
<td>EDL</td>
<td>Essential Drug List</td>
<td>OECD</td>
<td>Organisation for Economic Co-Operation and Development</td>
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<tr>
<td>EFPIA</td>
<td>European Federation of Pharmaceutical Industries and Associations</td>
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<tr>
<td>FDA</td>
<td>Food and Drug Administration</td>
<td>PVi</td>
<td>Pharmaco Vigilance</td>
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<tr>
<td>FIE</td>
<td>Foreign Invested Enterprise</td>
<td>R&amp;D</td>
<td>Research and Development</td>
</tr>
<tr>
<td>GCP</td>
<td>Good Clinical Practice</td>
<td>SFDA</td>
<td>State Food and Drug Administration</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
<td>SME</td>
<td>Small- and Medium-sized Enterprise</td>
</tr>
<tr>
<td>GMP</td>
<td>Good Manufacturing Practice</td>
<td>TCM</td>
<td>Traditional Chinese Medicine</td>
</tr>
<tr>
<td>GP iii</td>
<td>General Practitioner</td>
<td>US</td>
<td>United States</td>
</tr>
<tr>
<td>IDL</td>
<td>Import Drug Licence</td>
<td>WFOE</td>
<td>Wholly Foreign Owned Enterprise</td>
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<td>IMS</td>
<td>IMS Health</td>
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<tr>
<td>IPR</td>
<td>Intellectual Property Rights</td>
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Key Recommendations

1. **Encourage Foreign Companies to Better Contribute to the Rail Transportation Industry**
   - Allow foreign companies to compete freely in the market, especially in new segments where there is no Chinese product or relevant professional service available.
   - Revise the localisation policy required by NDRC to involve more the experienced foreign suppliers in order to optimise the technology, project execution and safety.
   - Refrain from mandating specific industrial organisations in the regulatory framework and provide for flexibility in the industrial set-up that all companies may adopt.
   - Allow Sino-foreign joint-ventures that have invested in China and have a proven track record in delivering quality products to bid for projects, e.g. in rolling stock, signaling, electrification and safety certification, regardless of their industrial set-up. In this way, some flexibility should be introduced in the criteria for qualification to bid.

2. **Protect Intellectual Property Rights (IPR)**
   - Respect and protection for IPR should be further improved in the rail transportation industry for the benefit of foreign technology and equipment providers as well as Chinese industry and customers.

3. **Set Rail Standards and Specifications in a More Transparent and Open Environment**
   - Fully consult with both foreign and domestic companies at the drafting stage of the standards and specifications.
   - Fully allow both foreign and domestic companies to comment on the draft standards and specifications before they are released.

Introduction to the Working Group

The Rail Working Group is comprised of manufacturers in the fields of rolling stock, rail infrastructure and signaling systems along with services for rail. The working group represents the common interests of the European rail industry.

Recent Developments

In recent years, China has experienced a rapid development in the construction of railways and has become the world’s largest market for rail transit (railway and mass transit). This unprecedented development comprised the central component of the CNY 4000 billion economic stimulus package introduced in 2008 and was crucial for dealing with severe bottlenecks in China’s aging rail system, which is a constraint on regional and national economic growth.

According to the Ministry of Railways, in 2010, the investment in railway infrastructure totaled CNY 823 billion, this is up from CNY 600 billion in 2009, which was a 79% increase from 2008. By the end of 2010, the length of China’s railways in operation reached 91,000 km, with 8,358 km of high-speed railways. In 2011, the total railway investment is expected to reach CNY 745.5 billion, with CNY 600 billion going towards infrastructure construction.

By the end of 2015, China’s total mileage of railways open to traffic will increase to 120,000 km. During the 12th Five-Year Plan Period, the Ministry of Railways has also promised investments to reach CNY 2.8 trillion, and that they proceed with railways construction in accordance with the country’s economic and social development and the public’s satisfaction.
These future plans will provide great business opportunities to domestic and European train producers and benefit the whole society.

**Key Recommendations**

1. **Encourage Foreign Companies to Better Contribute to the Rail Transportation Industry**

**Concern**

In order to accelerate rail development, the Chinese government has promoted a policy of technology/knowledge transfer and localisation. While we recognize the achievement and the merits of the Chinese policies in general, we believe that a number of regulations in place are restricting foreign companies from making future contributions.

**Assessment**

Foreign suppliers play a key role in transportation industry development in China. The Chinese government holds “import, digest, absorb and reinnovate” as the principle and implements it by requiring a high level of localisation and know-how transfer; meanwhile, only a limited number of domestic companies are qualified to be bidders or primary contractors. Consequently, limited access to the procurement market remains a major issue for foreign suppliers in the rail industry.

In the mainline sector no foreign entity is allowed to bid directly for a project in rolling stock and signaling segments.

In the urban rail sector, the regulatory system in place restricts the ability of foreign companies to be qualified to bid directly for rolling stock projects, signaling and has also been preventing some Sino-foreign joint ventures from obtaining a license or qualification to bid. We understand that in the future the Chinese government aims at further developing the local industry and has identified a number of criteria necessary to qualify for bidding on projects. These criteria are defined in great detail and do not allow for flexibility in the industrial set-up adopted (for instance the traction package, Train Control and Monitoring System (TCMS) and bogie capability are to be held by the local rolling stock manufacturer), whereas some foreign companies may prefer to locate these capabilities in different entities, such as Wholly Foreign Owned Enterprise (WFOE) and Joint Venture (JV).

In terms of repair facilities, there is a clear indication from the government that such facilities should be centralised in each city and that China Northern Railway (CNR) and China Southern Railway (CSR) should hold a majority stake in those companies.

In the fields of railway product safety certification, the present set-up of a single entity belonging to the Ministry of Railways - China Railway Certification Centre may be a conflict of interest and not in fulfillment of international safety standards’ requirement for independence.

**Recommendation**

- Allow foreign companies to compete freely in the market, especially in new segments where there is no Chinese product or relevant professional service available.
- Revise the localisation policy required by NDRC to involve more the experienced foreign suppliers in order to optimise the technology, project execution and safety.
- Refrain from mandating specific industrial organisations in the regulatory framework and provide for flexibility in the industrial set-up that all companies may adopt.
- Allow Sino-foreign joint-ventures that have invested in China and have a proven track record in delivering quality products to bid for projects, e.g. in rolling stock, signaling, electrification and safety certification, regardless of their industrial set-up. In this way, some flexibility should be introduced in the criteria for qualification to bid.

2. **Protect Intellectual Property Rights (IPR)**

**Concern**

The way technology transfer is conducted and IPR protection is enforced have an important impact on the whole industry’s development. This can have serious implications for the safety of products manufactured in China and eventually passengers if not correctly addressed.

**Assessment**

European rail manufacturers welcome the growth of Chinese domestic enterprises and wish to conduct further cooperation with them. However, technology transfer and IPR remain a concern to companies operating in the rail sector.

The general environment for technology transfer and
IPR protection is an important factor of consideration for European companies when it comes to investment and/or the latest technology transfer decisions. Companies are concerned that without stringent measures to protect IPR, local partner companies may be tempted to use the transferred know-how prematurely in their own products without being necessarily familiar in the use of these advanced technologies. This could lead to risks such as safety lapses during the manufacturing process and fatal failures in crucial components.

**Recommendation**

- Respect and protection for IPR should be further improved in the rail transportation industry for the benefit of foreign technology and equipment providers as well as Chinese industry and customers.

### 3. Set Rail Standards and Specifications in a More Transparent and Open Environment

**Concern**

Foreign players are sometimes excluded from the consultation process for setting standards and specifications in the rail industry. This has sometimes generated entry barriers and unfair competition for European suppliers.

**Assessment**

In order for both foreign players and domestic players to provide compatible products and services to Chinese customers, foreign players should have more opportunities to be fully involved in the specification and standards processes.

A more transparent rail specification and standard processes will benefit the Chinese rail industry and customers.

**Recommendation**

- Fully consult with both foreign and domestic companies at the drafting stage of the standards and specifications.
- Fully allow both foreign and domestic companies to comment on the draft standards and specifications before they are released.

**Abbreviations**

- CNR  China Northern Railway
- CNY  Chinese Yuan
- CSR  China Southern Railway
- IPR  Intellectual Property Rights
- JV   Joint Venture
- NDRC National Development and Reform Commission
- TCMS Train Control and Monitoring System
- WFOE Wholly Foreign Owned Enterprise
Renewable Energy Sub-Working Group

Key Recommendations

1. Support and Promote a Level Playing Field for both Domestic and International Companies in the Wind Energy Sector in China
   - Allow the sector to be driven by market forces for the healthy and sustainable development of the wind power industry. Therefore, the following is needed at the policy-making level:
     - Eliminate any piece of legislation-interfering market forces, such as turbine size restrictions or any other similar quantitative requirements, and shift the focus to quality indicators, such as the cost of energy
     - Involve all main key industry players, both domestic and international, and broaden current cooperation and communication channels, when developing key industry policies
   - Introduce and keep a transparent tendering system and set comprehensive bidding criteria:
     - Strengthen criteria other than price and provide official definitions to concepts or indicators. Use the cost of energy as a paramount indicator combining several key concepts. The international prevailing formula is (Initial Investment + Operation & Maintenance (O&M) 20 years) / Produced Energy
     - Enforce clarity and avoid ambiguities and in exactitudes, especially when evaluating and assessing the bidders’ proposal
     - Recognition of international testing and certification, as well as international track records
   - Allow equal access to offshore wind projects for all wind industry players, both international and domestic

2. Increase Transparency and Overall Participation in the Drafting and Enforcement of Technical Industry Standards
   - Increase transparency in the drafting and decision-making processes for technical industry standards and allow for more participation and knowledge-sharing with foreign players in these processes
   - Recognise certification issued by internationally recognised certification bodies and grant international certification bodies the official authority to conduct test and certification in China
   - Introduce regulatory or legal measures to ensure intellectual property protection during the testing and certification process
   - Allow sufficient time (minimum six months) for industry players to prepare for, and adjust to, newly introduced standards

3. Guarantee Clear and Transparent Grid Connectivity Procedures and Further Develop the National Grid Infrastructure
   - Guarantee timely grid connection for all renewable projects
   - Further improve co-ordination on wind power planning and grid construction planning
   - Intensify the interregional exchange of electricity and create interregional electricity markets in order to have a broader base for balancing production and demand. Enforce mechanisms to support and absorb electric energy from renewable energy sources by the National Grid Infrastructure
   - Increase transparency of the Grid Code and clarify grid-connected testing for wind turbine generators:
     - Define clear requirements and the follow-up process for the securing of the certification resulting from this testing
     - Issue a list of institutes and organizations officially recognised and entitled to provide these certifications
   - Facilitate access to grid information for developers of renewable energy projects (future development, forecasts centers, capacity)
4. Allow Equal Access to Government Funds
   - Allow all WTG producers to apply directly for government R&D funding. In the case of Sino-foreign joint research projects, allow FIEs the possibility to control or share resultant IP
   - In the field of biogas, equalise conditions for domestic and foreign-invested firms in applying for government funds, subsidies and tax holidays

5. Promote the Underdeveloped Biogas Sector to A Sustainable Industry
   - Change the subsidy model from investment subsidies to a mainly output-oriented support scheme, for example, a feed-in tariff. Only operating plants shall be funded
   - Change so far inefficient governmental funding in not operating plants, to a long term (10-15 Years) state guaranteed operation oriented (feed-in-tariff). This would encourage the private and institutional investors, to grant loans even to poor farmers based on this long term operation payback system. Result: Funding and Operation is secured for biogas
   - Create a combination of long-term support schemes for bio-methane, electrical energy, waste heat (Combined Heat and Power) and direct biogas use, which takes China's low price of energy into account, as the key to successful energy production from biogas
   - Create additional income for the biogas plant operator by subsidizing the use of effluent as organic fertiliser, replacing the chemical fertilizer. At least in the beginning to make the users familiar with the benefits of this form of fertilizer
   - Support a system of centralised biogas plants combining smaller waste sources to encourage economies of scale, because, currently, smaller facilities for energy or biomethane production are economically unattractive
   - Encourage co-operation between the agricultural and municipal sectors to enable utilisation of a co-processing of agricultural and bio-organic waste from restaurants and households (kitchen waste). This has the potential to increase biogas productivity of the existing facility by five to ten times
   - Support CDM or other carbon-credit incentive systems to reward the function of Greenhouse Gas (GHG) emission reduction in line with Chinese national policies, such as a 40% to 45% reduction in carbon intensity by 2020
   - Develop lean technical standards, focusing on reliable operation and efficient performance. Use standards to eliminate old biogas facilities from the market, which are of insufficient quality and poor performance
   - Streamline the project permission process and grid/ gas station connection to increase opportunities for biogas and speed up the plant realisation time from three years to about six months
   - Increase education on biogas operation and maintenance and establish the profession of large-scale biogas plant technicians. Support Chinese publications on international biogas technology and application

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 (WG) is composed of primarily renewable energy equipment manufacturers and developers and is very active in engaging with the Chinese and European authorities on policies and regulations in the field of renewable energy.

Recent Developments
Recent developments in the renewable energy sector include the following:

- August 2010: National Development and Reform Commission (NDRC) awards in total 280MW of utility scale PV power projects to Chinese developers via a concessionary bidding mechanism launched in June
2010.

- October 2010: Result issued of China’s first round of offshore concession bidding, including two offshore and two inter-tidal wave projects totalling 1GW.
- November 2010: National Energy Administration (NEA) launches nationwide wind turbine quality survey and investigation.
- December 2010: US Trade Representative’s Office files a complaint against China over aid to wind turbine manufacturers.
- December 2010: Ministry of Finance (MoF) announced that after 2012 the annual financial support for solar power installations shall cover at least 1GW.
- December 2010: NDRC issues Opinions on Promoting Healthy and Orderly Development of Wind Power Equipment Industry.
- February 2011: MoF announces discontinuation of “Special Fund for Wind Power Manufacturing”.
- March 2011: National People’s Congress (NPC) approves the Outline for the 12th Five-Year Plan for National Economic and Social Development. Under the plan, 11.4 percent of primary energy consumption will come from non-fossil fuels by 2015. 70GW of new wind projects will be installed by the same year.
- April 2011: Ministry of Commerce (MOFCOM) calls for comments on the 2011 revision of [The Catalogue of Industries for Guiding Foreign Investment].

New amendments encourage Foreign Direct Investment (FDI) in 3MW or larger wind-turbine production.

- April 2011: State Electricity Regulatory Commission (SERC)-Notice on strengthening the safety management of wind farms and reducing the frequent grid disconnection accidents of wind turbines.

By the end of 2010, according to the Global Wind Energy Council (GWEC), with 18.9GW newly installed wind power capacity, China’s total installed wind power capacity has reached 44.7GW, surpassing the US to rank first in the world. The Renewable Energy Sub-Working Group noted the rapid growth in the renewable energy market in China and welcomes China’s commitment to encourage the development of renewable energy. However, The WG’s main concerns about general developments in the wind energy sector are the following:

- Lack of transparency in the drafting and implementation process of industry technical standards.
- Unequal treatment in various projects, denial of a level playing field for domestic and international operators, and lack of recognition of international track record and certificates.
- Limited access to wind power special funds and transparency in its awarding process.

**Key Recommendations**

1. **Support and Promote a Level Playing Field for Both Domestic and International Companies in the Wind Energy Sector in China**

**Concern**

China’s wind power sector, despite the efforts and the good intention of the regulators’ recent statements, is far from being driven by a market mechanism. which would

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allow the conception of a competitive industry, with more generated electric energy, better quality of electricity, at a lower price. This will also lead to better products and services at a better price.

Assessment

Wind power equipment and development projects are awarded through the NDRC/NEA’s concessionary bidding mechanism. Since 2005, when the industry began to grow steadily in China, no single international Wind Turbine Generator (WTG) manufacturer has won a major national tender. In the last rounds the tenders focused on the procurement and development of wind farms in mega wind power bases in designated areas.

There are a number of concerns:

Firstly, the concessionary bidding system focused foremost on turbine price rather than elements that truly drive lifetime economics such as the cost of energy, which combines several key concepts. These important elements are not weighted as importantly as they should be in the tendering selections criteria and the prices required were well below market prices.

Secondly, some of the concession/wind base bidding projects allowed only for certain sizes of turbines, thus ignoring the suitability of turbines for individual locations.

Thirdly, although bidding requirements are relatively clear, there is no transparency on how the evaluation and assessment of the bid is conducted.

Finally, the international track record of the machines is not taken into account.

In February 2010, the NEA and the State Ocean Administration (SOA) issued details on offshore wind-project development, officially kicking off the development of China’s offshore wind market. However, only domestic or Joint Venture (JV) firms (with at least 50% Chinese ownership) can develop and/or operate offshore wind farms. As most international developers are not joint ventures, they are not able to participate in this new market as such. The reason provided by the government for blocking international developers is national security. The most recent public offshore concession tendering awarded its first four offshore wind power concession projects, totaling 1GW, to domestic companies. The WG believes that nurturing an open, international level offshore industry will improve international cooperation in this high-tech sector. Foreign-owned turbine manufacturers possess valuable technologies, offshore project management experience and turbine-service experience. Such cooperation between domestic and international players would attract investment through feasible project economics and hence encourage the development of a complete offshore value chain in China. The value of these benefits may be more strategic and long term than insisting on cutting costs and keeping tariffs low at the beginning of China’s offshore wind industry.

Recommendation

- Allow the sector to be driven by market forces for the healthy and sustainable development of the wind power industry. Therefore, the following is needed at the policy-making level:
  - Eliminate any piece of legislation-interfering market forces, such as turbine size restrictions or any other similar quantitative requirements, and shift the focus to quality indicators, such as the cost of energy
  - Involve all main key industry players, both domestic and international, and broaden current cooperation and communication channels, when developing key industry policies

- Introduce and keep a transparent tendering system and set comprehensive bidding criteria:
  - Strengthen criteria other than price and provide official definitions to concepts or indicators. Use the cost of energy as a paramount indicator combining several key concepts. The international prevailing formula is (Initial Investment + Operation & Maintenance (O&M) 20 years) / Produced Energy
  - Enforce clarity and avoid ambiguities and inexactitudes, especially when evaluating and assessing the bidders’ proposals
  - Recognise of international testing and certification, and recognition of international track records

- Allow equal access to offshore wind projects for all wind industry players, both international and domestic

2. Increase Transparency and Overall Participation in the Drafting and Enforcement of Technical Industry Standards

Concern

Insufficient recognition and adoption of internationally established best procedural practices will lead to added costs for foreign-owned wind companies in China as well as
Chinese companies operating abroad and, in turn, reduce the global competitiveness of China’s wind energy sector.

**Assessment**

In its efforts to set up an effective industry standards system, China formed the Wind Energy Standards Committee (WESC) in 2010. With representatives from both government and industry, the committee set to lead China’s standard-making efforts for wind energy.

However, international players with offices and factories in China have not been included as full members of the committee, there is no direct access to works and activities by the committee, and there are no channels available to discuss the process of initiating new standards.

Recognising the importance of certification for the enforcement of industry standards, China is preparing for the roll-out of mandatory certification requirements. However, there has been little indication that internationally acknowledged certificates will be properly recognised, or that international certification bodies will be eligible to apply the upcoming new Chinese standards. If China will only recognise its own domestic certification, the result will be extra cost and time for obtaining overlapping certificates for both international players in China and domestic companies that want to expand their business overseas. In addition, allowing for only domestic certification would artificially hinder competition in the certification industry and thus lead to a monopoly, which will be of detriment to overall industry growth.

Intellectual property protection will also be an area of concern if certification becomes mandatory in China. Completion of a certification process requires the disclosure of a range of confidential data by manufacturers. However, many companies in China find that the country still has ample room for improvement when it comes to having a system and culture that properly enforces the protection of intellectual property.

It is good to see China’s acceleration in laying out standards for the industry. Yet, there were occasions where insufficient time was given for the industry to adjust properly to new standards and requirements. An example would be the promulgation of the Interim Measures for the Administration of Grid Connectivity Testing of Wind Energy Equipments. It requires a mandatory grid connection test for all turbines installed in projects approved after Jan 1, 2011, which was just a few days after the publication of the requirement.

**Recommendation**

- Increase transparency in the drafting and decision-making processes for technical industry standards and allow for more participation and knowledge-sharing with foreign players in these processes
- Recognise certification issued by internationally recognised certification bodies and grant international certification bodies the official authority to conduct test and certification in China
- Introduce regulatory or legal measures to ensure intellectual property protection during the testing and certification process
- Allow sufficient time (minimum six months) for industry players to prepare for, and adjust to, newly introduced standards

3. Guarantee Clear and Transparent Grid Connectivity Procedures and Further Develop the National Grid Infrastructure

**Concern**

Despite significant investment and improvement, China’s grid infrastructure needs further development in order to successfully integrate existing and future power projects. Furthermore, unclear grid-integration approval procedures and lack of communication are hindering quality project development.

**Assessment**

China’s grid has failed to keep up with the pace of wind turbine installation. According to Chinese Wind Energy Association (CWEA) statistics, approximately only 70% of China’s cumulative installed wind capacity was connected to the grid at the end of 2010. Completed projects frequently have to wait for months before they can be connected and generate revenues by selling energy. This represents a high risk for developers. In addition, grid-connection capacity is unbalanced, especially in wind development areas with sound resources. Quite often the grid does not have the capability to manage and transmit wind-generated power to the load centre. Some wind farms have been shut down because the power they generated cannot be absorbed by the grid. This leads to further uncertainty for developers. According to SERC, in the first half of 2010 the wasted wind-generated electricity amounted to 2.8TW.h, which is equivalent to half of the electricity produced by China’s wind farms in the period.

To make better use of the electricity from renewable sources, the inter-regional exchange of electricity has to
be intensified. According to a recent International Energy Agency (IEA) working paper\(^{12}\), the exchange between the eight grid regions of China (Northeast, North, Northwest, Central, East, South, and Tibet and Xinjiang) only amounts to 4% of the total electricity generation. Therefore, the regional grid administrations should be authorised to intensify inter-regional exchange and a proper market-based mechanism that provides incentives for integrated cross regional electricity market development should be set up.

The successful development of the grid also requires the full implementation of the mandatory purchase of renewable energy as stated in the amended Renewable Energy Law\(^{13}\). It is still the case that power generated by wind farms is not being prioritized and accepted by grid companies.

Also important is clarity on several issues. The current lack of transparency on critical grid connection makes it very difficult for developers to obtain important information about the grid in a timely fashion. Recently, the NEA issued “Notice on Issuing Interim Measures on Administration of Grid Connection Testing for Wind Turbine Generators” requiring newly approved WTG, which will be connected to the grid, must be tested and comply with the grid code as well as other standards. However, the measures entered into force without sufficient explanation, especially on the mechanisms how to enforce it. Currently, China Electric Power Research Institute (CEPRI) is still working on the grid code, which is still under approval procedure. It is not clear which standards WTG have to comply with. The testing procedures are not defined either. According to the Measures, only institutions accredited and authorised by the government are allowed to conduct the test; however, there is no reference for all available accredited institutions.

Furthermore, there seems to be a lack of communication between developers and utilities’ representatives. Cooperation between these agents could result in a more efficient wind power industry. The lack of information regarding investment in the national grid and future grid development hinders developers’ ability to plan and make renewable project-development decisions. Cooperative action between these two parties, such as accelerating the deployment of reliable wind power prediction systems to predict wind power output in the short term and the application of international best practices to reduce the forecast errors in locally available prediction systems, are recommended. Such systems have enabled the power dispatchers in countries with a longer track record in wind power generation to securely manage a much higher wind power penetration in their electricity grids.

**Recommendation**
- Guarantee timely grid connection for all renewable projects
- Further improve co-ordination on wind power planning and grid construction planning
- Intensify the interregional exchange of electricity and create interregional electricity markets in order to have a broader base for balancing production and demand. Enforce mechanisms to support and absorb electric energy from renewable energy sources by the National Grid Infrastructure
- Increase transparency of the Grid Code and clarify grid-connected testing for wind turbine generators:
  - Define clear requirements and the follow-up process for the securing of the certification resulting from this testing
  - Issue a list of institutes and organizations officially recognised and entitled to provide these certifications
- Facilitate access to grid information for developers of renewable energy projects (future development, forecasts centers, capacity)

4. Allow Equal Access to Government Funds

**Concern**
A number of special government funds relating to Research and Development (R&D) and other subsidies are not directly available to foreign-invested companies. In some cases, Foreign Invested Enterprises (FIEs) are deterred from applying for government funds due to partnership or Intellectual Property (IP) requirements. In others, FIEs are barred outright from applying for tax holidays, subsidies and high-tech status enjoyed by domestic firms.

**Assessment**
Chinese Premier Wen Jiabao and other senior government leaders have stated on numerous occasions that foreign enterprises should enjoy the same treatment as national companies according to Chinese laws. However the WG believes that some conditions do not allow foreign
operators to receive such treatment, nor are some of the conditions based on international industrial practices.

The 863 and 973 research and development programs continue to provide grants and subsidies for domestic companies in renewable energy, resulting in an unbalanced playing field for FIEs. Investment in energy research under the 863 programme grew nearly fifty-fold between 1991 and 2005, the most recent year on record. The 973 programme is the main central government programme for basic research and, by some estimates, receives about 10 percent of central government funds for science and technology.

While international companies are permitted to apply for such R&D funding, they can only do so through Chinese partners and research institutes. Any IP generated from such joint-research projects would be controlled by the Chinese partner, not by the foreign company, which deters real R&D work. Meanwhile, Chinese WTG manufacturers are allowed to apply directly for special R&D funding, keeping any IP generated as a result.

Some international WTG manufacturers have set up R&D centres in China and are willing to do serious R&D work, given the right conditions. However, they are unwilling to simply trade their technology and future Intellectual Property Rights (IPR) in exchange for government funding. Conditions for applying to R&D funding between domestic and international WTG manufacturers should be equalised.

In the field of biogas, FIEs cannot receive government funds in the form of tax holidays, subsidies and high-tech status enjoyed by domestic firms. Without equal access to these government funds, foreign-invested biogas companies cannot fairly compete with domestic companies that receive special government treatment.

**Recommendation**

- Allow all WTG producers to apply directly for government R&D funding. In the case of Sino-foreign joint research projects, allow FIEs the possibility to control or share resultant IP.
- In the field of biogas, equalise conditions for domestic and foreign-invested firms in applying for government funds, subsidies and tax holidays.

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**5. Promote the Underdeveloped Biogas Sector to a Sustainable Industry**

**Concern**

The current incentive system and business environment are not sufficient to develop a biogas industry with state-of-the-art technology for medium and large biogas power plants and thus does not capture the energy potential of biogas.

**Assessment**

Biogas is an efficient CO₂-neutral energy source. In addition, biogas plants can reduce water pollution, avoid methane emissions and improve agricultural production. Biogas as a renewable energy source has a big energy potential in China and could play an even more important role as in the current planning of NDRC, with the target of 14 billion m³ from Medium and Large Scale Biogas Plants (MLBGPs) equivalent to 3GW in 2020).

Between 2006 and 2009, China gave approximately RMB 35 billion in subsidies for the construction of MLBGPs. But the majority of the 16,000 MLGBP installations in the agricultural sector function far below international standards. Even the most efficient of these plants work at only 60% of their annual capacity potential. Of the 16,000 installations, only five are grid-connected and five were registered as Clean Development Mechanism (CDM) projects with their Certified Emission Reductions (CERs) below their design targets.

The WG believes that the two main reasons for this market situation are the inefficient subsidy system that focuses on construction only and feed-in tariffs that are too low. The current biogas feed-in tariff of RMB 0.25/kW in combination with the average RMB 0.45/kW coal power generation price makes profit generation from energy and fertilizer sales not possible. The feed-in tariff does not even cover the operational costs of a biogas plant and the combined

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heat and power plant.

**Recommendation**

- Change the subsidy model from investment subsidies to a mainly output-oriented support scheme, for example, a feed-in tariff. Only operating plants shall be funded.
- Change so far inefficient governmental funding in not operating plants, to a long term (10-15 Years) state guaranteed operation oriented (feed-in-tariff). This would encourage the private- and institutional investors, to grant loans even to poor farmers based on this long term operation payback system. Result: Funding and Operation is secured for biogas.
- Create a combination of long-term support schemes for biomethane, electrical energy, waste heat (Combined Heat and Power) and direct biogas use, which takes China’s low price of energy into account, as the key to successful energy production from biogas.
- Create additional income for the biogas plant operator by subsidizing the use of effluent as organic fertiliser, replacing the chemical fertilizer. At least in the beginning to make the users familiar with the benefits of this form of fertilizer.
- Support a system of centralised biogas plants combining smaller waste sources to encourage economies of scale, because, currently, smaller facilities for energy or biomethane production are economically unattractive.
- Encourage co-operation between the agricultural and municipal sectors to enable utilisation of a co-processing of agricultural and bio-organic waste from restaurants and households (kitchen waste). This has the potential to increase biogas productivity of the existing facility by five to ten times.
- Support CDM or other carbon-credit incentive systems to reward the function of Greenhouse Gas (GHG) emission reduction in line with Chinese national policies, such as a 40% to 45% reduction in carbon intensity by 2020.
- Develop lean technical standards, focusing on reliable operation and efficient performance. Use standards to eliminate old biogas facilities from the market, which are of insufficient quality and poor performance.
- Streamline the project permission process and grid/ gas station connection to increase opportunities for biogas and speed up the plant realisation time from three years to about six months.
- Increase education on biogas operation and maintenance and establish the profession of large-scale biogas plant technicians. Support Chinese publications on international biogas technology and application.

**Abbreviations**

- CDM: Clean Development Mechanism
- CEPRI: China Electric Power Research Institute
- CER: Certified Emission Reduction
- CWEA: Chinese Wind Energy Association
- FDI: Foreign Direct Investment
- FIE: Foreign Invested Enterprises
- GHG: Greenhouse Gas
- GW: Gigawatt
- GWEC: Global Wind Energy Council
- IEA: International Energy Agency
- IP: Intellectual Property
- IPR: Intellectual Property Rights
- JV: Joint Venture
- NDRC: National Development and Reform Commission
- NEA: National Energy Administration
- MLBGP: Medium and Large Scale Biogas Plant
- MoF: Ministry of Finance
- MOFCOM: Ministry of Commerce
- MW: Megawatt
- NPC: National People’s Congress
- R&D: Research and Development
- O&M: Operation & Maintenance
- SERC: State Electricity Regulatory Commission
- SOA: State Ocean Administration
- TW.h: Terawatt Hour
- WESC: Wind Energy Standards Committee
- WG: Working Group
- WTG: Wind Turbine Generator
Key Recommendations

1. Facilitate Smart Grid Project Participation

- Facilitate cooperation between European businesses and Chinese stakeholders in smart grid planning and research
- Provide meaningful access to smart grid pilots and emerging projects within both SGCC and CSG
- Support an exchange platform of best practices in an open range of smart grid development areas among all stakeholders, particularly between SGCC/CSG and European businesses

2. Coordinate Standardisation and Certification Processes

- Define and map the organisation involved with smart grid standards definition in China
- Ensure sufficient access to relevant institutions that are responsible for drafting the standards
- Allow European companies to participate in the standards drafting process
- Enhance cooperation with European companies and institutions on the development of a harmonised set of standards, norms and certification procedures for smart grids

Introduction to the Working Group

The Smart Grid 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 (WG) is composed of power equipment manufacturers, IT solution developers as well as other important stakeholders. It has been proactively engaging Chinese and European policymakers on policies, regulations, and standards related to the development of smart grids.

The WG seeks to establish effective and constructive dialogues on relevant issues among key stakeholders to:

- Facilitate smart grid project participation
- Coordinate standardization and certification processes

Recent Developments

Premier Wen Jiabao and other key Chinese government officials publicly recognised the importance of smart grids for China to achieve energy security and sustainability, support economic development and reduce CO₂ emissions. Smart grids are instrumental for the transition towards a low-carbon economy, as they are enablers of renewable power from wind and solar as well as more efficient power transmission and distribution grids.

China’s 12th Five-Year Plan reaffirmed the significant role and the priority of smart grids. State Grid Corporation of China (SGCC), the largest of the only two power grid operators in China, planned to invest CNY 2,550 billion in grid in the next five years. According to SGCC’s three-stage smart grid development plan, 2009-2010 is the trial stage focusing on planning, standardisation, and research of key technologies; 2011-2015 is the full-scale construction stage with emphasis on Ultra High Voltage (UHV) grids, urban and rural distribution grids, technology breakthrough and application of key technologies and equipment, a preliminary implementation of grid operation control and interactive service systems; and finally, 2016-2020, during the 13th Five-Year Plan, is the improvement and enhancement stage targeting a unified strong and smart grid with world leading equipments and technologies.

The electric power industry in China is dominated by State Owned Enterprises (SOEs). The transmission sector is controlled by SGCC and China Southern Power Grid (CSG). SGCC is the largest utility in the world and covers

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80% of the market share in transmission sector while CSG is responsible for the rest 20% of the market in six provinces in southern China. In 2009, SGCC announced a CNY 3.45 trillion investment plan for a strong and smart grid in the next 11 years. This plan will make China the biggest smart grid market in the world by 2020.

The primary goal is to build unified, strong and smart grids based on UHV grid as a backbone with successive development of the grid at all levels. The smart grid in China will cover generation, transmission, transformation, distribution, consumption and dispatching. It should also be strong and reliable, economic and efficient, clean and sustainable, transparent and open, as well as user-friendly and interactive. Although there is no development plan at the national level, many believe SGCC’s plan will be a de facto national one. CSG will by and large take direction from the SGCC roadmap.

According to the SGCC, its framework and roadmap serve as the guideline to develop corporate smart grid standards, as well as being an important reference for industrial, national and international standards. As a first step, the SGCC in 2010 announced its Research and Development (R&D) plan for key components of the smart grid and the plan for the smart grid standard framework. In the standard framework, eight domains, 26 technical fields and 92 series of standards are identified as priorities. In 2011, the SGCC announced around CNY 500 billion will be invested to cover research, pilot projects, installation and operation for the next five years.

The WG welcomes the rapid development in the smart grid sector in China; however, the WG is concerned by the unequal market access and the unlevel playing field created in part by the dominance of the two utilities. Being suppliers and customers at the same time, SGCC and CSG possess clear dominating competitive advantages that repel other suppliers to enter this market. European businesses have been among the primary technology contributors to China’s past three decades growth in the electricity market, and they look forward to continuing to contribute to the development of smart grid in China. The WG will seek further communication with Chinese officials to improve the business environment for European industries in this sector.

**Key Recommendations**

1. Facilitate Smart Grid Project Participation

Concern

Pilot projects and subject research were the two major approaches to understand the market, identify the priorities and prepare for large scale deployment as smart grid development is still emerging from the research and development stage. The second load of pilot projects announced in 2010 by SGCC included more than 16 categories covering various aspects of smart grids. According to SGCC’s plan, 2011 will see the start of full-scale construction of smart grids. So far, the technology and product providers for the past pilots and subject research have seen limited foreign companies, although more cooperation between European companies and Chinese stakeholders will facilitate the development of smart grids in China. European businesses have expertise and advanced technologies to contribute to sustainable development of this market in China. Nevertheless, it is very difficult for European industries to acquire sufficient information to understand the requirements of this sector, which prevents them from contributing to the market.

Assessment

With CNY 500 billion to be invested within the next five years, China is at the top of the list of smart grid investors, not only demonstrating a clear ambition to improve drastically its electric grid networks and energy efficiency, but also a determination to set technology trends and lead global standardisation for all smart grid-related topics.

China’s smart grid development is accelerating and pilot projects are multiplying but both rarely include participation from foreign companies. Ensuring European companies gain access to these and other emerging projects would not only raise the projects’ success rate but also attract foreign investment and experiences to back up China’s smart grid development.

In Europe, over EUR 5.5 billion[^2] has been invested in about 300 smart grid projects during the last decades.

European experience has proven that smart grids can contribute to energy efficiency and carbon reduction as

well as renewable energy integration. European companies have acquired great knowledge and experiences from a wide variety of research and pilot projects in Europe. By allowing their participation in the pilot projects in China, China can maximise its utilisation of the latest, advanced leading smart grid technology and business practice. It can also learn from and avoid errors previously made abroad, fast tracking its development to becoming a world leader in this sector.

To be able to contribute effectively, European businesses need to be able to draw a clear picture of the current state of smart grid development. Due to the sheer size of the market and the lack of effective coordination among different institutions, it is very difficult for European businesses to acquire sufficient information to respond to rapid market changes. Furthermore, the sector is driven by SGCC as both a grid operator and an equipment provider. It creates conflict of interests that exacerbate the market complexity.

**Recommendation**

- Facilitate cooperation between European businesses and Chinese stakeholders in smart grid planning and research
- Provide meaningful access to smart grid pilots and emerging projects within both SGCC and CSG
- Support an exchange platform of best practices in an open range of smart grid development areas among all stakeholders, particularly between SGCC/CSG and European businesses

2. **Coordinate Standardisation and Certification Processes**

**Concern**

Standardisation for smart grids in China is by and large defined by SGCC. This exclusive standard drafting process prevents European businesses from sharing their knowledge and best practices in this field. It raises the concern that these standards will be used as potential trade barriers towards European companies.

**Assessment**

To promote the development of the sector, China is moving swiftly to establish new national and international standards for the entire smart grid value chain. Extensive research has been conducted on standards for all smart grid related topics. Governmental institutions, trade associations, and domestic industries are involved in the standard drafting process. In November 2010, to drive forward the standard drafting process and framework for smart grids, the Standardisation Administration of China (SAC) and the National Energy Administration (NEA) jointly established the Smart Grid Standardisation Promotion Committee (SGSPC). Under this committee, two special task forces were established to draft and coordinate standards for grids and equipments. In addition, another task force was set up for international cooperation.

Due to the lack of national standards in some fields, utilities and grids establish their own standards for certain products, which poses tremendous obstacles to European companies who follow strictly the international standards. For example, SGCC identified thousands of smart grid related standards or potential ones and decided to work intensively on defining around 95 core standards, for which there is no other international equivalents and where they can become the global reference or standard. SGCC structured its approach among eight core domains of research, 26 related technological fields, from generation to consumer services, including transmission, distribution, electric vehicles, and renewable energy integration.

It is important for the Chinese standardisation institutions to cooperate with their European counterparts and create a harmonised policy and regulatory framework to facilitate the technology and market development. Discrepancies between Chinese and international standards will not only increase the costs for companies, prevent European companies from entering Chinese market, but also hinder Chinese companies entering foreign markets. An integrated and well structured set of demonstration projects that includes the participation of international companies will accelerate the transition from the pilot stage to full scale, commercially viable roll-out. Chinese officials and companies can benefit significantly from enhanced cooperation with European companies and institutions for sharing of best practices to increase the confidence with which both the public and private sector may invest.

**Recommendation**

- Define and map the organisation involved with smart grid standards definition in China
- Ensure sufficient access to relevant institutions that are responsible for drafting the standards
- Allow European companies to participate in the standards drafting process
- Enhance cooperation with European companies and institutions on the development of a harmonised set of standards, norms and certification procedures for smart grids
Abbreviations

CNY      Chinese Yuan
CSG      China Southern Power Grid
NEA      National Energy Administration
R&D      Research and Development
SAC      Standardisation Administration of China
SGCC     State Grid Corporation of China
SGSPC    Smart Grid Standardisation Promotion Committee
SOE      State Owned Enterprise
UHV      Ultra High Voltage
WG       Working Group
Section Four: Trade in Services
The development of an internationally competitive service sector is one of China’s major goals as put forward in the 12th Five-Year Plan. The greater encouragement of European and foreign players in this sector would help achieve these targets by bringing in their international experience and expertise. Chinese officials recognised that the service sector was lagging behind during the 11th Five-Year Plan era. This can be clearly seen when examining statistics of European Union (EU)-China trade in services. The balance of imports and exports fell from €4.9bn in 2008 to €4bn in 2010 (see Graph 1 below). The draft of the Catalogue for Guiding Foreign Investment in Industry 2011 is particularly disappointing in this area since it contained no indication of further opening up of the service industry. The European Chamber recommends addressing the development of the service sector as a matter of urgency. This will help meet the strategic goal of shifting the economy to a more domestic consumption-driven model.

Graph 1: EU-China Trade in Services from 2008 to 2010

<table>
<thead>
<tr>
<th>Year</th>
<th>Imports</th>
<th>Exports</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>15.2bn</td>
<td>20.2bn</td>
<td>4.9bn</td>
</tr>
<tr>
<td>2009</td>
<td>13.2bn</td>
<td>18.6bn</td>
<td>5.3bn</td>
</tr>
<tr>
<td>2010</td>
<td>16.3bn</td>
<td>20.2bn</td>
<td>4bn</td>
</tr>
</tbody>
</table>

Source: The Directorate General for Trade of the European Commission

The opening up and further liberalising of the services sector require a coordinated approach among Chinese regulatory bodies as well as fair and equal treatment of foreign companies in China. Common issues raised throughout the Position Papers in this section include the need for deepening market access for foreign companies, making regulations compatible with international standards, protecting Intellectual Property Rights (IPR) and easing restrictions at customs. Prominent examples can be found in the Position Papers that follow in sectors such as Aviation, Construction, Information and Communication Technology (ICT), Information Security, and IPR.
In the Construction industry, service providers such as architects, engineers, project managers and contractors whose expertise and experience in the area could contribute greatly to China are not given full market access. Similarly, foreign companies in the Maritime industry are prohibited from operating between Chinese ports. Additional market access barriers are faced in numerous industries, including but not limited to the Aviation, ICT, Logistics and Travel industries. Please refer to these papers to see specific examples.

The compatibility of Chinese regulations with international norms remains a significant challenge for foreign firms in various industries. For example, in the Information Security industry, encryption regulation differs markedly from the international norm by handling encryption as a unified concept encompassing commercial and state security applications. A similar situation is visible in the Aviation industry as local procedures at major Chinese gateways such as in Beijing and in Shanghai differ from the International Air Transport Association’s (IATA) worldwide scheduling guidelines and have their own timetables, making scheduling more difficult for European carriers. Lack of compatibility of Chinese regulations to international norms affects firms’ profitability and operational strategies as well as effective development of China's service sectors.

The market for trade in services in China does not allow for fair market access, and faces various problems as presented in this Position Paper. The European Chamber hopes the Chinese government will take action to address these issues. In this section, the European Chamber offers a number of recommendations for the development of the service sector in China in specific industries including Construction, ICT, Information Security, IPR, Logistics, Maritime, and Travel.
Key Recommendations

I. Operation
1. Add Entry and Exit Points and Expand the Network of Air Routes
   - Add more entry and exit points within China’s airspace and expand the network of air routes available to civil aviation through dynamic joint use of civilian and military airspace
   - Encourage utilisation of Low-Altitude Airspace, with a view to reform the mid and upper-airspace, as an effort to reduce the environmental impact of the aviation industry

2. Disclose the Slots Allocation Process
   - Continue to work with the International Air Transport Association (IATA) to help better align local procedures with those in the Worldwide Scheduling Guidelines (WSG)

3. Restriction on Time Slots for Air Cargo Airlines
   - Remove the restriction for international cargo airlines at first-tier airports from night-time slots only

II. Market Access
1. Introduce Foreign Computer Reservation Systems (CRS)
   - Release the final draft of the CRS regulation in a timely manner to establish a consistent and efficient system of licensing procedures and management
   - Study the possibility of further liberalisation of China’s CRS market and allow foreign Global Distribution Systems (GDS) providers to provide services to sales agents of both Chinese and foreign airlines

III. Ground Service
1. Improve Transit Facilities and Baggage Clearance
   - Enforce all regulations on an equal basis for all industry players, both international and domestic
   - Facilitate luggage clearance for passengers transiting from a domestic regional airport to international destinations and vice-versa

IV. Commercial
1. Reduce Airport and Terminal Charges
   - Apply Airport, Terminal and Reservation System Charges on an equal basis to all domestic and foreign airlines to ensure fair and transparent competition
   - Allow airlines to collect the Passenger Service Charge (PSC) directly from passengers
   - Charge the Terminal Navaid Charge (TNC) only once, in accordance with global practice
   - Ensure that the cost benefits of the removal of royalty fees on ground-handling are passed in full to the airline by the ground-handling companies

2. Increase Competition in the Jet Fuel Market
   - Allow for international, fair and open competition in China’s jet-fuel market
   - Take Singapore Petroleum Company Aviation Sales Unit as a benchmark for price fixing and fluctuation. The company has been providing aviation fuel for 30 years to airlines at the airports of Singapore, Hong Kong, Bangkok and Taipei and can function as a guideline
V. Regulations

1. Open the Employment Agency Market

- Abolish the Foreign Aviation Service Corporation (FASCO) monopoly position and allow foreign airlines to hire staff either directly or through various employment agencies

Introduction to the Working Group

The Aviation Working Group consists of European airlines and service providers with interests in the Chinese market. It aims to establish a constructive dialogue with relevant ministries to assist China in meeting its World Trade Organisations’ (WTO) obligations and to create a fair and transparent regulatory framework for the benefit of a sustainable aviation industry.

Recent Developments

China’s civil aviation industry profitability continued to soar in 2010, with the Civil Aviation Administration of China (CAAC) stating the nation’s aviation industry reported a full year profit of CNY 43.7 billion, considerably ahead of previous forecasts of a CNY 30 billion profit. This marks a threefold surge in profitability from 2009 levels to a record high. The results reflect the booming local economy and increased propensity to travel as domestic consumption expands, and government-led investment in the aviation industry that has resulted in what many industry participants see as the beginning of a “golden” era for the Chinese civil aviation industry.

According to CAAC, it is predicted that air passenger numbers will increase 13% year-on-year to 300 million passengers in 2011 and cargo volume to increase 11.5% to 6.2 million tons in 2011. Chinese carriers are expected to handle 450 million passengers per annum by 2015 and 1.5 billion by 2030.

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5 The 2011 Passenger Transport Number of Civil Aviation is predicted to reach 300 million, Civil Aviation Administration of China, 12 January 2011, viewed 19 May 2011, http://www.caac.gov.cn/A1/201101/02/20110112_36970.html

2011 is the first year of China’s 12th Five-Year-Plan, during which China plans a significant investment of more than CNY 1.5 trillion for the civil aviation sector.\(^7\) CAAC stated that China will make a fixed-asset investment of CNY 70 billion in 2011,\(^8\) which will include CNY 55 billion in airport construction including work on six new airports; CNY 5 billion in Air Traffic Management (ATM) infrastructure construction; and CNY 5 billion in safety. This forms part of efforts by the nation to continually develop the civil aviation industry to a worldwide and internationally competitive standard.

The Working Group warmly welcomes the CAAC’s call for comments on the draft Computer Reservation System (CRS) regulation.\(^9\) Opening China’s CRS market to foreign Global Distribution Systems (GDS) would bring cutting-edge technology and efficient tools that would meet the increasing requirements of Chinese aviation enterprises and through new competition in the market it will help the domestic GDS to increase the level of services to the airlines and travel agencies to further benefit Chinese consumers. The Working Group welcomes this draft regulation and asks for timely promulgation.

The Working Group is also encouraged by the progress on the reform of China’s airspace, which has been the biggest restriction hindering the development of China’s civil aviation industry. As planned, airspace reform will be trialed in some places in 2011 and then expanded to the whole country from 2011 to 2015. The Working Group welcomes this reform action but still has the concerns regarding the possibility to add more entry and exit points and expand the network of air routes along with the airspace reform.

Finally, the Working Group members are still concerned about the restrictions on time slots and are looking forward to a more transparent process of slots allocation. The Working Group believes that the proposals in this paper are important for the sustainable and harmonious development of the Chinese civil aviation industry. The Working Group members are always committed to China’s marketplace and believe that they could play a key role in sharing technical knowledge and resources with CAAC through systematic consultation.

I. Operation

1. Add Entry and Exit Points and Expand the Network of Air Routes

Concern
The utilisation of airspace for civil aviation remains insufficient.

Assessment
80% of current Chinese airspace remains exclusively dedicated to military use. This leaves minimal space for civil aviation and a limited number of entry and exit points. The narrow airways are also very limited, and as a result, the routes assigned are often significantly longer than the shortest distance to the final destination.

Due to inefficient usage of the airspace, consumers do not benefit from the shortest available flight routes; therefore, planes unnecessarily consume more fuel, resulting in a higher contribution to carbon emissions and environmental impact than necessary.

The Working Group warmly applauds the Guidelines for Management Reform on Low-Altitude Airspace jointly issued by the State Council and Central Military Commission. Limited air space costs airlines more energy, which increases consumption of jet fuels, while better airspace usage expands capacity, maintains high safety levels and achieves ecologically responsible industry behavior.\(^{10}\)

Recommendation

- Add more entry and exit points within China’s airspace and expand the network of air routes available to civil aviation through joint use of civilian and military airspace
- Encourage utilisation of Low-Altitude Airspace, with a view to reform the mid and upper-airspace, as an effort to reduce the environmental impact of the aviation industry

2. Disclose the Slots Allocation Process

Concern
Local procedures at major Chinese gateways (e.g. Beijing,

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\(^8\) The 2011 Passenger Transport Number of Civil Aviation is predicted to reach 300 million, Civil Aviation Administration of China, 12 January 2011, viewed 19 May 2011, http://www.caac.gov.cn/A1/201101/20110112_36970.html

\(^9\) Notice on Comments for Foreign Air Transportation Companies Access to Foreign IT Reservation System via Appointed Sales Agents in China (Draft), Civil Aviation Administration of China, 10 January, viewed on 19 May 2011, http://www.caac.gov.cn/P1/201101/20110110_36903.html

Shanghai and Guangzhou) differ from the International Air Transport Association’s (IATA) worldwide scheduling guidelines (WSG) and have their own timetable that makes scheduling more difficult for international carriers.

Assessment
European Slot Coordinators apply a clear and neutral slots allocation process. All carriers submit their requests according to the IATA guidelines and at the end of IATA’s biannual conferences, all airlines obtain clear information on allocated and available slots. At any time allocated slots can be retimed. It is important to establish a single slot process for international and domestic slot allocation. This would enable Chinese and foreign carriers to gain fair access to available slots and optimise schedules according to the needs of all stakeholders.

Recommendation
• Continue to work with the IATA to help better align local procedures with those in the WSG

II. Market Access

1. Introduce Foreign CRS

Concern
According to the CRS draft regulation issued by CAAC for public consultations in January 2011, foreign GDS providers will be limited to only provide services to the sales agents of foreign airlines in China.

However, under this draft CRS regulation sales agents of China’s domestic airlines are not permitted to choose to use a foreign GDS providers’ cutting edge technology. Meanwhile, some of the requirements and procedures in the draft regulation are still unclear and may need CAAC’s further modification in the final draft law.

Assessment
Compared to the many innovations and improvement in terms of physical infrastructure, China has fallen behind in terms of travel retail technology. Over the past 10 years, the major global GDSs have launched a wide range of improvements that have empowered intermediaries, and provided travelers with better choices and greater value. From introducing a graphical user interface, to integrating more robust choices, and creating a powerful suite of accuracy and efficiency tools, the global GDSs have taken travel distribution technology to a new level. Chinese airlines, travel agents and consumers however, are not able to benefit from the same standard of technology due to the market access restrictions.

With full liberalisation of China’s CRS market - allowing foreign GDS to provide services to both domestic and foreign airline’s sales agents - it would bring two fundamental changes to the industry. First, it would ensure that stakeholders all along the industry’s value chain can benefit from the technology, innovation and transparency that has transformed and empowered the industry elsewhere.

The second key change is that opening up the CRS market would bring competition and in effect provide greater breadth of choice to suppliers and intermediaries alike, e.g. airlines would have more choices of distribution channels to increase revenue and global competitiveness,
and more efficient management tools, accurate airfare and powerful solutions would be brought to travel agencies, online travel agencies and travel management companies. With dynamic international players entering the market, Chinese CRS companies would be compelled to offer similar tools and technology in order to compete. It would also help Chinese CRS providers to improve their customers’ satisfaction levels and therefore make the CRS itself stronger.

Recommendation

· Release the final draft of the CRS regulation in a timely manner to establish a consistent and efficient system of licencing procedures and management
· Study the possibility of further liberalisation of China’s CRS market and allow foreign GDS providers to provide services to sales agents of both Chinese and foreign airlines

III. Ground Service

1. Improve Transit Facilities and Baggage Clearance

Concern

According to present regulations, baggage is cleared at the first airport of entry into China. However, selected domestic airlines (on certain air routes like Shanghai, Chengdu) benefit from preferential treatment and are allowed to transfer luggage directly to the final destination without their passengers having to claim and re-check their baggage.

Assessment

A passenger flying from Europe to Wuhan, for example, may have a stopover in Beijing or another major airport in China. Upon arrival at the Beijing airport, the luggage is claimed by the passenger and re-checked for the domestic flight to Wuhan. This procedure lacks efficiency and is time consuming.

A recommendation to CAAC is to implement a similar procedure as in other international transit hubs where the same first entry clearance exists to handle luggage in transit. In other international transit hubs, on a similar flight, the passenger would claim and recheck his luggage at a specially designated and convenient place in the airport. Today in China, this procedure has not yet been implemented.

It has also been noted that Air China has received exceptions to this rule and is allowed to clear luggage to the final destination.\(^2\)

Recommendation

· Enforce all regulations on an equal basis for all industry players, both international and domestic
· Facilitate luggage clearance for passengers transiting from a domestic regional airport to international destinations and vice-versa

IV. Commercial

1. Reduce Airport & Terminal Charges

Concern

The new civil airport charges implemented by CAAC in 2008 have increased operating costs by 43%. At the same time the Chinese CRS, Travelsky, charges foreign carriers four times as much as it charges domestic carriers for bookings.

Assessment

While the Working Group initially welcomed the reform to bring International Civil Aviation Organization (ICAO) compliant policies into the airport charging system, the Working Group also recognises that according to the IATA\(^3\) the overall cost increase for passenger flights averages 43% or about CNY 15,251 per aircraft movement. The Terminal Navaid Charge (TNC) is being charged twice - once for take-off and once for landing. This results in one of the highest TNC costs in the world. The flight charge has been changed as well with the implementation of a new CNY 70 Passenger Service Charge (PSC). Airlines are facing the full cost burden of the PSC since they are unable to get back from ground handling companies the savings coming from the abolition of the airport royalty fees. High airport costs have a direct impact on the profitability of a route and threaten its development. It makes starting routes, which have a low profit margin, less viable to operate, thereby threatening the development of international flights to second-tier airports in China. The Working Group suggests that CAAC take urgent action to correct the negative impact of the new airport cost structure.


\(^{13}\) International Air Transport Association, Paper from International Air Transport Association to Civil Aviation Administration of China, 31 May 2008
Recommendation
- Apply Airport, Terminal and Reservation System Charges on an equal basis to all domestic and foreign airlines to ensure fair and transparent competition
- Allow airlines to collect the PSC directly from passengers
- Charge the TNC only once, in accordance with global practice
- Ensure that the cost benefits of the removal of royalty fees on ground-handling are passed in full to the airline by the ground-handling companies

2. Increase Competition in the Jet Fuel Market

Concern
There is a lack of competition in the jet-fuel market and as a result, prices are artificially high.

Assessment
Only the China National Aviation Fuel (CNAF) or joint venture companies of CNAF are permitted to sell jet fuel to airlines. Due to this non-competitive structure, fuel prices are artificially high.

Recommendation
- Allow for international, fair and open competition in China’s jet-fuel market
- Take Singapore Petroleum Company Aviation Sales Unit as a benchmark for price fixing and fluctuation. The company has been providing aviation fuel for 30 years to airlines at the airports of Singapore, Hong Kong, Bangkok and Taipei and can function as a guideline

V. Regulations

1. Open the Employment Agency Market

Concern
Foreign airlines are limited to employing local staff through the Foreign Aviation Service Corporation (FASCO). This stipulation limits the flexibility of foreign airlines to hire personnel in China.

Assessment
In Europe, a domestic or foreign airline is free to hire its employees through any means that best suit the company’s practice. The obligation to recruit personnel using a special employment agency, such as FASCO, represents forced outsourcing. This directly affects their performance in an industry where customer service satisfaction, and hence commercial success, is very much dependent on the attitude and motivation of staff.

Recommendation
- Abolish the FASCO monopoly position and allow foreign airlines to hire staff either directly or through various employment agencies

Abbreviations
ATM         Air Traffic Management
CAAC        Civil Aviation Administration of China
CNAF        China National Aviation Fuel
CNY         Chinese Yuan
CRS         Computer Reservation Systems
FASCO       Foreign Aviation Service Corporation
GDS         Global Distribution System
IATA        International Air Transport Association
ICAO        International Civil Aviation Organisation
PSC         Passenger Service Charge
TNC         Terminal Navaid Charge
WSG         Worldwide Scheduling Guidelines
WTO         World Trade Organisation
Key Recommendations

1. Promote Sustainable Development
   - Promote eco-cities as China’s new model for sustainable urbanisation
   - Accelerate the establishment of an effective regulatory framework and policy environment aimed at minimising energy consumption by buildings that covers the complete building life-cycle

2. Improve Market Access for Foreign Construction Service Providers
   - Amend the relevant regulations to improve market access for foreign construction service providers (project managers, architects, engineers, contractors and sub-contractors), thereby facilitating the deployment and transfer of their advanced knowledge and expertise to China

3. Encourage Use of Advanced Construction Materials and Equipment
   - Put in place measures to support the use of advanced construction materials and equipment, thereby achieving a step change in building performance

4. Encourage Foreign Investment in Real Estate
   - Amend relevant regulations and policies to facilitate foreign investment in real estate development, thereby allowing China to benefit more widely from the skills and expertise that international investors/developers bring in designing, building and operating world-class properties

Introduction to the Working Group

The Construction Working Group was first established in February 2003 to represent European construction-related enterprises operating in China. The main objectives of the Working Group are to maintain frequent dialogue with key stakeholders - including, but not limited to, the Ministry of Housing and Urban-Rural Development (MOHURD), the European Commission and construction-related associations - to provide technical assistance on Chinese construction priorities, in particular sustainable urban development, and to promote investment in high-quality and energy-efficient buildings.

Many issues, which concern the construction group, overlap with issues from Energy, Non-Ferrous Metals and Environment Working Groups in particular. Therefore, the recent developments as well as the key recommendations in this section should be read in conjunction with those mentioned in the other sections of this Position Paper.

Recent Developments

The European Chamber has also lead on the European Union (EU) funded project SWITCH-Asia “Train the Trainers”, now in its third year, has expanded its scope and provides training sessions also for policy-makers to enhance the enforcement of energy-efficient policies in the construction environment. A high-level workshop was held in Shanghai with fifty officials participating.

With significant financial and industrial policy support from the Chinese government, the construction sector in China is continuing to grow strongly. Chinese fixed asset investment increased, according to the National Bureau of Statistics, by almost 24% in 2010, year on year.¹ This fast growth makes the Chinese construction market the world’s most active and brings enormous business opportunities for companies, following the rapid urbanisation and opportunities for research or education projects. Foreign participation in the construction sector is limited to specifically

designated areas, such as contracts wholly financed by foreign investment. In 2009, the total income of construction companies in China was CNY 7.5 trillion. Foreign companies were only awarded a negligible part of that: CNY 84 billion Yuan, or 1% of the total income.²

The 12th Five-Year Plan marks a turning point that will greatly affect the construction sector. Restructuring the economy through industrial upgrading, reducing the urban-rural divide, promoting the development of Western China and a focus on energy efficiency and environmental protection will move the sector towards better quality and sustainability. China has now also identified seven “Strategic Emerging Industries” (SIE), which are earmarked for government and legislative support in the next decade:

- Energy-saving and environmental protection
- Next generation information technology
- Bio-technology
- High-end / advanced equipment manufacturing
- New energy
- New materials
- New energy vehicles

All related enterprises in the construction sector, including contractors, architectural offices, real estate developers, manufacturers and the distributors of building products, will be impacted by these SEIs.

The expansion of China’s cities will bring about challenges, such as securing sufficient public funding for the provision of urban infrastructure and social services, dealing with scarcity of land, scarcity of energy, water and minimising environmental problems, placing huge strain on China’s social fabric.

At the EU Strategic Dialogue with China’s State Councilor Dai Bingguo, High Representative of the Union for Foreign Affairs and Security Policy Catherine Ashton said: “The European Union is also determined to start real cooperation projects on issues, such as sustainable urbanisation. Together with China, it wants to be able to achieve the goals set out in the Shanghai Expo’s “Better City, Better Life” project. Europe has very advanced sustainable urban development models and stable development in China is of great interest to the Working Group.

The Working Group appreciates the openness of the Chinese Authorities and hopes to continue and strengthen its contributions to China’s sustainable development. It, therefore, looks forward to engaging with the Chinese government on issues of interest in 2011 and beyond.

Key Recommendations

1. Promote Sustainable Development

Concern

The housing, transportation, sanitation and social services required to meet the needs of the approximately 350 million people moving to cities in the next 20 years will severely increase the demand for raw materials, such as steel and cement, representing a huge challenge to China’s ability to exploit natural resources sustainably. Within this context, China’s ability to meet its praiseworthy energy performance targets is at risk, unless supported by an environment that aligns all stakeholders’ interests towards rapidly improving the energy efficiency of its building stock.

Assessment

Governments around the world are giving increasing attention to the construction of eco-cities, often defined as a city that provides an acceptable standard of living for its human occupants without depleting the ecosystems and biochemical cycles, on which it depends. Creating sustainable communities and low-carbon cities will be a long-lasting challenge globally. With its massive future urbanisation plans, China has a unique opportunity to construct eco-cities on a major scale. The unthinkable alternative being to become locked into inefficient and ultimately expensive systems for many years to come.

The Working Group welcomes China’s ambitious plans to move its economy to more sustainable footing, as evidenced most recently by the target set in the 12th Five-Year Plan to cut energy use per unit of GDP by 16%. As 40% of China’s overall energy consumption arises from the construction and operation of buildings³, achieving a marked improvement in the energy performance of China’s building stock will be crucial to the success of these plans.


² State Publication of National Economy and Social Development 2010, February 2011
China’s environmental policies and standards are increasingly similar to or better than those found elsewhere in the industrialised world. However, legislation alone is rarely enough to affect mindsets and drive change, and many of China’s new buildings are still being designed and built to sub-optimal energy performance standards. Furthermore, there is ample scope for improving the energy performance of China’s existing buildings that is not being adequately addressed.

For China to achieve a low-carbon economy, it is vital that it addresses sustainable design and construction to develop eco-cities that have resource-efficient buildings and ecologically-friendly water, power and transport systems. Their inhabitants must also be able to live sustainably.

Achieving such paradigm shift in development will require clear leadership to generate the necessary philosophical discussion, rethinking of the citizen’s place in society, institutional reform, new principles for city planning and technological advancement in building and city design, urban infrastructure, city management, smart energy grids, to name a few.

Specifically, China’s government will need to play a leadership role in three areas. Firstly, it should raise awareness of the urbanisation problem and accelerate the production of solutions. Secondly, it should support research and education in this field, creating platforms of information exchange and facilitating the private sector to take part in developing ideas and solutions. Thirdly, it should strengthen the capacity of government institutions for the construction of eco-cities through improved procedures, standards and policies.

In this context, greater attention is required both to the proper enforcement of standards and to encourage investment in improved energy performance. China needs to develop a comprehensive regulatory environment that not only sets appropriate performance standards, but also includes:

- Robust, independent procedures for verifying and then monitoring actual energy performance of new, old and retrofitted buildings and providing means of rigorously enforcing mandated energy performance standards. For example, Europe’s 2002 ‘Energy Performance of Buildings Directive’ (EPBD) requires that independent energy experts must issue an energy performance certificate after a building is constructed. The certificate includes reference values (e.g. current legal standards and benchmarks) and recommendations for additional energy efficiency gains. Such certificates give government regulators significant power, because, if a building fails to comply with regulations, the use of the building can be denied until an adequate efficiency level has been obtained. The certificates also make it possible to compare the energy performance of buildings.
- Incentives, for example ... in the form of credits or fiscal rebates, that encourage building owners and developers to invest in raising the energy performance of their buildings above the mandated minimum standards. In this regard, China should work with the international community with the aim of including building energy performance in the Low Carbon Development Mechanism.
- Streamlined approval procedures that encourage the uptake by building owners, developers and designers of new building materials and systems that offer enhanced energy performance.
- Support for research and development as well as capacity building (or training) on new energy performance enhancing building materials and systems that encourage collaboration between the Chinese and European construction sectors.

To achieve maximum benefit, these measures should be designed to foster improved energy performance throughout the building life-cycle, starting from a building’s initial planning and design and finishing with its eventual decommissioning and reuse.

Recommendation

- Promote eco-cities as China’s new model for sustainable urbanisation by:
  - Building research and education platforms
  - Facilitating the participation of the private sector
  - Strengthening the capacity of government institutions to produce appropriate standards, procedures and policies
- Accelerate the establishment of an effective regulatory framework and policy environment aimed at minimising energy consumption by buildings that covers the complete building life-cycle:
  - Planning and Design
  - Construction
  - Operation, Maintenance and Refurbishment
  - De commissioning and Re use
2. Improve Market Access for Foreign Construction Service Providers

Concern
Many regulations present several barriers to effective participation by foreign companies in China’s market for construction services resulting in China foregoing the benefits.

Assessment
European construction service providers (architects, engineers, project managers, contractors and subcontractors) possess leading-edge expertise and technology. They are eager to deploy their wealth of experience in China, from which the country could derive considerable benefits in terms of design and construction best practice and knowledge transfer.

1. Design & Engineering
The “Regulations on Administration of Foreign-Invested Construction and Engineering Design Enterprises” (Decree 114) provide for the establishment of a foreign-invested qualified design company in China, but impose requirements and limitations that are unduly restrictive in three important ways.

- First, international design companies commonly operate as large groups, using their worldwide resources to bid for and undertake projects. However, group experience overseas (global track records) is currently not recognised as relevant to an application by a Foreign Invested Enterprise (FIE) for a design qualification in accordance with Decree 114.

- Second, when making an initial application for a design qualification, FIEs applications are limited to Grade B qualification or lower even if they satisfy all relevant requirements for a Grade A qualification. Easing the qualification process to allow FIE’s to submit for Grade ‘A’ qualifications and recognising the global track records of the FIE’s parent as well the single professional one, when assessing its qualification, would foster competition in design quality, and help usher technology transfer to China.

Alternatively, a foreign company may establish a design presence in China by acquiring a domestic design company. After such an acquisition, Decree 114 mandates that the acquired company’s qualification license(s) must be “re-determined”, but the criteria to be applied in this process are unclear. This lack of clarity significantly discourages overseas design companies considering entering China’s market via an acquisition.

Design companies working in a consortium may only undertake projects within the permitted work scope of the lowest-level design license held by any member of the consortium. This bars design companies holding a lower grade design license from contributing to projects requiring a higher grade of license, even in a consortium with companies that hold a license of the required grade. It effectively prevents Chinese design companies from benefiting by partnering with foreign companies that have specialist expertise relevant to a particular project.

2. Project Management
Regulations allow FIE’s to register as a “construction consultancy” to deliver project management services. However, the regulations lack clarity and unnecessarily restrict the work due to the following concerns:

- The provisions within Joint Decree 155 pertaining to Foreign-Invested Construction Services Enterprises (FICSEs) remain unclear, providing neither an explanation of required qualifications nor the performance criteria, against which an FICSE application will be evaluated.

- Similarly, the relationship between Joint Decree 155 and Circular 200 is unclear. Joint Decree 155 could be construed as complementary to Circular 200, but this is not clearly stated and requires clarification.

- Further clarification is needed on the potential overlap between Circular 200 and “Measures for Recognising the Qualifications of Engineering Consulting Entities” (Decree 29) with regard to qualification requirements for firms performing engineering consulting services in China.

- Finally, clarification is requested regarding access by FIE’s to sectors, which previously have not been open to foreign PM’s, such as healthcare, aged care & education.

3. Contractors & Sub-Contractors
Regulations specify a minimum registered capital requirement to ensure contractors do not undertake work beyond their financial capability and to provide for a means of redress in the event that problems arise. While the requirement is sensible, an alternative approach is to use financial instruments to underwrite the risk. Financial instruments, such as bank guarantees and insurance bonds, provide direct recourse to third parties, such as
banks and insurance companies, in the event of a default by the contractor. In addition, the financial strength of parent companies or affiliates could also provide further comfort regarding a contractor’s financial capability.

Moreover, under “Regulations on Administration of Foreign–Invested Construction Enterprises” (Decree 113), wholly foreign-owned construction companies (WFCC) are currently limited to undertake projects either financed entirely or partially, by international institutions or Sino-foreign projects, where the foreign investment is greater than 50% or domestic construction projects, which cannot be undertaken by a domestic enterprise for technical reasons. This limitation prevents the introduction of world-class construction technology and know-how by a WFCC into the Chinese construction market.

Furthermore, Article 27 of the People’s Republic of China Construction Law provides that, where two or more companies with different qualification grades undertake construction projects as a consortium, the scope of projects shall be determined by the lowest grade qualification of the companies. This is not in line with international practice and impedes China from benefiting from the best know-how and technology and discourages collaboration between Chinese and foreign construction companies.


Recommendation

- Amend relevant regulations to improve market access for foreign construction service providers (project managers, architects, engineers, contractors and sub-contractors), thereby facilitating the deployment and transfer of their advanced knowledge and expertise to China:
  - Allow FIEs to apply for all levels of project management and design qualification, including Grade A, and recognise the track records of an FIE’s parent and affiliates as well the single professional one when assessing its qualification
  - Allow wholly foreign-owned construction companies (WFCC) to undertake all kinds of construction projects, thereby treating them equally to local contractors in fair competition
  - Allow companies working in a consortium to undertake work permitted by the highest qualification achieved by any member of the consortium, thereby facilitating the ability of foreign companies to partner with local companies
  - Introduce a simple and clear procedure for reassessing a local design company’s qualifications, upon its acquisition by a foreign company
  - Clarify the relationship between Joint Decree 155 and Circular 200 with respect to the provision of project management services
  - Further clarify and implement the Engineering Procurement Construction (EPC) contracting rule

3. Encourage Use of Advanced Construction Materials and Equipment

Concern

Currently, only very few construction projects in China use advanced construction materials that increase energy conservation and reduce carbon footprint. Furthermore, less advanced building materials result in shorter lifespan of buildings and increase safety risks, such as fires.

Assessment

In order to meet the country’s energy saving targets, China needs to commit to sustainable construction. This is a huge challenge, considering that China will construct some 40 billion square meters of new floor space by 2030, an equivalent of adding more than one Chicago per year. The use of advance materials, equipment, technologies and processes is, thereby, a key concern.

Recommendation

- Put in place measures to support the use of advanced construction materials and equipment, thereby achieving a step change in building performance, such as:
  - Clearly defined systems and methods for independently verifying compliance of (i) manufacturing processes with environmental regulations and (ii) services/products with technical specifications
  - A verification system for energy performance of buildings that includes (i) consistent calculation methods for the design phase, (ii) standardised testing of building components, (iii) quality control procedures

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during the planning and construction phases and (iv) confirmation of actual performance during operation.

- More support for international exchange of technologies, experience and capacity-building on energy-efficient technologies
- Financial support, for example reduced import tax tariffs and, tax subsidies, for construction accessories and materials that are highly energy-efficient and/or manufactured with verifiable environmentally-friendly processes. Issue policies to encourage property developers and contractors to use such techniques and materials.

4. Encourage Foreign Investment in Real Estate

Concern
Real estate developments with high foreign investment are impeded by a complicated and lengthy verification process. This hinders the adoption of advanced financing solutions and cutting-edge technology that benefit both energy efficiency and sustainability.

Assessment
FIEs in real estate are restricted to purchasing properties that are not for their own use. Also, specific taxes and rules apply for FIEs to obtain financing. The current restrictions imposed upon foreign real estate investors have not slowed down the surge in prices, as foreign investors only account for a small proportion of overall real estate investment. However, these restrictions have served to block the inflow of advanced financial solutions and high-quality projects with cutting-edge environmental technology entering China.

Recommendation
- Amend relevant regulations and policies to facilitate foreign investment in real estate development, thereby allowing China to benefit more widely from the skills and expertise that international investors/developers can bring to bear in designing, building and operating world class properties:
  - Simplify the investment approval process as it relates to foreign investors, including the delegation of greater approval power to local government
  - Amend current circulars that restrict foreign investment in real estate to encourage more investment, particularly by adding more real estate sub-sectors into permitted categories
  - Simplify and relax the procedures for the joint venture establishment between foreign companies and domestic private or state-owned real estate enterprises.
- Support sustainable and environmentally-friendly real estate projects, as encouraged in the latest Circular 1542
- Encourage foreign investment in 2nd, 3rd and 4th tier cities by providing more local government support.

Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CHP</td>
<td>Combined Heating and Power</td>
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<tr>
<td>CCHP</td>
<td>Combined Cooling Heating and Power</td>
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<tr>
<td>EC</td>
<td>European Commission</td>
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<td>EPC</td>
<td>Engineering Procurement and Construction</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>FIE</td>
<td>Foreign Invested Enterprise</td>
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<td>FISCE</td>
<td>Foreign-Invested Construction Services Enterprise</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>JGJ</td>
<td>Construction Engineering Technology Code (Jianzhu Gongcheng Jishu)</td>
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<tr>
<td>MOC</td>
<td>(formerly) Ministry of Construction of China</td>
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<tr>
<td>MOHURD</td>
<td>Ministry of Housing and Urban-Rural Development</td>
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<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>SEI</td>
<td>Strategic Emerging Industry</td>
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<td>SME</td>
<td>Small and Medium-sized Enterprise</td>
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<td>WFCC</td>
<td>Wholly Foreign-Owned Construction Company</td>
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<td>WFOE</td>
<td>Wholly Foreign Owned Enterprise</td>
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<tr>
<td>WTO</td>
<td>World Trade Organisation</td>
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Key Recommendations

   - Ensure that foreign invested enterprises (FIEs) have equal access to the China Communications Standards Association (CCSA), specifically full and equal membership in all technical committees (TCs).
   - Channel Chinese innovation into international standardisation initiatives and bodies, following China’s successful contribution to the global harmonisation of International Mobile Telecommunication-Advanced (IMT-Advanced) systems/technologies in the International Telecommunication Union (ITU).
   - Provide certification requirements in writing, well in advance of the implementation date, and provide notification under the World Trade Organisation’s (WTO) Technical Barriers to Trade (TBT) Agreement for any standard that is applicable to mandatory certification and market access.
   - Eliminate WLAN Authentication and Privacy Infrastructure (WAPI) as a mandatory certification.

2. Enhance Access for Foreign Companies to the ICT Services Market
   - Remove the restrictions that limit the choice of Chinese telecom operator partners and encourage opportunities for new operators in the market.
   - Encourage telecom operators to further open their capital to strategic investment.
   - Streamline the Value Added Services (VAS) licence application approval process by allowing for the provision of multiple VAS with one single VAS licence.
   - Eliminate ownership restrictions on VAS providers.
   - Allow foreign companies to participate in opportunities presented by convergence through equitable treatment of equipment, software and content/interactive service providers and institutional investors.

3. Enhance Cooperation in ICT Research Programs
   - China should allow FIEs in China to participate in Chinese government-funded ICT Research and Development (R&D) projects.

Introduction to the Working Group

Created in 2001, the Information & Communication Technology (ICT) Working Group consists of major European telecommunication vendors, service providers, digital content providers, consulting firms and law firms that meet on a regular basis to assess China’s reforms in the ICT industry. The group also serves as a platform for information exchange on ICT industry developments, including issues related to media (including digital media) and telecom-media convergence.

European ICT companies are among the largest investors in China today and aid in China’s development by transferring technology, creating jobs, contributing know-how, and training a new generation of Chinese engineers in the ICT field. In addition, a large percentage of these European companies have significant local Research and Development (R&D) units with well-established links to Chinese universities, as well as research institutes that contribute significantly to the development of the ICT sector in China. The Working Group’s activities are intended to contribute to the consultation and dialogue process with all government agencies responsible for the ICT sector. Increased dialogue between Chinese decision-makers and the European ICT industry will help create better mutual understanding and inform the policy and regulatory initiatives that are necessary to ensure that the ICT sector in China continues to grow and develop in a way that is sustainable and beneficial for consumers and industry alike.
Recent Developments

The ICT Working Group is pleased to see that, despite international economic woes, the Chinese ICT sector experienced robust growth in 2010, including a 6.4% increase in basic telecom service revenue and a 15.7% increase in mobile value-added services revenue. The wide-scale application of 3G technologies has been smooth, with a total of 47.05 million 3G subscribers by the end of 2010.1 It is estimated that 30% to 40% of total mobile revenues for all three Chinese telecoms operators are now derived from value-added services (VAS).2

The Working Group welcomes China’s increasing participation and contribution to ICT-related international standardisation initiatives in recent years. In particular, the Working Group notes China’s valuable contribution to the global harmonisation of International Mobile Telecommunications - Advanced (IMT-Advanced)3 systems/technologies in the International Telecommunication Union (ITU).4 The China Communications Standards Association (CCSA) has supported the Third Generation Partnership Project (3GPP)5 in the submission of IMT-Advanced technologies. Time Division Long Term Evolution (TD-LTE) and its evolution has been a key element coming from the Chinese angle and is now a fully harmonised component of the IMT-Advanced approved proposal in ITU. The Working group also welcomes China’s active involvement in 3GPP LTE security-related work and the submission of the ZUC encryption algorithm for evaluation and standardisation in 3GPP. Finally, the Working Group notes the active contribution of Chinese companies to European standardisation work at the European Telecommunications Standards Institute (ETSI) and encourages further participation going forward.

Whilst the Working Group notes improved access to Chinese ICT standardisation technical committees (TCs) for foreign-invested enterprises (FIEs) in recent years, full participation of wholly foreign owned enterprises (WFOE) is still not possible. Furthermore, network and information security related standardisation work in China remains closed to any type of foreign participation. In relation to this, the Working Group has growing concerns over the amalgamation of China’s national security interests with commercial security interests and forcing 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. See the Information Security section of this paper where this issue is covered in more detail.

In terms of the mandatory certification/type-approval schemes for ICT equipment in China, the past year has also seen several improvements. Firstly, the Working Group welcomes a notable improvement in notification periods provided to the ICT industry for compliance to China-specific mandatory requirements. The Working Group also welcomes the decision of the National Development and Reform Commission (NDRC) to reduce Network Access Licence (NAL) and China Compulsory Certification (CCC) fees by 25% for mobile phones as of June 2011.6

Despite this, China’s mandatory certification requirements still substantially deviate from international norms and remain a key concern for industry as they increase costs and time to market of products, which ultimately result in restricted choice for consumers in China as well as higher prices.

Despite market strength and some receptiveness from regulators, the market remains highly regulated and closed to foreign companies in several parts of ICT. The already closed telecom services market has seen further tightening of restrictions and opaque regulations of value-added services. Furthermore, as a result of the complexities of telecom-media convergence, parallel government agencies beyond the Ministry of Industry and Information Technology (MIIT), such as the State Administration of Radio, Film, and Television (SARFT), continue to play an active role in regulating the sector, therefore making the market even more difficult for foreign companies to enter. The Chinese government in May 2011 announced the establishment of the State Internet Information Office to

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2. Member company research data June 2011, European Chamber
3. IMT-Advanced is a concept from the ITU for mobile communication systems with capabilities which go further than that of IMT-2000. Such systems provide access to a wide range of telecommunications services including advanced mobile services, supported by mobile and fixed networks, which are increasingly packet-based. For further details on IMT-Advanced refer to website:http://www.itu.int/ITU-R/index.asp?category=information&file=imt-advanced&lang=en
4. ITU is the United Nations specialized agency for information and communication technologies. It works to coordinate the efforts of government and industry and private sector in the development of a global broadband multimedia international mobile telecommunication system, known as IMT. For further details on ITU refer to website: http://www.itu.int/en
5. For further details on 3GPP refer to http://www.3gpp.org/
coordinate and supervise online content management in China. The Working Group hopes that this will contribute to better clarity over regulations in this field and result in opportunities for European companies.

Key Recommendations


Concern
There are several distinct concerns in the area of standards, intellectual property, and certification, including:

- Lack of access to, and equal membership in certain Chinese standardisation bodies in the telecommunication sector, such as Technical Committee 8 (TC8) of the CCSA.
- China’s deviation from international standards in the ICT sector fragments the global market, which adds costs for Chinese consumers and industry.
- Inclusion of voluntary standards within mandatory certification schemes, creating a difficult and opaque regulatory environment and risking circumvention of the World Trade Organisation’s (WTO) Technical Barriers to Trade (TBT) notification requirements.

Assessment

a) Provide Equal Access and Membership Rights to Foreign Companies in Both National and Industrial Standardisation Organisations

The Working Group welcomes the statements of China’s senior leaders ensuring foreign companies that they will be treated the same as domestic companies in China. In line with this, the Standardisation Administration of China (SAC) issued a new policy whereby representatives of entities legally registered within China may participate as voting “P” members in Chinese national TCs (at the discretion of the TC Chair). In practice, however, this policy has not been implemented in any TC nor in most Working Groups in the ICT sector.

The CCSA does not admit as full members WFOEs legally registered in China. WFOEs are admitted only as observers that have no voting rights. Furthermore, TC8:

b) Alignment of Chinese and International Standards

China’s “Indigenous Innovation” scheme and related policies have been carried out to support home-grown technologies that depend on domestic standardisation efforts, rather than success in the global marketplace e.g. WLAN Authentication and Privacy Infrastructure (WAPI) and Ultra High Throughput (UHT) in the ICT sector. These measures have brought substantial negative impacts for the development of standardised international solutions. This has also increased costs for both foreign and Chinese companies, in turn increasing what Chinese consumers pay to use the products/services.

Another trend in Chinese standardisation of persistent concern to European industry in the ICT sector relates to the overly-detailed standardisation of mobile communication devices. Mobile phones, for example, are affected by detailed standards on battery size, Universal Data Exchange (UDX) data exchange format, and some multi Subscriber-Identity Module (SIM) standards. Such implementation-specific standards create unnecessary burdens for all ICT vendors, including domestic Chinese manufacturers, by requiring them to develop two sets of products: one for the China market and one for the international market.

Despite this, the Working Group acknowledges China’s increased contribution to the ICT international standardisation bodies in recent years, as described in the ‘Recent Developments’ section, and encourages China’s further participation in the international standardisation landscape.

Please also see the Standards & Conformity Assessment and Information Security sections of this paper where these issues are also discussed.

c) Certification

When it joined the WTO, China made the commitment to create and implement internationally aligned certification...
procedures, including the creation of identical certification schemes for domestically and foreign-manufactured products. However, current certification procedures for many mobile communications devices include three independent mandatory certifications: Radio Type Approval (RTA), Network Access Licence (NAL), and China Compulsory Certification (CCC) that measure compatibility and compliance to a selected portfolio of standards developed by standards development organisations (SDOs). This very costly process is a significant drain on company resources and has negative consequences for consumers by delaying time to market and limiting product choice. The Working Group acknowledges the decision of NDRC to reduce NAL and CCC fees by 25% for mobile phones as of June 2011, and encourages further price reductions and streamlining of the certification process going forward.

The selection of standards for inclusion in testing is not transparent: finished certification requirements for these three certificates are not provided with sufficient detail in writing. Of the utmost concern to industry is the practice of (1) including voluntary, non WTO TBT notified standards in mandatory certification requirements, (2) checking for blacklisted technologies and configurations without a transparent process, and (3) failing to file WTO TBT notifications on changes in the certification criteria (see Figure 1). Examples of these include the industry standard that attempts to create a unified charger interface for telecom terminals (YD/T 1591-2006) and restrictions on the use of WiFi or mobile TV hardware.

Providing clear, written requirements well in advance of the implementation date and notifying WTO TBT 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 Standards & Conformity Assessment section of this paper where this issue is discussed.

Figure 1: Issues with Mobile Phone Standardisation and Certification in China

- Standardisation of product features (e.g. batteries)
- Non equal access to standard drafting working groups for FIEs and MNCs
- Standard drafting WGs are typically not legal entities with clear rules of membership
- Missing or not implemented internationally compatible and transparent IPR policies
- Inclusion of voluntary standards into mandatory Type Approval criteria without transparent processes or WTO TBT declarations
- Checklists for prohibited technologies and forbidden configurations without transparent processes or WTO TBT declarations
- Missing or unclear documentation of criteria
- Unclear, or missing documentation, overlapping and inconsistent testing
- Lack of alternative accredited test houses and under-utilisation of manufacturer conformity self declarations
- Requirement of blue sticker to prove authenticity of device adds cost & time (1 week) to an already long certification process
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Source: European Chamber ICT Working Group
Case Study: Using Certification to Arbitrarily Block Certain Technologies from the Chinese Market

Case 1: WLAN Authentication and Privacy Infrastructure (WAPI)

Without any notification to the WTO TBT, W-LAN capable phones have been denied type approval and, hence, legal market access in China for years. On 15th April 2009, MIIT announced that it would start allowing type approval for WiFi-enabled phones, provided they are equipped with the WAPI encryption standard. This is a clear case of certification criteria being used to selectively control the products and technologies entering the Chinese market.


Since 1st May 2010, the testing and certification of 13 types of information security products has been included under the CCC scheme (CC-IS) as a mandatory pre-condition for government procurement. Of the 13 products, the standards used for certification in all but one case deviate from international standards. Furthermore, 6 of the 13 products require the ‘Commercial Encryption Testing Certificate’ from the Office of the State Commercial Cypher Administration (OSCCA) as a precondition for CC-IS certification. As such, it may be impossible for FIEs to obtain CC-IS certification for these 6 products because OSCCA does not publish the requirements to obtain the Commercial Encryption Testing Certificate and so far has not certified any product from any FIE in these product groups. In the unlikely case that FIEs can go forward with the certification process, OSCCA also requires that the encryption-relevant parts of the source code be disclosed to OSCCA.

A lack of clarity in the wording of the “Notice on the Implementation of Government Procurement of Information Security Products (MOF 2010/#48)”, released by the Ministry of Finance in May 2010, also raises concern regarding the ambiguity in the scope of implementation of CC-IS for government procurement e.g. whether state owned enterprises (SOEs) can ‘voluntarily’ require a CC-IS certificate from its suppliers, de facto excluding foreign-invested Chinese companies from participating in SOE-funded projects.

Please also see the Information Security section of this paper where these issues are also discussed in more detail.

Recommendation

- Ensure that FIEs have equal access to CCSA, specifically full and equal membership in all TCs.
- Channel Chinese innovation into international standardisation initiatives and bodies, following China’s successful contribution to the global harmonisation of IMT-Advanced systems/technologies in ITU.
- Provide certification requirements in writing, 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.
- Eliminate WAPI as a mandatory certification.

2. Enhance Access for Foreign Companies to the ICT Services Market

Concern

European companies have a long history in China’s ICT market, yet European access to participate in China’s ICT services market lags dramatically behind participation in China’s ICT infrastructure and devices 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 and devices to China, creating a significant source of employment in design and R&D, they have been by and large excluded from the opportunity in ICT services.

As China’s market continues to develop, ICT revenues will increasingly be derived from the supply of services, applications and content. The convergence of telecoms, consumer electronics and media industries is transforming the ICT industry and driving a shift in value away from basic connectivity towards more rich forms of services, content and entertainment. These are areas where European companies are well positioned to offer value to China as it seeks, as stated in the 12th Five Year Plan, to transform culture into a ‘pillar industry’ by 2016.9

a) Basic Services

While offshore structures do exist to facilitate investments in the share capital of holding companies for China’s state-run telecom operators, as we approach the 10th anniversary of China’s accession to the WTO, significant

9 2011 China’s 12th Five Year Plan
hurdles remain for any European companies seeking an active role in the management or share capital of onshore service providers.

According to current regulations, only existing Chinese licence-holders are able to team up with a foreign operator and enable their proposed Joint Venture (JV) to provide mobile or basic services in China. This limits the potential partners to the three incumbents, and these parties remain reluctant to open up their networks to foreign partners. As long as no new licences are awarded and the restrictions on Chinese partners remain, it is unlikely that any JV in basic telecom services with a foreign partner will be established.

b) Value Added Services (VAS)

Similarly, there has been little or no tangible progress in opening China’s telecom value-added services (VAS) market. Applying for a VAS licence is a long and unnecessarily arduous process (see Figure 2) and obtaining licences has been problematic. In addition, the following issues are of key concern to European ICT service providers:

Figure 2: Typical Procedures for VAS JV Application in China

- Approval to establish a VAS JV from MIIT (two months in theory);
- Approval to establish a foreign invested telecom VAS JV by MOFCOM;
- Sectoral service approval from the MIIT (four months in theory);
- Business licence approval from SAIC.

<table>
<thead>
<tr>
<th>Application Process Summary</th>
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<tr>
<td>MIIT JV Approval</td>
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<td>MOFCOM JV Approval</td>
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<td>MIIT Service Licence Approval</td>
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<td>Business Licence Approval from SAIC</td>
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<th>MOFCOM Approval Process</th>
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<tr>
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<td>Company Name Reservation with AIC</td>
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<tr>
<td>Submission of Documents to Local MOFCOM</td>
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<td>Application Issues</td>
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<td>Notify Applicant</td>
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<tr>
<td>Approval Issued by MOFCOM</td>
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<td>Local MOFCOM Notification</td>
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<td>MOFCOM Issues Licence</td>
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<th>MIIT Approval Process</th>
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<td>Document Preparation</td>
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<td>Submission of Documents to CATR of MIIT</td>
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<td>Application Issues</td>
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<tr>
<td>Notify Applicant</td>
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<tr>
<td>Approval Issued by MIIT</td>
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</tbody>
</table>

Source: APCO Worldwide
Interpretation of permitted services: Authorities only permit FIEs to provide services listed in the VAS Catalogue that China agreed to within the WTO, rather than on the VAS classification list used by domestic companies. This is an additional cause for concern as it reduces market access options.

Ownership restrictions: Current ownership restrictions permit only 50% equity participation for foreign investors, and require the use of the equity joint venture (EJV) structure. Additionally, a Chinese ID holder is required to set-up the legal person of a VAS JV. Given the very large number of VAS providers in China, and the extent of domestic private sector participation, the rationale for maintaining these ownership restrictions is not clear. These ownership restrictions are a deterrent to foreign strategic investment in the sector as international firms with global operations would prefer to have full operational control of the businesses they run.

c) Benefits of Improved Collaboration in Services

Easier collaboration in services ventures would benefit both Chinese and international players in three key areas:

Consumer Services Market

China is pursuing an ambitious policy of three-network convergence to integrate its voice, data and cable-TV networks. European service, software and content providers have extensive experience in providing a wide range of consumer offerings ranging from triple-play to quad-play providers to digital terrestrial and satellite broadcasters to a wide range of smaller but fast growing creative firms with experience in delivering attractive content across multiple platforms.

Enabling meaningful forms of partnerships in China for these firms would benefit Chinese consumers and further the international ambitions of China-based content and applications providers.

Corporate Services Market

Multi-national companies (MNCs) including fast-growing China-based companies offer major opportunities for ICT service providers. Increasingly the tenders to serve these MNCs are conducted on a global basis. Enabling further European investment into China’s ICT services market through onshore partnerships with Chinese telecom operators will allow for a more seamless offer to MNC customers as well as facilitate the international expansion of Chinese telecom operators as they develop partnerships with their peers overseas.

Procurement of Equipment and Devices

The procurement by telecom operators of ICT infrastructure and devices is increasingly conducted through international tenders. Enabling deeper partnerships between Chinese telecom operators and their international counterparts will allow for greater economies of scale for telecom operators in their procurement activities. In addition, for China-based providers of telecom equipment and devices, the ability to participate in global tenders, which includes China as well as international markets, could serve to lessen anti-dumping activity, which is hindering the further growth of China-based providers in some markets.

Recommendation

- Remove the restrictions limiting the choice of Chinese telecom operator partners and encourage opportunities for new operators in the market.
- Encourage telecom operators to further open their capital to strategic investment.
- Streamline the VAS licence application approval process by allowing for the provision of multiple VAS with one single VAS licence.
- Eliminate ownership restrictions on VAS providers.
- Allow foreign companies to participate in opportunities presented by convergence through equitable treatment of equipment, software and content/interactive service providers and institutional investors.

3. Enhance Cooperation in ICT Research Programs

Concern

The current status of the research cooperation between the European Union (EU) and China is less than optimum and restricts the exploration on great opportunities that would benefit both sides. The Working Group encourages the strengthening of ICT R&D cooperation and more active participation in programs from both sides.

Assessment

The positive outcomes of improved EU-China collaboration in standardisation shows the need to expand this model to ICT research, as the cross-fertilisation of research ideas between the two sides could add significant value to research programs. Chinese companies enjoy opportunities to participate in EU research programs.
benefiting both China and the EU. European companies would welcome similar access to research programs in China.

Additionally, the R&D bases that many European-invested ICT companies have built up in China play a significant part in their global R&D activities. These companies are long-standing industry leaders and innovators that are committed to the local market and have become increasingly active in driving the development of Chinese-initiated activities in global standardisation forums. As such, they are equally dedicated to the growth of R&D initiatives in China as domestic enterprises. Moreover, in recent years, many European companies in China have made a significant contribution to China’s Intellectual Property Rights (IPR) development through filing an increasing number of patent applications with the State Intellectual Property Office (SIPO), in the name of local affiliate companies as the patent applicant. Furthermore, patent licensing and cross-licensing schemes are a recognised means of accelerating the development of licensee know-how. The contribution of European companies in IPR, both in terms of licensing and patent filings, supports the government’s goal of increasing innovation in China.

Thus, it is the hope of the Working Group that the Chinese government encourages European companies to participate in government-funded ICT R&D projects, so that European companies can contribute more technical expertise to the development of China’s innovation.

Recommendation

- China should allow FIEs in China to participate in Chinese government-funded ICT R&D projects.

Abbreviations

3G 3rd Generation of mobile telephone standards and technology
3GPP Third Generation Partnership Project
CCC China Compulsory Certification
CC-IS China Compulsory Certification for Information Technology Security Products
CCSA China Communications Standards Association
EJV Equity Joint Venture
ETSI European Telecommunications Standards Institute
EU European Union
FIE Foreign Invested Enterprise
ICT Information and Communication Technology
IMT-Advanced International Mobile Telecommunications Advanced
IPR Intellectual Property Rights
ITU International Telecommunication Union
MIIT Ministry of Industry and Information Technology
MLPS Multi-Level Protection Scheme
MNC Multinational Company
NAL Network Access License
NDRC National Development and Reform Commission
OSCCA Office of the State Commercial Cypher Administration
R&D Research and Development
RTA Radio Type Approval
SAC Standardisation Administration of China
SDO Standards Development Organisation
SIM Subscriber-Identity Module
SIPO State Intellectual Property Office
SOE State Owned Enterprise
TBT Technical Barriers to Trade
TC Technical Committee
TD-LTE Time Division Long Term Evolution
UDX Universal Data Exchange
UHT Ultra High Throughput
VAS Value Added Services
WAPI WLAN Authentication and Privacy Infrastructure
WFOE Wholly Foreign Owned Enterprise
WTO World Trade Organisation
Key Recommendations

1. Commercial Encryption Regulations
   - Publish all rules and regulations regarding application, certification and testing for the Commercial Encryption Regulations, including scope of products covered.
   - Ask that OSCCA communicate in writing with FIEs regarding certificate application requirements and grounds for non-acceptance of applications.
   - Accelerate the development of China’s information security market and domestic industry by removing non-tariff barriers to the market, e.g. market access consequences of OSCCA licensing and certification requirements for foreign-invested enterprises.
   - Involve industry - including FIEs - in the process of revising the Commercial Encryption Regulations.
   - Apply the internationally proven transparent approach to standardisation and certification of encryption products in order to increase the robustness, competitiveness and inter-operability of Chinese solutions.
   - Encourage China to become an active member in relevant international organisations.
   - Seek further clarification of the following aspects of OSCCA Bulletin #18:
     - Rationale;
     - Plans for evolution of scope;
     - Application of “core function” test to products included in the annex “Catalogue of encryption products and equipment with encryption technology subject to import administration”.

2. China Compulsory Certification for Information Technology Security Products
   - Publish all necessary standards, test standards and testing specifications necessary for companies to apply for the CC-IS.
   - Publish through OSCCA the exact testing specification and requirements necessary for successful application of the “Commercial Encryption Testing Certificate”.
   - Discourage state-owned enterprises from unilaterally requiring CC-IS in their tenders.
   - Eliminate duplication of evaluations by joining the Common Criteria Recognition Agreement (CCRA) which sets internationally accepted standards for the evaluation and certification of IT products.
   - Recognise CC-IS certification by commercially independent testing laboratories
   - Enter into a dialogue with foreign industry and authorities to clarify and refine CC-IS certification requirements.
   - Clearly define the border line between National Security and Commercial Security in a new clear and transparent policy which is in line with international best practices.

3. Multi-Level Protection Scheme (MLPS)
   - Remove discriminatory procurement restrictions contained in Article 21 of the Administrative Measures (2007).
   - Clarify the requirements to be met in order to obtain the OSCCA approval necessary for MPS Sales certification of encryption products.
   - Enter into a dialogue with foreign industry and authorities to clarify and refine MLPS regulations and application procedures.
Introduction to the Working Group

Over the past 20 years European companies have played a pioneering and determining role in bringing semiconductor and smart card technology to the Chinese market. Many European companies in the smart card industry have invested substantially in China: in Research & Development (R&D) facilities, training and employing Chinese engineers, in state-of-the-art production facilities, in advanced sales and service networks, and in management know-how. European-invested Chinese companies in the semiconductor and smart card industries have been successful in China because they blend the high service level expectations of the Chinese customers with excellent technology at a competitive price. Chinese banks, telecom operators, public transportation companies and their clients are the principal beneficiaries of European smart card and semiconductor industries’ heavy investment in the China market.

The Information Security Industry 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 in the face of an ever increasing inhospitable regulatory environment which risks severely curtailing their business activities and future investments. The Group aims to provide a platform for European Information Security companies active in China to exchange information and engage in constructive dialogue with Chinese authorities to seek ways of supporting China’s goal of bolstering information security policies without reducing the market’s development, competitiveness and openness.

The Chinese government approach to encryption regulation differs markedly from the international norm by handling encryption as a unified concept encompassing commercial and state security applications. This lack of division, in turn, leads to an overly burdensome and restrictive approach to the regulation of commercial encryption. Such lack of distinction between different levels and applications of encryption leads to it being handled as a priority by the Chinese leadership. 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 highest authority to manage encryption policy in China is the Director of the General Office of the Central Committee of the CPC.

The Office of the State Commercial Cypher Administration (OSCCA) is a subordinate organisation to SEMB/CCAA and is responsible for policy execution. As such, OSCCA is industry’s principle interlocutor on encryption matters.

Information security regulation in China is marked by heavy restrictions towards foreign market access on the grounds of appeals to national security, as well as a lack of clarity and transparency. The Information Security Working Group therefore strongly encourages relevant Chinese authorities to enter into a dialogue with both foreign industry and authorities in the spirit of openness and transparency as advocated by China’s 12th Five-Year Plan and in the spirit of the World Trade Organisation (WTO) Agreement.

Correspondingly, the Information Security Working Group urges European Commission authorities and the EU member countries governments to promote the establishment of this dialogue with relevant Chinese government authorities as a priority.

Recent Developments

Semiconductors have been the building blocks of the IT revolution. Today, they can be found in such varied applications as computing, electronics, mobile devices, e-Government, automobiles, lighting, radio frequency identification (RFID), secure payment and infrastructure.

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<tr>
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<td>TOTAL SENSORS &amp; ACTUATORS</td>
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<tr>
<td>TOTAL SEMICONDUCTOR</td>
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<td>57.395103</td>
</tr>
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1 World Semiconductor Trade Statistics
2 The original figure was given in US Dollars. The conversion rate used was based on the average exchange rate for 2010 from the China Foreign Exchange Trade System, http://www.chinamoney.com.cn/fe/Channel/17383
The Chinese market for semiconductors is highly internationalized, with the majority of units sold going towards the manufacture of goods for re-export and, increasingly, for the Chinese domestic market.

One particular semiconductor application is the smart card. In an increasingly information-based economy, smart cards are found in numerous and ever increasing applications—from financial services (bank and credit cards, e-banking) to transportation (fare cards) as well as in the industrial engineering sector, telecommunications (SIM cards), public utilities (electricity cards, gas cards, water cards) and government (ID cards, passports, social security cards). Key to a successful smart card system is that the contents of the card can be changed only within a well defined process. The method to implement the proper authorization and the protection of the contents of a smart card is by using encryption technology – this fact puts the smart card in the central focus of the working group as some encryption regulation issued by OSCCA have become market access barriers for European invested Chinese companies. According to the Working Group estimates, the Chinese smart card market was worth approximately EUR 1 billion in 2010.

**Regulatory Developments**

**The 12th Five-Year Plan:**

The drafting and subsequent release of China’s 12th Five Year Plan dominated China regulatory landscape in late 2010 and early 2011. Ratified and released at the occasion of the 4th session of the 11th National People’s Congress in March 2011, the Plan lays out the government’s economic and social policy blueprint for the coming five years. The Plan contains specific references to the need to promote the development of China’s semiconductor market and for the need to improve information security.

Chapter 13, Section 3 of the 12th Five Year Plan explicitly states the need to strengthen network and information security. The points laid out within section 3 mirror the recommendations made within this Information Security Working Group Position Paper. Most importantly, the 12th Five Year Plan calls for an improvement of “laws and regulations on network and information security, the system of standards, and the system of certification and authentication for information security.”

Recommendations to improve laws and regulations can be found in Key Recommendations 1 and 2 of this position paper which calls for the publication of all rules and regulations regarding application, certification and testing for the Commercial Encryption Regulations, including scope of products covered. Improvements to the laws and regulations and the development of China’s information security market and domestic industry can be achieved through removing non-tariff barriers to the market, e.g., market access consequences of OSCCA licensing and certification requirements for foreign-invested enterprises (FIEs) and through involving industry, including FIEs, in the process of revising the Commercial Encryption Regulations.

Improvements to the system of standards and the system of certification and authentication for information security can be achieved through applying internationally proven transparent approaches to standardisation and certification which would be benefited through China’s active membership in relevant international organisations, in particular through eliminating duplication of evaluations by joining the Common Criteria Recognition Agreement (CCRA) which sets internationally accepted standards for the evaluation and certification of IT products (see Key Recommendations 1 and 2).

The Plan calls for the implementation of information security protection rating. This is an important aspect of all national information security systems, and should not prevent the participation of foreign invested enterprises, nor bar foreign intellectual property rights (IPR) from constituting core technology or key components (see key recommendation 3).

Semiconductors are promoted as a Strategic Emerging Industry within the 12th Five Year Plan. One of the seven promoted strategic emerging industries is the new material industry, for which the plan calls to “promote the R&D and industrialization of carbon fibers, semiconductor materials, high temperature alloy materials, [and] superconductive materials…”.

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3 A smart card is a device that includes an embedded integrated circuit chip (ICC) that can be either a secure microcontroller or equivalent intelligence with internal memory or a memory chip alone. The card connects to a reader with direct physical contact or with a remote contactless radio frequency interface. With an embedded microcontroller, smart cards have the unique ability to store large amounts of data, carry out their own on-card functions (e.g., encryption and mutual authentication) and interact intelligently with a smart card reader. http://www.smartcardalliance.org/pages/smart-cards-intro-primer
The 12th Five-Year Plan therefore points to promising opportunities for the sector as a whole as it promises to further expand the growth of the semiconductor industry as it targets the expansion of China’s entire supply chain, from design to manufacturing. Indeed, six of the seven strategic emerging sectors depend on or include semiconductors, these are:

- Energy conservation and environmental protection industries
- New-generation IT industry
- High-end equipment manufacturing industry
- New energy industry (includes high-end semiconductors)
- New material industry
- Clean energy vehicles

The 12th Five-Year Plan emphasizes the key role which foreign investment will continue to play in China’s growth, these sectors are to be developed into “pillar” industries, where the state is expected to provide high-levels of support to develop major domestic state owned enterprise (SOE) players in these industries. European industry should be regarded as a key partner for the broader aims of the 12th Five-Year Plan to upgrade the industrial economy of China into a more value-added based economy. European industry is the global leader in information security technology and can provide the high-technology and high-quality technologies and products required to upgrade China’s information security system and within the downstream industrial chains for various promoted sectors in China.

Information Security Regulatory Developments:

No major information security-specific regulations have been released since May 2010 and the implementation of the China Compulsory Certification for Information Security Products (CC-IS) (see below).

The principal text regulating information security products in China – Circular 273 - dates back to 1999. Over the past decade, new regulations by several government agencies have contributed to developing a thicket of extremely broad, vague, and discriminatory information security regulations. Please see Key Recommendation 1, Figure 3 for a brief timeline.

2009 and early 2010 witnessed increasing regulatory activity in the area of information security.

Figure 2: Changes to the Information Security Regulatory Environment in 2009 and 2010

On 29 April, 2009, following months of engagement with industry stakeholders, the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), the Ministry of Finance (MOF) and the China National Certification and Accreditation Administration (CNCA) announced a postponement of CC-IS as well as a restriction of its scope to government procurement. In June of the same year, OSCCA released detailed regulations regarding additional requirements for “six categories of Information Security products” identified as having encryption as a “core function.” According to publicly available documents, the regulations would require applicant companies to disclose highly confidential source code information.

In December, 2009, OSCCA issued Bulletin 18 containing new requirements for the import of encryption products. The Bulletin, scheduled to become effective on 01 January, 2010, less than two weeks after publication of the new rules, contained such vague wording that it was impossible to comply with it by the imposed deadline.

On 22 April, 2010, the State Encryption Management Bureau (SEMB) published Circular 19 to announce the release of the “Cryptography application interface specification for smart card and smart token” without providing any details. At the time of drafting, the Industry was still seeking clarification on this Circular.

In May 2010, the Ministry of Finance (MOF), the Ministry of Industry and Information Technology, AQSIQ and the China National Certification and Accreditation Administration (CNCA) jointly issued “Notice on the Implementation of Government Procurement of Information Security Products (MOF 2010/#48)”. The Circular reiterates previous pronouncements regarding the scope of the mandatory application of CC-IS being limited to the area of government procurement. However, a lack of clarity in the wording of the Notice does not alleviate industry concerns

Information Security Industry Working Group

Section Four: Trade in Services

regarding state-owned enterprises’ (SOE) requests for “national certification” in their tendering procedures. Unfortunately, industry reports that in 2010 certain SOE’s have indicated that they would start requiring CC-IS certificates in future tenders on a ‘voluntary’ basis.

In spring 2011, rumours have been heard that a revised version of the Circular 273 is being discussed within some government agencies. In case the rumours are true the Working Group would like to encourage the relevant authorities to enter in a dialogue with all stakeholders at an early stage. In addition to consulting all relevant stakeholders during the revision process, including foreign industry and governments, it is also necessary that the revised regulations be fully notified to the World Trade Organisation Technical Barriers to Trade (WTO TBT).

Disclaimer: The regulatory framework for the research, production, sale, purchase and use of information security products is highly complex and opaque. The specific roles and responsibilities of some of the Chinese government bodies responsible for the drafting and implementation of these standards, rules and regulations are uniquely opaque. The information contained in this paper is based on the limited publically available information as well as dialogue with Chinese authorities. The Working Group looks forward to further dialogue with relevant government bodies in order to receive clarification and rectify any misunderstandings or factual errors in the following paper.

1. Commercial Encryption Regulations

Concern
Current Commercial Encryption Regulations effectively exclude foreign-invested enterprises (FIE) from some areas of the Chinese market. For some products, the regulations have forced foreign-invested Chinese companies out of a market which they have already been active in for some time. These regulations are being revised. It is important that the revisions take into account the valid market access concerns of all businesses registered in China.

Assessment

Figure 3: Historical Development of the Commercial Encryption Codes and Commercial Encryption Regulations

On 7 October 1999, the State Council of the People’s Republic of China issued the Regulation of Commercial Encryption Codes (CEC).

Key Elements in the Directive include that:

- No CEC products may be produced without authorisation
- No CEC products may be sold without proper authorisation
- Imported and Exported CEC products must be approved, as well as imported equipment containing CEC technologies
- Only approved CEC products may be used in China
- No foreign CEC products may be sold in China
- Foreign organisations or individuals must report and obtain approval for using CEC products or equipment using CEC technology

The so-called “Year 2000 Clarification” was issued a year later, stating that such rules only applied to products in which encryption was the “core function” (meaning core commercial functionality).

Building on that foundation, a spate of regulations released in 2006 and early 2007 and collectively referred to as the “Commercial Encryption Regulations” set out the following licensing and certification requirements:

- Regulations for Production of Commercial Encryption Products, effective January 1st 2006 (“Production Regulations”) -- the precondition to manufacture commercial encryption products in China
- Regulations for Research & Development of Commercial Encryption Products, effective January 1st 2006 (“Research Regulations”) -- the precondition for research & development of commercial encryption products in China
- Regulations for Sale of Commercial Encryption Products, effective January 1st 2006 (“Sale Regulations”) -- the precondition for selling relevant commercial encryption products in China
- Regulations for Use of Commercial Encryption Products by Overseas Organisations and Individuals in China, effective May 1st 2007 (“Foreign Use Regulations”).
- The Product Type Certificate for commercial encryption products --- the precondition for a product to be listed by OSCCA as an approved product to be sold in China
- Encryption Testing Certificate is a precondition to pass China
The Tax Card Project including the Tax-control card, Tax-control The ongoing Social Insurance Card project: In Section 9 of The Chinese National ID (NID) card project, which is the largest have been closed to FIE participation include: Important projects which have been closed to FIE participation include:
- The Chinese National ID (NID) card project, which is the largest NID card project in the world with an estimated 800 million issued RFID cards and related semiconductors. European industry has been excluded from the whole process chain, including semiconductor, component manufacturing and final assembly.
- The ongoing Social Insurance Card project: In Section 9 of the Action Plan for Improving People’s Livelihoods’ of the 12th Five-Year Plans puts forward the aim to issue 800 million of such social security insurance cards. As the social insurance cards require the use of a “National Algorithm” 8 European semiconductor and European made Smart Card Operation Systems will be excluded from the value chain.
- The Tax Card Project including the Tax-control card, Tax-control Terminal and Tax-control System required OSCCA Manufacturer and Sales certificates. 9
- Certification Authority Projects, require the use of a “National Algorithm”. 10
- USB-Smart Tokens, e.g. for secure online banking (see Case Study 2).
- Trusted Platform Module (TPM) security chips, which are dedicated to safe storage of critical data and measuring of the integrity of computer platforms. TPM is the central part of the Trusted Computing standard, defined by a worldwide industrial standardization group and now also an ISO standard. China’s IT industry, with government support and funding, started its own proprietary Trusted Computing efforts some years ago with participation from only Chinese companies. Within this, a working group on Trusted Computing was established and has resulted in Trusted Cryptographic Module (TCM) being promoted in China and being pushed through the China national standards process. As a result, since December 2008, no TPM has been sold in China. OSCCA approval is required to sell or develop TCM or systems with TCM, meaning that foreign companies cannot enter this market.

a. Opaque Procedures Create Uncertainty in the Business Environment

Much uncertainty in the business community remains with regards to which products are, or are not, affected by these encryption regulations. The so-called “core function” test set forth in the “2000 Clarification” is at the root of the scope of these regulations. Unfortunately, no written detailed definition was provided in the “2000 Clarification” or subsequent regulations regarding what products had encryption as a “core function”. Such persistent vagueness in formal communications contributes to uncertainty and unpredictability as to the scope of application of the OSCCA regulations.

The unpredictability caused by this regulatory vagueness is exacerbated by the OSCCA’s continued refusal to communicate in writing to FIEs the detailed technical requirements necessary to successfully apply for OSCCA licenses or the technical grounds for non-acceptance of licence applications submitted by FIEs. Certain internal execution guidelines to these regulations are considered as confidential by OSCCA and are not available to the public or industry. The Working Group has been told (verbally only) that according to the internal rules foreign-controlled FIEs are not eligible to apply for OSCCA certificates (the sole exception is the “Certificate for the Use of Commercial Encryption Products by Overseas Organisations or Individuals”), but no written statement to this effect has ever been received from OSCCA or any other government authority.11 The only written proof in the matter is the list of certified companies on OSCCA’s website.12 All 150-plus certified companies are Chinese-controlled enterprises.

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8. Ministerial Regulation No. 36 /2003, Ministry of Labour and Social Security (now Ministry of Human Resources and Social Security)
9. “Management regulations for the Manufacturers’ Certificate to provide Tax-control cash products”.

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11 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 OSCCA. This practice creates significant uncertainty for international business, as well as additional costs as any delay in the application procedure affects downstream activities.
Case Study 1: Unpredictability Resulting from Oscca Bulletin 18

On January 1 2010, OSCCA released Bulletin 18, which set out new requirements for the import of encryption products. According to the Bulletin, importers must provide an encryption import licence for any product with encryption capabilities, even those not included within the above-mentioned catalogue. These requirements seem to contradict the “2000 Clarification” which states that the scope of the Commercial Encryption Codes is restricted to specialised hardware and software for which encryption and decryption operations are core functions (the so-called “core function” test). In the meantime, SEMB has confirmed that the clarification statement from 2000 is still valid which seems to be a contradiction of Bulletin 18. It is not clear how Bulletin 18 relates to prior regulations regarding the import of encryption products, such as the 2009 H.S. Code. Thus far, Bulletin 18 has had no noticeable impact on companies operating in the Chinese information and communication technology (ICT) and information security industry, but its very existence increases unpredictability and raises concerns regarding challenges to the business continuity of China-based operations and the ability to serve clients in China.

Case Study 2: Loss of Banking Sector Business Due to OSCCA Regulations.

In 2007, China’s “Big Four” state-owned banks started requesting their prospective vendors to provide an OSCCA sales certificate and an OSCCA manufacturing certificate in their tender documents for second generation USB tokens. Because of this requirement all FIE companies who were long term suppliers of these banks lost that market to the benefit of Chinese companies without a comparable track record. Since 2008 all banks require the OSCCA sales and manufacturing certificates in their tender documents. These tender documents are often withheld from FIEs as the banks consider them to be confidential.

Given such a comprehensive lack of clarity, the Regulations on the Commercial Encryption Codes act as non-tariff barriers and their enforcement is shutting out FIEs from whole segments of a market the development of which they greatly contributed to through significant investments, R&D.
and technology transfers.

These regulations remain in place, and even continue to be further developed, despite China being a member of the Government Authority Meeting on Semiconductors (GAMS), which supported the World Semiconductor Council (WSC) recommendation on encryption\(^\text{15}\) and “agreed that open markets, free from government discrimination ensuring IPR protection and open to global collaboration for commercial encryption technologies, are critical to the development of secure and innovative ICT products” in the meeting in Kobe on October 26th, 2010. In the same meeting, “GAMS also underlined that it was important to prevent unnecessary restrictions on trade, and that therefore, products with cryptographic capabilities that are, or will be, widely available and deployed should, as a general rule, not be regulated.”\(^\text{16}\)

**Recommendation**

- Publish all rules and regulations regarding application, certification and testing for the Commercial Encryption Regulations, including scope of products covered.
- Ask that OSCCA communicate in writing with FIEs regarding certificate application requirements and grounds for non-acceptance of applications.
- Accelerate the development of China’s information security market and domestic industry by removing non-tariff barriers to the market, e.g. market access consequences of OSCCA licensing and certification requirements for foreign-invested enterprises
- Involve industry - including FIEs - in the process of revising the Commercial Encryption Regulations.
- Apply the internationally proven transparent approach to standardisation and certification of encryption products in order to increase the robustness, competitiveness and interoperability of Chinese solutions.
- Encourage China to become an active member in relevant international organisations.
- Seek further clarification of the following aspects of OSCCA Bulleting #18:
  - Rationale;
  - Plans for evolution of scope;
  - Application of “core function” test to products included in the annex “Catalogue of encryption products and equipment with encryption technology subject to import administration”.

\(^{15}\) See footnote 19

\(^{16}\) [http://trade.ac.europa.eu/doclib/cfm/doclib\_section.cfm?sc=193\&lang=fr](http://trade.ac.europa.eu/doclib/cfm/doclib_section.cfm?sc=193\&lang=fr)

## 2. China Compulsory Certification for Information Security Products

**Concern:**

- Divergence of standards underpinning CC-IS from international standards.
- Risk of spill-over to tendering processes outside government procurement.
- Inability of FIEs to receive the Encryption Testing Certificate, thereby barring them from government procurement contracts.
- Unnecessary disclosure of trade secrets and high risk of forced IP transfer during testing.

**Assessment**

In August of 2007, the Chinese National Certification and Accreditation Administration (CNCA) notified the WTO-TBT Committee that it was planning mandatory testing and certification of 13 types of information security products such as firewalls, smart cards and secure databases (for full list see below). Implementation was to start 1 May, 2009, and was to be carried out by the China Information Security Certification Center (ISCCC) under the CNCA and would be included in the China Compulsory Certification (CCC,) making its certification a mandatory pre-condition to market access. This extension of the CCC scheme to information security products raised serious concerns among the global ICT industry given the closed process leading to the formulation of these standards, which were then used to underpin this mandatory certification scheme. Following concerns from foreign companies, the scope of mandatory enforcement was reduced to government procurement and the date of implementation pushed back one year to 1 May 2010.\(^\text{17}\)

None of these regulations make reference to the “core function” test. All but one deviate from international standards.

On 22 April 2010 the SEMB published Circular 19. This document consists of only one sentence: “This is to publish the “Cryptography application interface specification for smart card and smart token” and is valid from the published date”. Again this document raises questions: the circular was published only eight days before the CC-IS deadline of 1 May 2010. It is impossible to implement a specification within that extremely limited time frame under the best of circumstances. Furthermore, there is no explanation in the Circular about how to get the referred specification and without the detailed specification, implementation in a product is impossible.

In May 2010 the Ministry of Finance, Ministry of Industry and Information Technology, the General Administration of Quality Supervision, Inspection and Quarantine Certification and Accreditation Administration of the PRC jointly issued the “Notice on the Implementation of Government Procurement of Information Security Products (MOF 2010/#48)”. The Circular reiterated previous pronouncements regarding the scope of mandatory application of CC-IS being limited to the area of...
government procurement. However, a lack of clarity in the wording of the Notice does not alleviate industry concerns regarding the ambiguity in the scope of implementation. For example, if an SOE is implementing a project that is partially funded by the central government then it is still not clear whether the SOE would require a CC-IS certificate from its supplier. Such a request would de facto exclude foreign-invested Chinese companies from participating in such projects.

Without CC-IS certification, the government indicated that "no products shall be allowed to be put into the market within the territory of China after the enforcement of the rules." Testing requirements to obtain certification diverge substantially from existing international standards. One system for China and another for the rest of the world would result in significant costs for companies and restricted choice and higher costs for Chinese end-users.

For FIEs it may be impossible to get the CC-IS because the required Encryption Testing Certificate from OSCCA might be impossible to get because OSCCA does not publish the requirements. In the unlikely case that FIE can go forward with the certification process OSCCA requires that the security-relevant parts of the source code be disclosed to OSCCA. FIEs are very concerned about these disclosure requirements because the Chinese government has yet to demonstrate that it has implemented sufficient precautions to prevent that proprietary intellectual property from being leaked to domestic competitors or used by other government agencies.

Based on prior member company experience in China, the Information Security Working Group is concerned that SOEs will nevertheless demand the CCC certificate from potential suppliers, especially where SOEs are seen to be a part of the critical infrastructure. In consequence the impact of the information security regulation would go far beyond government procurement which by definition in the "China Government Procurement Law" does not include state-owned enterprises.

"National security" is clearly beyond the scope of CCC. So long as national security is not concerned, additional certification should not be imposed by the government for either government procurement or commercial applications.

**Recommendation**

- Publish all necessary standards, test standards and testing specifications necessary for companies to apply for the CC-IS.
- Publish through OSCCA the exact testing specification and requirements necessary for successful application of the “Commercial Encryption Testing Certificate”.
- Discourage state-owned enterprises from unilaterally requiring CC-IS in their tenders.
- Eliminate duplication of evaluations by joining the Common Criteria Recognition Agreement (CCRA) which sets internationally accepted standards for the evaluation and certification of IT products.
- Recognise CC-IS certification by commercially independent testing laboratories
- Enter into a dialogue with foreign industry and authorities to clarify and refine CC-IS certification requirements.
- Clearly define the border line between National Security and Commercial Security in a new clear and transparent policy which is in line with international best practices.

3. **Multi-Level Protection Scheme (MLPS)**

**Concern**

MLPS prevents certain business and administrations from using IT products containing foreign IP. This not only openly discriminates against foreign and foreign-invested companies but jeopardizes China’s overall information security and risks slowing the “informatisation” of China’s economy aimed for in the 12th Five Year Plan.

**Assessment**

China’s Multi-level Protection Scheme imposes information security compliance requirements on information systems in enterprises and administrations which China’s government considers to be critical infrastructure. The scope of application of these requirements extends vastly beyond the widely applied definition (internationally applied best practices) and the scope of government procurement and states that information security components in more critical information systems cannot contain “foreign intellectual property”.

a. **MLPS Regulations**

The Multi-Level Protection Scheme (MLPS) is a policy framework designed by China’s Ministry of Public Security (MPS) to guarantee security of information systems, which operate Chinese critical infrastructure.

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18 It must be noted that since September 2010, two firewall products manufactured by what appears to be the wholly-owned subsidiary of a foreign company are listed on MPS’s website as certified for use within MLPS specified systems.
The Administrative Measures for the Multi-Level Protection of Information Systems, a document issued jointly by the Ministry of Public Security (MPS), State Encryption Management Bureau (SEMB), 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 the 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 1 classified systems — the least critical — would lead to harm to private and company interests. Damage to Level 5 systems — the most critical — would threaten national security. (For more information see Figure 5 below).

An over-riding concern regarding MLPS is the fact that to date no authority in China has been willing to engage in dialogue on MLPS or its implementation with foreign stakeholders. MPS, the lead MLPS implementing authority has been unwilling to engage with foreign industry associations or government bodies about the program. Other trade-or industry-related ministries in China have been reluctant to talk about MLPS, asserting the matter needs to be taken up with MPS.

Key Elements in the Directive:

- System administrators for level three and above systems are required to procure products whose core technology and key components have independent Chinese IP and CC-IS certification.
- To sell the cryptograph relevant information security products based on the MLPS regulation, OSCCA approval is required to get the sales certificate issued by the MPS.
- The following two requirements are barriers for FIEs to sell their products used for level three and above systems:
  - Product research and development and manufacturing must be carried out by Chinese controlled enterprises.
  - The core technology and key parts of the product should have indigenous IPR.

### Figure 5: Analysis of the Five Levels of Classification under the Multi-Level Protection Scheme

<table>
<thead>
<tr>
<th>Level</th>
<th>Harm Caused by Damage</th>
<th>Object of Damage</th>
<th>&quot;Critical Infrastructure&quot;:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level 1</td>
<td>Harm</td>
<td>Lawful rights of private persons, companies and other organisations</td>
<td></td>
</tr>
<tr>
<td>Level 2</td>
<td>Serious harm</td>
<td>Lawful rights of private persons, companies and other organisations</td>
<td></td>
</tr>
<tr>
<td>Level 3</td>
<td>Damages</td>
<td>Social order and public interests</td>
<td></td>
</tr>
<tr>
<td>Level 4</td>
<td>Very Serious Damages</td>
<td>Social order and public interests</td>
<td></td>
</tr>
<tr>
<td>Level 5</td>
<td>Very Serious Damages</td>
<td>National Security</td>
<td></td>
</tr>
</tbody>
</table>

"Critical Infrastructure":
- Administration, management, production and logistics operations for the government bodies and business in the following industries:
  - commerce, banking insurance, securities, utilities, civil aviation, rail, customs, taxation, finance
  - audit, national resources, transportation, culture, education, statistics, postal services,
  - science & technology, development & reform, foreign affairs, public security, national defense 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
b. Unprecedentedly Broad Scope of Application

Requests for Proposals (RFPs) that reference MLPS and related requirements are increasingly prevalent. Research conducted through online searches have identified that, by January 6th 2011, almost 50 RFPs referencing MLPS were identified, with 12 issues by State-owned enterprises. The breadth of sectors covered by the SOEs, ranging from power grids to banking and from hospitals to tobacco companies, as well as the breadth of government units, ranging from hydrology bureaus to TV stations and from industry and commerce bureaus to food and drug administrations, demonstrates the extent of the scope of application of MLPS as it can be seen to be also covering a wide range of commercially used widely deployed and available products and applications.

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.

One Chinese market report published in October 2010 on Sina.com estimates that roughly 100,000 – 150,000 information systems in China have been graded level three or above, across 28 industries. The report predicts that 50 percent of these information systems will require some kind of system ‘upgrade’ to be compliant with MLPS requirements. The report goes on to assume that the price of the upgrade is about EUR 11,285 – 22,570 per system, putting the price tag on the market for level three systems at upwards of EUR 1.13 billion. Given the MLPS requirement that level three systems must adopt domestic information security products (no foreign IP), this EUR 1.13 billion market would be closed to foreign suppliers.

Figure 6: Examples of SOE RFPs that Close the Market to Foreign Suppliers Under MLPS

<table>
<thead>
<tr>
<th>NAME OF PROCURING ENTITY, DATE, AND LINK</th>
<th>PRODUCTS AND VALUE</th>
<th>RFP NOTES &amp; MLPS REFERENCES</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-owned Enterprises (SOEs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Bank of China 2010 Network-related Equipment Public Bidding (Firewall (MLPS) Equipment) March 22, 2010</td>
<td>High-end, middle-end, and low-end firewalls</td>
<td>Key components must have completely indigenous IPR, must provide effective computer hardware copyright registration certificate provided by State Trademark Bureau.</td>
</tr>
<tr>
<td>2 China State Ship building Corporation E-Commerce Platform (Phase 1) Information Security System Construction Project. Oct 10, 2009</td>
<td>n/a</td>
<td>In process of construction, must reference Level 3 requirements</td>
</tr>
<tr>
<td>3 Beijing University Shenzhen Hospital Network Security Products. Aug 3, 2010</td>
<td>Firewall</td>
<td>Conform to national MLPS level 3 requirements</td>
</tr>
</tbody>
</table>

21The original figure was given in US Dollars. The conversion rate used was based on the average exchange rate for 2010 from the China Foreign Exchange Trade System, http://www.chinamoney.com.cn/ifo/Channel/17383
23http://www.bankpi.ibicn.com/project/archive/201003/06/12471768302494349.html
25http://www.wordwendang.com/word_IT/0803/138653.html

20Multi-Level Protection Scheme (MLPS): Requests for Proposals (RFPs) citing MLPS, Information Technology Industry Council and United States Information Technology Office, 6th January 2011
c. MLPS Application Procedures

The 1999 Administrative Measures requires information system end users to abide by the 1999 Commercial Encryption Regulations. MLPS regulations emphasise that encryption technology products must be approved by encryption regulatory authorities. This means that OSCCA approval for projects classified at all levels is required as MPS certification in turn requires OSCCA approval. With no procedures or specifications ever published about how it is possible to obtain OSCCA approval, this creates further uncertainty in the business environment. So far no FIE has obtained OSCCA approval or license.\(^{26}\)

Such applications within MLPS are designed with the aim to protect national security through secrecy. However, attempting to provide secrecy through constraining choice has long been demonstrated to lead to weakened products. Competition leads to innovation and robust solutions and the technology transfer which occurs in a competitive marketplace has been shown to be the best guarantor of cutting edge solutions. In order to improve information security, products and solutions are key. Tested, challenged solutions have proven to be more robust than secret ones. Secrecy only serves to protect special interests, those of the protected companies, not the security of information network as a whole. Long-term isolation which deprives the market from the benefits of competition in the global market induced by such policies creates the real risk that the robustness of China’s information security solutions falls behind the rest of the world.

While there are cases where all that is needed is to purchase a batch of firewalls, often building secure IT infrastructure involves complex custom solutions, frequently involving both legacy and new system components. Building a solution tailored to an individual system’s security needs while under the constraint of not being able to incorporate components with foreign IP is impractical.

The focus on the components of the system also ignores the technical complexity of how all the pieces connect. Particular products may meet the security protection requirements of the corresponding information system level. However, they may not meet technical system requirements such as system compatibility, stability, dependability and functionality.

\(^{26}\)In must be noted that since September 2010, two firewall products manufactured by what appears to be the wholly-owned subsidiary of a foreign company are listed on MPS’s website as certified for use within MLPS specified systems.
Logistics Working Group

Key Recommendations

1. Taxation Issues
   a. Zero-rate Treatment on the Exporting of International Express and International Forwarding Services
      • Extend the same BT treatment to all international express and international forwarding business on exporting of services.
      • Grant zero-rate VAT to the exporting of international express and international forwarding services after the VAT reform.

   b. Centralized VAT Filing of Logistic Enterprises
      • Allow logistic enterprises (including transportation, express delivery and freight forwarding) to conduct centralized VAT filing.

   c. VAT on Imported Services
      • Allow full credit/refund of VAT input paid on services purchased by IE and forwarding enterprises from abroad.

2. Customs Issues
   a. Further Promote “Classified Clearance”
      • Recommend China Customs to further promote the project of “Classified Clearance” and expend its coverage to include additional compliant international trade parties
      • Propose China Customs change the criteria of “providing paperwork post clearance” of an importer/exporter from grade A or AA to grade B or above.

   b. Procedures for Returning Shipments to Origin
      • Suggest China customs simplify procedures and shorten the overall processing time for shipments that have been declared.

   c. National Uniformity in Customs Practices
      • Issue sufficient and precise implementation rules at the national level to help promote unified customs practices across China.
      • Adopt the international practice of using ink pens for written instructions.

   d. Office Hours and Customs Clearance
      • Enforce 5+2 and the 24/24h working hour system and promote paperless Customs Clearance at the national level.
      • Speed up the customs clearance process in accordance with international best practices.

   e. Modifying and Revoking Customs Declaration
      • Differentiate procedures of demands taking into consideration data and customs tariff sensitivity and the credibility of logistics companies.
      • Simplify the process for non-ambiguous modifications and revoke applications and reduce the process time to within 24 hours.
f. Domestic Bonded Transfer  
• Issue standard regulations at the national level regarding domestic bonded transfers.

g. Registration in bonded areas  
• Issue more practical regulations from the national level for international freight forwarders to conduct business in these bonded areas.

h. Warehousing issues  
• Adopt the implementation of mixing bonded and non-bonded goods at a single warehousing location at the national level.

3. Express Delivery Service (EDS) Issues  
   a. Catalogue for the Guidance of Foreign Investment Industries  
• Adopt international best practices, loosen control over time and make the opening up time table available.

   b. Apply for the Domestic (Parcel) EDS business license  
• Speed up the approval process and work to offer license approval in a more timely manner.

   c. Registration of Branches  
• Attach attention to the business needs and difficulties facing networked express delivery and logistics companies when setting up branches and simplify the relevant pre-approval procedures.
• Introduce filing system instead of application approval for the establishment of affiliated sub-branches, or outlets of warehousing and other operations within the operation scope of the business license (or within the area of the municipality where the companies are located in).

d. Vehicles’ Entrance to City Centre  
• Suggest the local authorities especially of first-tier cities promulgate clear measures and supportive policy providing city access rights for EDS vehicles.
• Coordinate centrally especially with the Ministry of Public Security, the Ministry of Transport and relevant others to formulate corresponding vehicle standards for service industry usage and grant conveniences such as city access rights to vehicles conforming to specific standards.

4. Road Transport Issues  
• Provide low cost and easily accessible land for road transport companies’ road hub needs.
• Reduce road and bridge tolls to reduce the line-haul cost for road transport companies.
• Simplify administrative approvals to encourage road transport companies to set up branches (non-legal entities) in various areas.

5. Railway Transport Issues  
• Establish a contact window that enables all European forwarders to engage in rate negotiations and arrange direct bookings with China Rail.
• Encourage the rail transportation of dangerous cargo by accepting applications and by formulating regulations that grant approvals for an expanded range of dangerous cargo not currently permitted.

6. Water Transportation Issues  
• Abolish negative freight rates for LCL services.
• Enforce abolishment uniformly with both local and foreign-invested LCL service providers.
Introduction to the Working Group

The logistics industry is a multiple service industry that combines transport, storage, freight forwarding and information services. It plays an important role in the national economy in linking many fields, generating a large number of jobs, transforming the pattern of economic growth and enhancing economic competitiveness.

China’s economic boom requires the simultaneous investment in the development and modernisation of the country’s logistics infrastructure. Railways, roadways, airways, seaports and inland water ways all have a crucial part to play in sustaining this growth. This will become increasingly relevant as European companies adopt the government’s ‘Go West’ policy and seek new markets away from the east coast. Beyond infrastructure, European logistics providers also seek full access to the market on a national level and the clear and consistent implementation of regulations in the industry to improve services for all.

To this effect, the Logistics Working Group was founded in 2003 and represents a wide spectrum of logistics services providers in freight forwarding (sea/air/overland), express delivery, warehousing and distribution, customs brokerage, transportation services, contract logistics, and consumers of logistics services from various business sectors. Across the national network of the European Chamber, the Logistics Working Group currently operates in Beijing, Shanghai, and the Pearl River Delta offices. The Working Group aims to provide a more efficient and competitive logistics environment in China.

To do this the Working Group meets regularly to assess the legal and regulatory framework of the industry and to maintain dialogue with relevant government authorities in China and the European Union (EU).

Recent Developments

During the drafting of this paper, the continued increase in the logistics cost has been in the public eye in China. According to China Central Television’s special documentary, the total logistics cost in China accounted for 18% of the GDP in 2010, double that of developed countries. The staggeringly high cost is caused from a host of reasons, including repeated, unauthorized charges and penalties, oil price hikes, the difficult distribution in urban areas and repeated tax collection. They combine to make the logistics industry a top concern for Chinese society.

The logistics industry is the lifeline of economic operation. A logistic system that operates smoothly, efficiently and conveniently significantly promotes the circulation of commerce and trade, drives the development of relevant industries and elevates the competitive edge of both the market and products. The aforementioned problems plaguing the logistics industry as highlighted by the local media is an issue affecting all businesses operating in China. The Working Group welcomes both media organizations and the public inquiries into the bottlenecks facing the logistics industry and welcomes inputs and suggestions. The working group is looking forward to collaborating with (relevant departments addressing the concerns and opinions provided by the public, industries and media. The Working Group welcomes effective measures to address a series of issues over time, thus, facilitating the sustainable and healthy development of China’s logistics industry.

The Working Group believes China must fundamentally reform the current legal and regulatory structures governing the transportation and logistics industry in order to reach a position characterised by cost efficiency and timely delivery.

The Revitalisation Plan – meant -- was developed with a three year time frame for implementation. Since drafting, one and a half years have passed with the industry eagerly awaiting the implementation of other detailed measures, such as the optimisation of taxation and facilitation of nationwide business establishment to benefit the logistics industry and the Chinese economy.

The Working Group has noted some positive progress in recent months, in particular an increased focus on dialogue with industry on the part of the Chinese government. It is the European Chamber’s hope that this will go beyond formal meetings and due process with the Chinese government taking industry comments and international best practices into account.

Logistics in China’s domestic market, and the logistics industry itself are maturing quickly. These developments result in increasing competitiveness and a tightening of the logistics labour market for logistics personnel, therefore, more creativity is required in logistics solutions. With these increasing challenges, the logistics industry will shift its focus on improving efficiency and productivity in the supply chain.
The Logistics Working Group remains enthusiastic about the continuous dialogue with authorities across China and the EU.

Key Recommendations

1. Taxation Issues

Please refer to the Finance and Taxation Working Group for further taxation issues relating to the services industry.

a. Zero-rate Treatment on the Exporting of International Express and International Forwarding Services

Concern
It is uncertain whether all enterprises engaged in international express and international forwarding business would be entitled the same VAT exemptions as other transportation enterprises after the VAT reform. Those international express and international forwarding enterprises may be forced to raise price and pass the additional costs to their customers (especially those in the exporting business).

Assessment
Currently, countries representing major economies and markets, such as European Union, United States, and Australia, etc. do not generally impose indirect taxes on international transportation services and zero-rate Business Tax is enjoyed by all enterprises providing international transportation services. Moreover, in most of the listed countries, the scope of international transportation services is not restricted to a direct transportation service provider who own and uses the transportation vehicle (i.e. airline, cargo, railway and truck). Indirect tax provisions apply both to a direct transportation services provider and a freight forwarder provider arranging for these same services.

In China, BT exemptions is endeavoured to international transportation services provided by Chinese enterprises and individuals. The term “international transportation” refers to outbound, inbound and offshore passenger and cargo transportation. In most circumstances, only a direct transportation services provider (e.g. an airliner) enjoys such exemptions. In this respect, the enterprises engaged in international express and international forwarding (“IE and forwarding”) business are excluded.

In fact, IE and forwarding enterprises provide fully integrated services to customers, i.e. door-to-door delivery. This entails pick-up / delivery, road / air line-haul, customs clearance, and hub handling. The services are either provided by IE and forwarding enterprises themselves or sub-contracted to third parties.

After the VAT reform, if the IE and forwarding enterprises are not granted the same VAT exemptions as other direct transportation service providers for revenue from overseas customers, those IE and forwarding enterprises must take the VAT into consideration when quoting their price to customers. It is likely that the costs are eventually passed on to the customers, which may negatively impact exporting activities.

Meanwhile, if IE and forwarding enterprises subcontract services to third parties, they are responsible for VAT input on the service purchased. If no zero-rate treatment is entitled on the export of services, the VAT input incurred for this purpose will not be fully creditable/refundable, adding costs. Consequently, IE and forwarding enterprises would have to seek recovery of the costs from their customers, most likely through raising price, which will also negatively impact export activities.

Recommendation

· Extend the same BT treatment to all international express and international forwarding business on exporting of services.
· Grant zero-rate VAT to the exporting of international express and international forwarding services after the VAT reform.

b. Centralized VAT Filing of Logistic Enterprises

Concern
The VAT reform may cause additional compliance risks and burdens to logistic enterprises.

Assessment
Under the current VAT regime, most large scale manufacturing enterprises, despite having sales from all over China, are able to conduct the VAT filing on a centralized basis, which eases the compliance work of these manufacturers.

Under the prevailing BT system, however, BT is generally filed locally. For transportation enterprises which often have business operation throughout China, it is common for each branch/depot to file BT separately. Therefore, in addition to the administrative and managerial costs and
burdens to set up and maintain the numerous branches/depots, tax compliance is an additional burden to transportation enterprises.

After the VAT reform, it is foreseeable that there will be a large number of problems regarding tax compliance for transportation enterprises. If the VAT is filed locally, the risks for the branches/depots would increase remarkably, which contradicts the limited function and risk profile assumed by such branches/depots.

**Recommendation**

- Allow logistic enterprises (including transportation, express delivery and freight forwarding) to conduct centralized VAT filing.

c. **VAT on Imported Services**

**Concern**

A vast majority of the costs of IE and forwarding enterprises in delivering their services are network costs charged by overseas service providers, that may not be able to issue VAT invoices after the reform, thus making the VAT input credit (if payable on purchase of the line haul services) impossible for the IE and forwarding enterprises to claim. Consequently, the relevant costs could be double taxed.

**Assessment**

Under the prevailing VAT system, importation of goods and certain services is subject to VAT, borne by the importer. After (receiving the package?), the importer can claim VAT input credit and/or refund based on the tax receipts issued by the Customs office.

Currently, the network costs charged to IE and forwarding enterprises are not governed by the aforementioned importation mechanism. The IE and forwarding enterprises receive diversified invoices and the BT deduction is claimed by branches/depots separately in their respective BT filing with in-charge tax authorities. After the VAT reform, it is very likely that the network charges will be treated as importation of services, and therefore liable for VAT which (the service?) would become the VAT input of the “importer” of the network services.

If such VAT inputs are not creditable or refundable, the costs of the IE and forwarding enterprises would increase significantly. However, it is a commonly adopted international practice that VAT paid on imported services can be used for credit/refund. Material deviation from this international practice (hence increasing the costs for export) may reduce the competitiveness China’s exporters.

**Recommendation**

- Allow full credit/refund of VAT input paid on services purchased by IE and forwarding enterprises from abroad.

2. **Customs Issues**

Customs facilitation plays an essential role in achieving productivity in the logistics industry in China. In many other countries or regions (e.g. the EU), industry and trade benefit largely from a unified set of customs practices, regulations, and customs tariffs.

Please refer to the Maritime Transport Working Group Position Paper for more examples of customs issues.

a. **Further Promote “Classified Clearance”**

**Concern**

A limited number of importers/exporters enjoy the facilitation of “Classified Clearance” projects.

**Assessment**

The Working Group is pleased with the continuous efforts made by China Customs on clearance facilitation. The most recent development is the new Customs clearance mode – “Classified Clearance”. According to the implementation guideline of “Classified Clearance” (GAC announcement No. 56 - 2010), import/export companies certified by customs as grade A or AA enterprise and the company’s broker (also certified grade A or above) can enjoy the facilitated arrangement of providing clearance paperwork post-clearance. This greatly expedites the import/export clearance process and is in line with the world best practices. Both parties, including the business and customs benefit on efficiency gains and reduced cost from this new arrangement.

Here, the Working Group would like to share the following observations:

- Per the Working Group’s survey, grade A or AA importer/exporter only account for 2-3% of the total registered companies in customs. The majority are grade B importer/exporters. This severely limits the number of companies that can enjoy these benefits.
- The Working Group also noticed that China Customs
recently published the Specification of Service for China Brokerage (HS/T 32-2010), comprehensive and specific guidelines for customs brokerage companies to conduct business. To improve the mentioned above criteria will expedite the full implementation of the Specification, helping to achieve high customs compliance. The Working Group believes this positive change will help China’s customs brokerage service industry to be more robust and better regulated.

**Recommendation**
- Recommend China Customs to further promote the project of “Classified Clearance” and expend its coverage to include additional compliant international trade parties
- Propose China Customs change the criteria of “providing paperwork post clearance” of an importer/exporter from grade A or AA to grade B or above.

**b. Procedures for Returning Shipments to Origin**

**Concern**
The current approval process on shipments return is time consuming and cumbersome.

**Assessment**
According to GAC Decree 156, the customs processing time for return shipments which have not been cleared at customs is a maximum of 20 days and is subject to an extension of 10 days. The Working Group appreciates that the necessary customs examination and approval procedures are useful to curb the evasion of licenses and tariffs and is useful in the fight against smugglers, but the timeframe concerns the time-sensitive EDS industry. In particular, when companies voluntarily apply for return shipment before the declaration is lodged, the risk of violation is low.

**Recommendation**
- Suggest China customs simplify procedures and shorten the overall processing time for shipments that have been declared.

**c. National Uniformity in Customs Practices**

**Concern**
There is a lack of uniformity in customs practices across China, including the implementation of regulations and tax tariff evaluations, which adds unnecessary complexity and unpredictability to managing the flow of goods in and out of China.

**Assessment**
Customs offices across China have the same overriding objectives in terms of security, compliance and data collection. However, quite often each bureau, and even individual officials within a bureau, employs different methods to execute these objectives. Member companies report that sometimes pencils are used to fill in the Harmonised Commodity Description and Coding System (HS) Codes on clearance documents. These can be easily changed during the clearance process and potentially lead to higher duties. As the industry is happy to comply with local laws and regulations, transparency and consistency is the key to help achieve this goal.

**Recommendation**
- Issue sufficient and precise implementation rules at the national level to help promote unified customs practices across China.
- Adopt the international practice of using ink pens for written instructions.

**d. Office Hours and Customs Clearance**

**Concern**
Customs clearance still relies on manual procedures in China and is relatively slow compared to the EU and other south East Asian countries. Insufficient access to customs personnel, i.e., limited customs working hours on weekdays and at weekends, significantly hampers efficiency of supply chain management.

**Assessment**
The European Chamber commended the China Customs initiative to promote so-called 5+2 working days and 24/24h in recent years. However, such measures have not yet been fully implemented and the customs procedure is still slow compared to the EU. Consequently, companies have borne additional costs due to goods pending in warehouses and client dissatisfaction due to delayed delivery of goods. Customs clearance efficiency is an important aspect when establishing supply chains. Such administrative bottlenecks and lengthy procedures do not help China stand out from neighbouring countries, but force operators to look for alternative places in view of the industry’s constant search for locations with the best supply chain management.

**Recommendation**
- Enforce 5+2 and the 24/24h working hour system and promote paperless Customs Clearance at the national
level.
• Speed up the customs clearance process in accordance with international best practices.

e. Modifying and Revoking Customs Declaration

Concern
The current process to amend and/or withdraw submitted customs data is time consuming and cumbersome.

Assessment
According to Article 10 of the General Administration of Customs (GAC) Order No. 143, 2005), the time frame of administrative decision to accept amendments or withdrawals of customs declarations can take up to 20 working days and in special cases as many as 30 working days.

While European Chamber members understand the need for customs to thoroughly assess some cases before making a decision, most cases of amendments or withdrawals are straightforward and do not require more than a few hours to process. Variations in processing times, by taking into consideration the data and customs tariff sensitivity and credibility of logistics companies, will allow properly controlled companies to have their goods cleared or released from customs in a timely manner.

Recommendation
• Differentiate procedures of demands taking into consideration data and customs tariff sensitivity and the credibility of logistics companies.
• Simplify the process for non-ambiguous modifications and revoke applications and reduce the process time to within 24 hours.

f. Domestic Bonded Transfer

Concern
There are big challenges regarding domestic air bonded transfer between different cities’ bonded areas. The approved process is complicated and time consuming, and lacks a standard customs process and interactive solutions.

Assessment
Current China lacks a standard operation procedure to cover domestic air bonded areas. Bonded areas in different cities follow their own local processes, resulting in longer time frames and additional steps to implement domestic air bonded transfer between different cities.

Recommendation
• Issue standard regulations at the national level regarding domestic bonded transfers.

g. Registration in Bonded Areas

Concern
Logistics companies who are not registered in bonded areas (such as Free Trade Zone, Bonded Logistics Park) can not independently operate business in these areas, forcing them to work with agents who registered in the bonded areas.

Assessment
In some ways this hinders business development of international freight forwarders like DGF as it is unpractical to register legal entities in every bonded area where they have business.

Recommendation
• Issue more practical regulations from the national level for international freight forwarders to conduct business in these bonded areas.

h. Warehousing issues

Concern
Logistics in China is often labelled as inefficient and ineffective. One of the main reasons for this is the fragmentation of warehousing (due to various warehousing statuses and licences per location).

Assessment
Within Europe, it is not the location but the warehouse management system that indicates whether goods are bonded goods or free goods. Warehouse Management Systems are linked with Customs Systems. This means that a warehouse can combine bonded and non-bonded operations at one single warehousing location.

How does it work? Normally, when goods are imported into the free circulation of the EU, VAT and customs duties should be paid for before the goods can be stored and are waiting to be sold. However, it is also possible to store the goods in a customs bonded warehouse which results in the postponement of customs duty/VAT at import payment. It is possible to store the goods in a customs bonded warehouse for an unlimited period of time. During this period no customs duties and VAT are due. Customs duties and VAT at import only need to be paid when the goods are actually imported into the free circulation of the
EU. In case the client is located in a non-EU country the goods can be kept under customs bond. This means that the goods are transported under customs bond from the (customs bonded) warehouse to the country where the buyer is located. Customs duties and VAT at import are subsequently paid in the country of destination.

The majority of the customs bonded warehouses in Europe are administratively controlled. This means that because of the intensive administrative control, the number of physical checks is reduced dramatically. Import takes place in the first week of the next month so if orders are sent to the logistics service provider the goods can be picked, packed and shipped without customs interference. This is only under the condition that the necessary simplifications are in place. If so, it is possible to operate a European Distribution Centre 24 hours a day, 7 days a week and 365 days a year.

This flexibility is allowed by customs but the requirements with regard to the administrative system of the logistics service provider are strict. Many details need to be registered, such as value, tariff code, weight and origin. The import can be carried out via EDI or via a disk. Supplying customs with information this way allows customs to do more detailed checks on the clearances as well as the mutations of the inventory. Physical checks are carried out at random and basically each logistics service provider is checked extensively once every three years. It is possible for foreign companies to apply for a licence to operate a customs bonded warehouse but in practice many companies outsource this type of storage to a logistics service provider.

The warehouse is allowed to carry out usual forms of handling in a customs bonded warehouse. No additional licence is required. A usual form of handling implies simple packaging, kitting, assembly, etc. If the bonded warehouse is combined with a licence “Inward processing” or “Processing under customs control”, it is possible to execute more extensive activities such as configuration and processing. Strict rules and regulations are applicable, which are too detailed to discuss in this document.

The many benefits of customs bonded warehousing include:

1. Unlimited storage period;
2. One warehouse can support both domestic as well as export operations. No duties or VAT at import are due for goods stored in the customs bonded warehouse. The payment of duty is postponed until the goods are actually imported (e.g. a buyer for the goods is found). Goods to destinations outside of China can remain under customs bond (no double duties);
3. Interest savings on customs duty payments (cash flow advantage). Less customs interference (dependent on the type of customs bonded warehouse);
4. Value-added logistics (assembly, configuration) can take place in a customs bonded warehouse.

Recommendation
- Adopt the implementation of mixing bonded and non-bonded goods at a single warehousing location at the national level.

3. Express Delivery Service (EDS) Issues

a. Catalogue for the Guidance of Foreign Investment Industries

Concern
The Working Group has noted that in Article 5 of the Catalogue for the Guidance of Foreign Investment Industries newly revised in 2011, industries which foreign investment is not allowed under transport, warehousing and postal industries, includes domestic EDS of mail.

Assessment
This provision has put a restriction on the autonomous right of domestic clients and consumers to select services that makes foreign investment unable to obtain a level playing field. It also compromises the role of market in elevating service standard, which may lead to the loss of Chinese consumers’ rights to select services freely and will result in a decrease in service standard. It thus goes against the long-term development interest of the EDS industry and China’s economy as a whole.

Recommendation
- Adopt international best practices, loosen control over time and make the opening up time table available iat

b. Apply for the Domestic (Parcel) EDS business license

Concern
Member companies report that after submitting the application for domestic (parcel) EDS business license, they do not receive a clear reply in a timely manner, nor
do they received an official acceptance notice issued by relevant authorities confirming the application procedure or keeping them informed of the latest developments. This seriously affects their business operation.

Assessment
A business license is a prerequisite for an enterprises to carry out businesses, establish branches and apply for business registration, among other procedures. Failure of enterprises in obtaining the license brings about uncertainties in normal operational activities. According to the provision of the Postal Law of the People’s Republic of China, it is legally permitted and legitimate for foreign enterprises to apply for domestic EDS. In particular, some enterprises launched domestic businesses before the Postal Law of the People’s Republic of China was promulgated, but they still have yet to receive their license approval. This makes many enterprises be subject to the questions of various authorities, including local postal bureaus and administrations for industry and commerce. In serious cases, the companies have been required to submit self-criticism or imposed with fines. Given this, enterprises have lodged their petition letters to relevant authorities repeatedly.

Recommendation
- Speed up the approval process and work to offer license approval in a more timely manner.

c. Registration of Branches

Concern
Under the system of tax-sharing system in China, local authorities are not proactive in expediting the establishment of branches by networked express delivery and logistics companies.

Assessment
When establishing new branches, networked companies often run into various obstacles, impeding their efforts to expand their business network and provide better services. After establishing branches in various provinces and municipalities, logistics and express delivery companies are required (by industry and commerce administrations) to apply for the set up of affiliated sub-branches or outlets. This has added burdens to enterprises in terms of registered capital and operating costs.

Recommendation
- Attach attention to the business needs and difficulties facing networked express delivery and logistics companies when setting up branches and simplify the relevant pre-approval procedures.

- Introduce filing system instead of application approval for the establishment of affiliated sub-branches, or outlets of warehousing and other operations within the operation scope of the business license (or within the area of the municipality where the companies are located in)

d. Vehicles’ Entrance to City Centre

Concern
In the absence of streamlined administrative measures adopted by PSB and MOT respectively, it remains a salient issue on how to offer a legal identity to EDS vehicles to transport and park in urban areas.

Assessment
Member companies expressed their appreciation to the concerted efforts made by provincial and municipal level legislative bodies, postal administrations and transport administrations in the past year, for having released various measures in assisting EDS vehicles entering urban areas. However, authorities of first-tier cities in China, especially Beijing and Shanghai, have not yet rolled out clear regulations. Due to the restrictions on city access, it is common practice that EDS companies use passenger vehicles to deliver goods, which conflicts with relevant national regulations.

Recommendation
- Suggest the local authorities especially of first-tier cities promulgate clear measures and supportive policy providing city access rights for EDS vehicles.

- Coordinate centrally especially with the Ministry of Public Security, the Ministry of Transport and relevant others to formulate corresponding vehicle standards for service industry usage and grant conveniences such as city access rights to vehicles conforming to specific standards.

4. Road Transport Issues

Concern
China is facing inflationary pressures this year and road transport companies are struggling. Clients remain very sensitive to price changes, cost for land usage remains high and costs for fuel and labour are increasing sharply. Road transport companies are struggling to strike a balance and many are operating near break even some are losing money.
Assessment
It is expected that cost increases are long term and the impact to the labour-intensive logistics industry is significant. Although the Logistics Industry Revitalization Plan was released last year, it has not brought any tangible benefits to the industry due to the lack of concrete measures.

Recommendation
• Provide low cost and easily accessible land for road transport companies’ road hub needs.
• Reduce road and bridge tolls to reduce the line-haul cost for road transport companies.
• Simplify administrative approvals to encourage road transport companies to set up branches (non-legal entities) in various areas.

5. Railway Transport Issues
Concern
Despite rapid developments in the rail transport infrastructure in China, which are warmly welcomed by the Logistics Working Group, there is still a lack of available space to meet current demand. Furthermore, transportation of highly dangerous cargo is practically impossible.

Assessment
China Rail has planned a highly advanced rail network consisting of 18 container hubs to be established by 2010.

This is expected to bring a vast improvement in the overall inland transportation infrastructure, especially with regard to inter-modal container transport. However, currently, very few local logistics companies are able to book space with China Rail directly. There have been no indications that better access and transparency for foreign logistics companies will be part of the new rail network plans. Furthermore, only a limited number of dangerous cargoes are approved for transportation by rail. The result is that the vast majority of dangerous cargoes used by industry (including those far less dangerous than those approved) are not permitted. There is an existing application procedure to include dangerous cargoes in a list of approved products, but in practice no new approval has been granted for many years. It has been indicated that an improvement of this situation is categorically not being considered. This will mean that despite rail being the safer mode of transport, dangerous cargo will still travel long distances by road.

Recommendation
• Establish a contact window that enables all European forwarders to engage in rate negotiations and arrange direct bookings with China Rail.
• Encourage the rail transportation of dangerous cargo by accepting applications and by formulating regulations that grant approvals for an expanded range of dangerous cargo not currently permitted.

6. Water Transportation Issues
Concern
Less-than-Container Load (LCL) consolidators are paying negative freight to shippers for prepaid cargo, leading to high destination charges levied on the consignees.

Assessment
Rate structure for LCL has been distorted, reputable players are unwilling to start their own consolidation boxes.

Recommendation
• Abolish negative freight rates for LCL services.
• Enforce abolition uniformly with both local and foreign-invested LCL service providers.
### Abbreviations

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<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<th>Full Form</th>
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<tr>
<td>BT</td>
<td>Business Tax</td>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<td>CBM</td>
<td>Condition-Based Maintenance</td>
<td>NVOCC</td>
<td>Non Vessel Operator Common Carrier</td>
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<tr>
<td>EDS</td>
<td>Express Delivery Service</td>
<td>PB</td>
<td>Post Bureau</td>
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<tr>
<td>EMS</td>
<td>Express Mail Service (offered by the postal-administration members of the Universal Postal Union)</td>
<td>PNESD</td>
<td>Plan for National Economic and Social Development</td>
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<td>ESS</td>
<td>Express Service Standards</td>
<td>PUD</td>
<td>Pick Up Delivery</td>
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<tr>
<td>EU</td>
<td>European Union</td>
<td>SAT</td>
<td>State Administration of Taxation</td>
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<tr>
<td>FIE</td>
<td>Foreign Invested Enterprise</td>
<td>SME</td>
<td>Small and Medium-sized Enterprise</td>
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<tr>
<td>FYP</td>
<td>Five Year Plan</td>
<td>SPB</td>
<td>State Postal Bureau</td>
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<tr>
<td>GAC</td>
<td>General Administration of Customs</td>
<td>T&amp;T</td>
<td>Tractor Trailer</td>
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<tr>
<td>HS</td>
<td>Harmonised Commodity Description and Coding System</td>
<td>VAT</td>
<td>Value-Added Tax</td>
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<tr>
<td>MOC</td>
<td>Ministry of Communication</td>
<td>WCO</td>
<td>World Customs Organisation</td>
</tr>
<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
<td>WFOE</td>
<td>Wholly Foreign Owned Enterprises</td>
</tr>
<tr>
<td>MOT</td>
<td>Ministry of Transport</td>
<td>WTO</td>
<td>World Trade Organization</td>
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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. Uniformly Implement Customs Regulations
   • Ensure that customs regulations are enforced uniformly in all customs districts
   • Implement Electronic Data Interchange (EDI) across China and phase out paper formats and manual reporting as soon as possible

3. Strengthen Enforcement of Laws Relating to Dangerous Cargo
   • Improve shippers’ access to information about risks
   • Conduct more examinations and investigations to detect declaration violations regarding cargo content and weight declaration
   • Impose stricter penalties on shippers for misdeclarations

4. Improve Navigational Safety
   • Strengthen enforcement of navigational rules
   • Improve the quality of VTS
   • Monitor compliance with rules for traffic separation zones.
   • Establish traffic lanes along the coast and close to ports for large commercial vessels where fishing is not allowed
   • Improve English skills and technical skills of pilots to allow better coordination
   • Study best practices from abroad in regards to fog navigation

5. Cooperate on Reducing the Carbon Footprint of International Shipping
   • Support the reduction of polluting emissions from international shipping through globally binding and equally applicable rules set by the IMO.
   • Promote and encourage the use of cleaner fuels in Chinese ports.

6. Strengthen the Supervision of Chinese Ports to Maintain the Harmony of the Market and Avoid Anti-Competitive Behaviour
   • Enhance the supervision of compliance through anti-monopoly laws in Chinese ports and take effective measures to restore a fair and orderly market when ports are found to be in violation of relevant laws.

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 for a more efficient and competitive maritime transport environment in China. To accomplish this, the group is engaging Chinese and European officials to contribute to the fair and healthy development of the transportation industry and the promotion of the interests of European transportation companies in China.

Recent Developments

With more than 80% of global trade being carried by sea, maritime transport is the backbone of international trade and globalisation. The European Union (EU) is China’s largest trading partner and China is the EU’s second
largest trading partner, as such maritime transport is an essential and integrated part of Sino-EU economic relations.

For the industry to fully realise its potential to enhance global trade and long-term economic growth, it is crucial that the industry and regulators work together to find solutions that will ensure the long-term health and efficiency of the liner shipping industry, e.g. by eliminating barriers to market access and other regulatory inefficiencies.

The dialogue with Chinese regulators, including the General Administration of Customs (GAC) and the Ministry of Transport (MOT), is positive and is contributing to continuous improvements in the business environment.

New ambitious targets have been set in China’s 12th Five-Year Plan for the maritime industry. The EU maritime industry welcomes the China’s maritime industry aspirations to significantly reduce emissions (ocean shipping at 16%, river shipping at 14%, and ports at 7%) and energy consumption and will contribute to this effort where feasible. In terms of infrastructure development, the Maritime Transport Working Group hopes that relevant authorities will continue to ensure that a healthy balance remains between supply and demand in terms of port capacity. Having in China in the past five years avoided bottlenecks in the port sector in a rapidly growing market is a significant achievement. The Maritime Transport Working Group also welcomes a higher focus on supervision and enforcement of compliance with rules related to maritime safety and anti-competitive behaviours, while encouraging that further deregulation takes place in regards to the ability of foreign maritime enterprises to provide commercial services on terms similar to those of Chinese maritime enterprises.

The Maritime Transport Working Group is looking forward to the continued dialogue with authorities across China and the EU.

### Key Recommendations

1. **Allow Transport of International Cargo Between Chinese Ports (International Relay)**

#### Concern

International cargo transport between Chinese ports (international relay) may only be carried out by Chinese-flagged vessels operated by wholly Chinese-owned companies.

#### Assessment

International relay remains an issue of the highest priority for the EU liner shipping community in China.

#### Permits

Permitting international relay will create flexibility for shipping lines, allowing shipping lines to optimise route networks, leading to shorter transit times, lower transport costs, less pollution, and generating increased revenues for Chinese ports.

Today, EU shipping lines are forced to trans-ship cargoes originating in China to overseas ports. Permitting international relay in China will bring significant benefits to the EU as well as to Chinese companies, including:

- Increased revenue for Chinese ports: significant volumes of cargo that are currently trans-shipped overseas, for example to South Korea and Singapore, could potentially be trans-shipped via China.
- Efficient utilisation of Chinese ports: Chinese ports have excess handling capacity; allowing international relay will aid the development of international hub ports in China and contribute towards 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. Today, foreign shipping lines choose to trans-ship containers outside of China rather than to use a domestic feeder service that would increase costs. Similar inefficiencies apply to Chinese carriers who are flying a foreign flag.

**Recommendation**
- Support the development of more efficient shipping services for China’s foreign trade by permitting international cargo relay.

International relay ok

### 2. Uniformly Implement Customs Regulations

**Concern**
Customs processes are crucial elements in global supply chains and the efficiency of such processes is also the key to competitiveness and has a large impact on the cost of international transport solutions. In China, there is still scope to further enhance the efficiency of customs processes without compromising national security. In many ways, changes that would improve the efficiency and cost of transport service providers may indeed enhance national security.

Please also refer to the Logistics Working Group Position Paper on customs issues.

**Assessment**
1. Uniformly Implement Customs Regulations:
The inspection ratios of containers and interpretation of customs regulations is not uniform between customs districts. The EU maritime industry has experienced that, as a consequence, some exporters are deliberately choosing ports with less strict criteria. This is inefficient from a transport and economic perspective and is not desirable from a security perspective.

As an example of simplification it could be considered to dispense with the vessel/voyage information requirement as the General Administration of Customs has done for the airfreight industry.

2. Speedy introduction of Electronic Data Interchange (EDI):
One of the most significant improvements to customs processes in China is the introduction of EDI between transportation providers and customs. The introduction of EDI has greatly reduced the amount of required paperwork. However, some customs districts have implemented EDI while in many districts, EDI still co-exists with the old paper formats, creating inefficiencies.

**Recommendation**
- Ensure that customs regulations are enforced uniformly in all customs districts
- Implement EDI across China and phase out paper formats and manual reporting as soon as possible

### 3. Strengthen Enforcement of Laws relating to Dangerous Cargo

**Concern**
As China presently accounts for one-third of worldwide exports by container, ensuring the safe transport of dangerous cargoes has become increasingly important. Numerous accidents impairing normal operations have resulted in casualties or even loss of ships. There needs to be coordination between the relevant departments such as the MOT and Customs, and the shippers and shipping lines to fully address this issue.

**Assessment**
Sea transport of dangerous cargo is regulated by the International Maritime Dangerous Goods (IMDG) code system. Many cases of fraudulent declarations of dangerous cargo from China have been reported, resulting in frequent fires and the increased risk of casualties, vessel damage, and heavy pollution. For instance, cargo declared as plastic toys could in fact be fireworks; loading these containers close to the engine room could be catastrophic.

Fraudulent declarations of cargo weight also impair safe navigation.

**Recommendation**
- Improve shippers’ access to information about risks
- Conduct more examinations and investigations to detect violations regarding cargo content and weight declaration
- Impose stricter penalties on shippers for misdeclaration

### 4. Improve Navigational safety

**Concern**
Many local Chinese vessels do not abide by navigational rules and pose a significant risk to safety. Safety and efficiency are further compromised by the insufficient use of Vessel Traffic System (VTS) and communication issues with pilots.
Assessment
Chinese waters have a particularly high density of traffic not only in areas near ports but also in the open sea; this density is due to the presence of numerous fishing boats. To navigate safely in those conditions, it is essential that all vessels strictly follow navigational rules and at the same time communicate clearly with other vessels and the traffic control stations. However, this is not always the case with local vessels. Many local vessels often have poor navigation equipment and disregard the rules (even with regard to traffic separation) impeding normal traffic flows and putting large vessels in dangerous situations, particularly at night or in adverse weather conditions.

VTS personnel sometimes lack the English skills required to efficiently communicate with foreign vessels, resulting in dangerous situations. Generally, all VTS services need to be improved by becoming more proactive, cooperative, and efficient. A good example to follow is the Hong Kong traffic control station. Also, communication with pilots is often difficult due to limited English and technical skills.

Fog navigation remains a problem in some Chinese ports with many unnecessary closures leading to inefficiencies for liner shipping companies and their customers.

Recommendation
- Strengthen enforcement of navigational rules
- Improve the quality of VTS
- Monitor compliance with rules for traffic separation zones.
- Establish traffic lanes along the coast and close to ports for large commercial vessels where fishing is not allowed
- Improve English skills and technical skills of pilots to allow better coordination
- Study best practices from abroad in regards to fog navigation

5. Cooperate on Reducing the CO₂ Emissions of International Shipping

Concern
International shipping is one of the very rare sectors that are not currently covered by international binding agreements aimed at reducing CO2 emissions. Recent years have therefore seen strong international political attention on international shipping, and in many countries consumer opinions advocate the idea of buying locally (instead of from abroad).

For international shipping to reduce its emissions of CO2, it is necessary for internationally binding agreements to apply equally to all vessels, as carbon leakage may otherwise occur. As a leading maritime nation, China’s support is critically important in the effort to reduce CO2 emissions.

Assessment
While shipping is a highly energy-efficient mode of transport, emitting less CO₂ than other modes of transport in terms of emissions per ton/kilometre, there is still significant potential for the shipping industry to further reduce its carbon footprint and emission of other pollutants such as SO₂ and NOx through the implementation of energy efficient measures, e.g. innovation, operational procedures, and slow steaming.

The global shipping industry is international in nature, fiercely competitive and its costs are largely determined by world market prices. At the same time, the cost of meeting higher emissions standards can be very high. Efforts towards setting higher emissions standards will therefore require international regulation to ensure that rules apply equally to all vessels and that companies investing in energy-efficient measures are not punished through a reduction in competitiveness due to higher costs. Moreover, if regulations are not equally binding to all nations, fleets in countries with stricter regulations may simply choose to register fleets in countries with lower standards – and carbon leakage would be the result. The development of an international level playing field is therefore essential.

China and the EU are global leaders within maritime transport. By working together with the International Maritime Organization (IMO) to establish an internationally binding regulation for emissions for shipping, significant environmental benefits may be achieved without distorting the competitiveness of individual companies. A first joint step could be the development and support of an energy efficiency index for vessels. Another step would be to introduce binding standards for fuel quality in Chinese ports and coastal waters similar to in the EU. From an emissions perspective, stricter fuel standards are preferred to cold ironing (shore-based electricity solutions) as cold ironing will be of use only when a vessel is actually berthed in a port. Moreover, the actual environmental benefit will be dependent on the source of the electricity. If the electricity is not produced in a clean manner, there may be a limited environmental benefit.
Recommendation

- Support the reduction of CO₂ emissions from international shipping through globally binding and equally applicable rules set by the IMO.
- Promote and encourage the use of cleaner fuels in Chinese ports.

6. **Strengthen the Supervision of Chinese Ports to Maintain the Harmony of the Market and Avoid Anti-Competitive Behaviour**

Concern

Most ports in China are monopolies. As with any monopoly, there is a risk that clients of the monopoly may become the victims of anti-competitive behaviour.

Assessment

The port industry is by nature asset-intensive and has high barriers to entry. As a consequence, there is typically only one or very few port operators in each port leading to monopoly situations. In larger ports, there are often several terminals with a constellation of owners. Typically, however, the local port group has a controlling stake in all terminals and a monopoly is the reality.

While many terminals operate in compliance with anti-monopoly and other competition laws, there are also examples that some ports engage in anti-competitive behaviour affecting the fairness of the markets. Examples of anti-competitive behaviours include the bundling of services, e.g. ports forcing shipping lines to use specific companies for unrelated services such as husbandry. There are also examples of discrimination, e.g. ports refusing to serve shipping lines calling at competing ports.

Such anti-competitive behaviour adds to the cost of shipping. These costs are eventually borne by Chinese exporters and overseas importers of Chinese products and are ultimately damaging China’s competitiveness.

Recommendation

- Enhance the supervision of compliance with anti-monopoly laws in Chinese ports and take effective measures to restore a fair and orderly market where ports are found to be in violation of relevant laws.

**Abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>EDI</td>
<td>Electronic Data Interchange</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>GAC</td>
<td>General Administration of Customs</td>
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<tr>
<td>CO₂</td>
<td>Carbon Dioxide</td>
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<tr>
<td>IMDG</td>
<td>International Maritime Dangerous Goods</td>
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<tr>
<td>IMO</td>
<td>International Maritime Organization</td>
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<tr>
<td>MOT</td>
<td>Ministry of Transport</td>
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<tr>
<td>PRC</td>
<td>People’s Republic of China</td>
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<tr>
<td>TEU</td>
<td>Twenty-foot Equivalent Unit</td>
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<td>VTS</td>
<td>Vessel Traffic Services</td>
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Travel Working Group

Key Recommendations

1. Allow All European Tour Operators to Operate Outbound Travel Services
   - Create a legal framework allowing all European tour operators to conduct outbound travel services in China with equal conditions as domestic tour operators
   - Clarify the process for issuing the outbound licenses and the timeline for new operators

2. Encourage the Use of Foreign Computer Reservation Systems (CRS) in China
   - Release the CRS regulation to establish a consistent and efficient system of licensing procedures and management in a timely manner
   - Further expand the usage of foreign CRS to all the travel agents and companies that are operating in China including domestic companies

Introduction to the Working Group

The Travel Working Group was first established in 2001 to represent the European travel industry, including tour operators, hotels and other travel-related service providers.

The objective of the Working Group is to promote a fair and transparent regulatory environment in the travel industry by maintaining constructive dialogues with the relevant Chinese officials, in particular the China National Tourism Administration (CNTA). The Working Group shares European knowledge and exchange best practices in the travel sector.

Recent Developments

China is one of the world’s fastest-growing tourism markets. The outbound market in particular, has been a major driver of this growth in recent years. In 2010, total departures exceeded total arrivals to China for the first time reaching 57 million travelers, an increase of 17.5 percent.1 In 2011, total departures from China are expected to grow to 70 million, an increase of 23 percent.2

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In 2010, Chinese travelers’ expenditure abroad amounted to CNY 327.2 billion, a 14 percent increase from 2009. In 2010, the domestic Chinese tourism market grew 21.7 percent, to CNY 1.57 trillion.

Europe has benefited by the growing outbound market. Total visas issued by European Union (EU) member states including Schengan and Schengan Non-EU countries to Chinese travelers grew by 28.7 percent (see Figure 2).

Despite the significant growth in the outbound market, the EU still represents a small portion of the final destination. The top four visited countries, in the EU, combined, still only represent 2 percent of China’s total outbound market (see Figure 3).

Every year the CNTA publishes a “Yearbook of China Tourism Statistics” that contains data and figures about tourism industry in China. One of the sections focuses on outbound travel from China, however many EU countries are not included in this section. The Working Group is pleased to see that CNTA has recognised the Working Group’s suggestion and included three more EU countries in the latest published version at the end of 2010. In the forthcoming edition of 2011, the Working Group welcomes inclusions of more EU countries and/or the EU as a whole.

In terms of policy developments, the Working Group warmly welcomes the following:

- Throughout 2010-2011, the overall efforts in formulating and drafting of the PRC Tourism Law by CNTA and related authorities
- In August 2010, the Interim Measures on the Regulation of Joint Venture Travel Agencies Operating Outbound Travel (Order. No 33) issued by CNTA
- In January 2011, the calls for comments on draft Computer Reservation Systems (CRS) regulation by Civil Aviation Administration of China (CAAC)
- In May 2011, the CNTA issued three outbound licenses to foreign joint venture tour operators under the pilot scheme for outbound travel

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7 Delegation of the European Union to China and Mongolia, Beijing, 6 May 2011
8 The Yearbook of China Tourism Statistics 2010, China National Tourism Administration, October 2010, viewed 14 April 2011
9 Since 2010, the Yearbook of China Tourism Statistics published by CNTA includes figure on outbound travel from China to United Kingdom, France and Italy
Key Recommendations

1. Allow All European Tour Operators to Operate Outbound Travel Services

Concern
The Working Group asks for equal treatment for foreign and domestic tour operators engaged in outbound tourism in China. Currently, the outbound market is still dominated by domestic tour operators with the three newly approved foreign joint venture tour operators who are allowed to operate outbound travel on a pilot basis.

Assessment
In May 2011, three foreign joint venture tour operators were issued the outbound license which would allow them to operate outbound travel from China. The Working Group appreciates the authorities’ efforts to open up the outbound market.

In line with CNTA’s goal to improve the quality and variety of the tourist products offered to Chinese travellers, the Working Group believes that allowing all foreign-invested tour operators to operate outbound services will be highly instrumental in fulfilling this goal.

With the gradual opening up of China’s outbound tourism it would create additional competition, improving quality and service delivery that will complement the existing Chinese market by providing more quality tailored services along with greater choices of tour packages.

In addition, further opening of the outbound sector would have a positive ripple effect on the industry as a whole. If allowed, foreign tour operators could train people in the latest customer service techniques and introduce the most up-to-date marketing and computer systems. Eventually transfer of know-how will spread to Chinese tour operators and bring Chinese practices in line with international standards.

Recommendation
- Create a legal framework allowing all European tour operators to conduct outbound travel services in China with equal conditions as domestic tour operators
- Clarify the process for issuing the outbound licenses and the timeline for new operators

2. Encourage the Use of Foreign Computer Reservation Systems (CRS) in China

Concern
Travel agents of foreign airlines in China have the opportunity to choose the cutting-edge technology provided by foreign Global Distribution Systems (GDSs) according to the draft CRS regulations. While, sales agents of China’s domestic airlines do not have the choice to use foreign CRS at all.

Assessment
China has fallen behind the West in terms of travel retail technology due to the market access restriction on foreign CRS. Over the past 10 years, there have been dramatic innovations and improvements in global travel distribution technology. The major GDS have a wide range of improvements that have empowered intermediaries, and provided travelers with better choices and greater value. From introducing a graphical user interface, to integrating more robust choices and creating a powerful suite of accuracy and efficiency tools, the global GDSs has taken travel retail distribution to a new level.

Ten years after China’s World Trade Organisation (WTO) accession, the continued lack of direct access by all travel agencies and airlines to foreign CRS is hindering the development of the Chinese tourism industry. The Working Group believes that the liberalisation of China’s CRS market would allow all travel agencies and airlines that are operating in China to benefit from the advanced technology and best business practices that foreign CRS companies are providing to customers in many markets outside of China. The Working Group will pay close attention to the timely promulgation of the CRS regulation.

Recommendation
- Liberalise the CRS regulations and establish a consistent and efficient system of licensing procedures
- Expand the usage of foreign CRS to all the travel agents and companies that are operating in China including domestic companies

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10 The three pilot joint ventures include one tour operator from each of the respective countries - United States, Europe and Japan.
### Abbreviations

<table>
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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CAAC</td>
<td>Civil Aviation Administration of China</td>
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<tr>
<td>CNTA</td>
<td>China National Tourism Administration</td>
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<tr>
<td>CRS</td>
<td>Computer Reservation Systems</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>GDS</td>
<td>Global Distribution System</td>
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<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
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<tr>
<td>WTO</td>
<td>World Trade Organisation</td>
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Section Five: Financial Services
In the area of financial services, the European Chamber has four separate Working Groups which present Position Papers in the following sections:

1. Banking & Securities
2. Consumer Finance & Non-Banking Financial Institutions
3. Insurance
4. Private Equity and Strategic Mergers & Acquisitions

While the area of financial services sees steady progress in terms of opening up, foreign players in this sector are still subject to a wide-range of market access restrictions that limit the scope of business that can be done. The effects of this can be seen in the extremely low market share for foreign banks and insurance companies.

In addition, the operations of companies in this sector are hampered by problems of regulatory efficiency that often stems from there being a large number of different regulatory bodies covering financial services. This can result in a lack of clarity as to where accountability lies and even in contradictory information being issued from different bodies.

Detailed recommendations to the relevant regulators are included in the following papers that it is hoped will be considered constructive input in relation to the development of China's financial services sector.
Key Recommendations

I. Market Access
1. Improve the Speed and Transparency of the Approval Process (CBRC, PBOC, SAFE, CSRC)
   - Improve regulatory speed, transparency, accountability and reliability with regard to foreign financial services institutions to reduce legal and operational uncertainties.
   - Abolish the three-year waiting period to which foreign bank branches are subject before being eligible to submit their application for the RMB licence (CBRC).

2. Develop a Coordinated Approach by Policy and Supervisory Authorities of the PRC Government (CBRC, CSRC, PBOC, SAFE)
   - Increase cooperation between the different government and regulatory bodies with responsibility for financial services and establish an authorised government body to coordinate.
   - Centralise reporting requests from different regulators and submit these in formal (written) format with deadline periods in line with international standards.

3. Allow Greater Ownership and Business Scope for Foreign Players (SCLAO, PBOC, SAFE, CBRC, CSRC)
   - 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.

4. Allow Easier Branch/ Sub-Branch and Business Expansion (CBRC)
   - 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.

5. Increase Access to the Bond Underwriting Market (PBOC, CSRC, MOF, NAFMII)
   - Provide clear application and screening rules for approval and grant foreign banks equal rights with local banks.
   - Accelerate the approval of foreign banks and securities companies to underwrite CGB, PBOC bills, and, financial and corporate bonds in the PBOC market.
   - Build the basic framework of a normal liquid government bond market:
     - with disciplined issuance programs to support large benchmarks.
     - with liquid classic repo market
     - with active and liquid government bond futures markets.
     - with broad range of liquid OTC.
     - with broad and active investors base – both onshore and offshore.
     - with competitive tax rates.

II. Operational
1. Increase Foreign Debt Quota (SAFE, NDRC, PBOC)
   - Increase, and ultimately remove, the short-term debt quota for genuine trade-related uses.
   - Deepen onshore liquidity by putting in place market-based means of funding, with PBOC acting as lender of last resort, using international rates as a benchmark.
2. Enhance Communication and Emphasis of Regulatory Policies (PBOC, CBRC, SAFE, CSRC)
   - Increase two-way communication between regulators and banks about key targets and upcoming policy announcements, to enhance mutual understanding and increase the stability of China’s banking environment.
   - Encourage the use of market-driven tools to regulate loan growth and enhance the quality of bank decision making and credit evaluation.

3. Review Prudential Ratios (CBRC)
   - Remove the net of long-term borrowings from overseas branches from current liabilities, to compare assets and liabilities with the same tenor.

4. Review Loan-growth Restrictions (PBOC, CBRC)
   - Improve regulatory coordination on the topic between PBOC and CBRC so as to take the particular situation of foreign banks into account when assigning such quotas - the impact of the foreign banks will be minimal on the macroeconomic picture.
   - Incorporate some granularity in relation to the industrial sectors so as to favour the sectors the government wishes to promote, and discourage sectors where, for instance, there may be overcapacity problems.
   - Increase transparency so as to supply all players with the same information.

5. Remove the Loan-to-Deposit Ratio Requirements (CBRC)
   - Replace the 75% loan-to-deposit ratio with an alternative measure based on international best practices, or at minimum allow the five-year transition period to start from the date of incorporation for each bank, rather than at a fixed date applicable for all.

6. Address Funding Limitations in the CFETS Interbank Market (PBOC)
   - Remove the two times capital limitation for all banks in China.

Introduction to the Working Group

The Banking and Securities Working Group represents more than 40 European banking and securities financial institutions in China (most of whom are active in commercial banking).

Recent Developments

By the end of 2010, market share for foreign banks in China was 1.83% (in terms of total banking assets). It has been indicated by high-ranking representatives of the China Banking Regulatory Commission (CBRC) to the European Chamber in meetings in late 2010 that it would be desirable for the Chinese market to have at least 5% of market share covered by foreign enterprises by the end of 2011. However, this target currently seems unlikely and market share of foreign banks in fact peaked in 2007 at 2.38%. To meet this 5% target, further encouragement of foreign involvement in this sector needs to occur and the European Chamber offers the constructive recommendations in this paper to help this process.

In April 2011, the revised Foreign Investment Catalogue was released, which maintained that financial services, such as Banking and Securities Companies, would remain “restricted” for foreign involvement in China and that joint-venture requirements for foreign involvement in both Securities and Fund Management companies will be maintained. This is viewed as a missed opportunity to open up these areas for the further involvement of foreign companies who can bring international experience and expertise. The Catalogue is a revision of a previous edition from 2007 and was released in draft format along with an invitation for comment. The Working Group gratefully accepted the opportunity to submit input on the draft and it is hoped that the encouragement of foreign involvement in financial services in China will be reflected in the final revised version.

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1 China Banking Regulatory Commission, ‘2010 Annual Report’
2 Legislative Affairs Office of the State Council, 1st April 2011, ‘The Catalogue of Industries for Guiding Foreign Investment (Draft)’
A number of significant developments have taken place in relation to the increasing internationalisation of the renminbi yuan (RMB) over 2010/2011 that has positive implications for foreign banks in China:

- Firstly, European banks have been heavily involved in the pilot scheme for RMB trade settlement that has been developing since 2009. There is now a growing offshore RMB market in Hong Kong, and other cities have signaled their ambitions to follow suit.
- In November 2010, China introduced credit risk mitigation instruments - a form of credit derivatives for the RMB bond market. To date, one foreign bank has been approved as a core trader and an issuer of these instruments by the National Association of Financial Market Institutional Investors (NAFMII).
- In January 2011, the People’s Bank of China (PBOC) launched a pilot scheme for RMB settlement of outbound direct investments, allowing some Chinese companies to use domestic RMB for overseas direct investment.
- The first RMB initial public offering (IPO) in Hong Kong took place in April 2011 and it is expected that foreign firms will be able to list on the Shanghai Stock Exchange in 2011.
- The State Administration of Foreign Exchange (SAFE) launched RMB options trading on the interbank market from 1st April, 2011, offering companies the chance to hedge against RMB appreciation.
- The PBOC announced on 15th June, 2011 that a trial program has been started to allow foreign companies to use RMB raised offshore to invest back on the mainland. This is the first time China has formalised rules on RMB-denominated foreign direct investment (FDI).

The full convertibility of the RMB on the capital account is regarded as a key component in Shanghai, Beijing and other Chinese cities becoming "international" financial centres, and announcements suggest that this will be achieved in the near future with predictions from analysts suggesting that it could become a reality within five years.

In other developments, the China Securities Regulatory Commission (CSRC) announced in June 2011 that foreign banks incorporated domestically would be allowed to sell mutual funds in China from 1st October 2011. This is a welcome development that should introduce competition to the market and benefit the mutual funds, as well as retail customers and investors.

One further notable development is the increasing presence of Chinese banks in overseas markets - including the acquisition of foreign banks.\(^3\) This development is significant in that foreign banks are not currently permitted to acquire Chinese banks (as detailed further in the ‘Allow greater ownership and business scope for foreign players’ section in this paper).

### Previous Key Recommendations

Last year, a major concern of a number of European banks with branch status was the inability to gain approval for China National Advanced Payment System (CNAPS) membership. Since the publication of the previous edition of this paper, significant progress was seen in terms of this issue, with a more transparent approval process put into place. The Working Group would like to acknowledge this progress and is grateful to the PBOC for their action in this area. However, the approval process remains overly long for those still seeking membership.

There are also a number of points that have been removed from this year’s paper in order to increase the focus on the priorities of the Working Group over 2011/2012. However, the recommendations below made in the previous paper(s) are still relevant and the issues outstanding.\(^4\) These include:

- **a. Data Processing Location** - Foreign banks are required to relocate their data processing systems onshore before receiving the bank card licence. Recommendation: Maintain the existing bank card policy stating data processing systems should be "safe and efficient" without specifying where they should be located.

- **b. Local Fund Agency** – CBRC, in principle, agrees that locally-incorporated banks are qualified to be the agent of local fund distribution, but to date no specific rules, nor approval by the China Securities Regulatory Commission (CSRC) has been granted. Recommendation: Open local fund agency sales to foreign banks on an equal footing with Chinese banks.

- **c. Custody Business** - Foreign bank Qualified Foreign Institutional Investors (QFII) custodians need to re-apply for Qualified Domestic Institutional Investor (QDII) custodians’ approval, whereas local bank QFII automatically qualify

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\(^3\) As of the end of 2010, the five large Chinese commercial banks had set up 89 branches and subsidiaries outside China and acquired or invested in ten foreign banks; six of the national joint stock commercial banks had established five branches and five representative offices overseas and two city commercial banks opened two representative offices overseas (CBRC, 2010 Annual Report).

\(^4\) For further details on any of these recommendations, please refer to the version of this Position Paper (2010/2011) which can be provided by the European Union Chamber of Commerce in China.
for QDII. Recommendation: Grant equal treatment to foreign banks and domestic banks with regards to QDII authorisation.

d. Taxation issues - No other major country levies indirect taxes on funding and lending activities by domestically-registered banks. Recommendation: Waive the 5% Business Tax on onshore lending. Waive the 10% Withholding Tax on offshore borrowing. Waive the 5% Withholding BT levied on payments to overseas service providers.

e. Account-Opening Procedures – The additional account opening procedures announced in late-2009 are overly burdensome on operating procedures. Recommendation: Allow a certain flexibility with regards to the detailed procedures based on the CBRC guidelines, as long as the ultimate goal of fraud-prevention can be achieved.

Key Recommendations

I. Market Access

1. Improve the Speed and Transparency of the Approval Process

Concern
Foreign financial services companies often face a complex, largely non-transparent and time-consuming licence approval process.

Assessment
The members of the Working Group understand the regulators’ need to perform a thorough analysis of each applicant before granting a business licence. The submission and approval process, however, often appears to be unduly long and complicated. For example, after the local incorporation licence has been obtained by a bank, they must also apply for the corporate and retail RMB licence separately. While it is acknowledged that there is a need for regulators to look at separate approvals, the length of time to do so and the lack of transparency in the process unnecessarily increases the time it takes until the newly-established institution is able to offer services to the Chinese consumer. Such delays make it difficult for the financial institution to plan their investment and resources. This time-consuming process eventually creates legal, operational and market uncertainty for the company seeking approval and it may alter its initial decision to enter or invest further in a market.

The three-year waiting period for the RMB licence is a considerable barrier to market entry and contravenes the basic idea of equal treatment for domestic and foreign banks. In addition to delaying investment in new branches, it also obstructs the development of the Chinese banking sector in an unnecessary way. Given the great efforts of the Chinese government to internationalise the RMB, it is unclear why banks registered within the country are not allowed easy access to do business in the domestic currency.

Recommendation
• Improve regulatory speed, transparency, accountability and reliability with regard to foreign financial services institutions to reduce legal and operational uncertainties.
• Abolish the three-year waiting period to which foreign bank branches are subject before being eligible to submit their application for the RMB licence.

2. Coordinated Approach by Policy and Supervisory Authorities of the PRC Government

Concern
The Working Group continues to see better integration of financial services in China. While businesses quickly adjust to these new requirements, the Working Group observes that coordination among different authorities and government bodies - as well as approval processes - often lag behind to the detriment of improved services for consumers and a sound contemporary financial industry in China.

Assessment
There are a large number of separate regulatory bodies in the area of financial services in China. These include PBOC, CBRC, SAFE, CSRC, the China Insurance Regulatory Commission (CIRC), the State Administration of Taxation (SAT) and the National Development and Reform Commission (NDRC). Also the Ministry of Finance (MOF) is authorised to make decisions on tax incentives for certain financial services that contribute towards social stability.

There is often overlap in the areas of responsibility of these bodies and there are cases where segregated approaches lead to conflicting requirements and, in other cases, separate approaches within the same regulatory agencies but in different geographic regions. This leads to delays in the timely expansion of the product scope and market structure in financial services and inefficient processes.

In general, improved coordination and cooperation would
benefit the development of this sector.

After local incorporation, all banks are still required to file or seek approval from local authorities for all new product and service initiatives. This makes the process cumbersome and inconsistent. As banking products become more complex and bundled into solution-oriented products for wholesale and retail customers, there is a need for the relevant Chinese authorities to formulate consistent guidance for all products and services. This will enable more consistent and efficient launches of products that are fast undergoing mass-customisation.

Coordination could be further improved as well in terms of reporting and information requests. The current three-calendar-days submission deadline for month-end reporting is too short and causes unnecessary workload peaks in the controller’s department. The Working Group suggests that the month-end reporting deadlines should be harmonised with international standards (seven working days). Further to this, regulators tend to submit informal requests for information with very short reply lead times (usually within hours). The Working Group has observed that its members can receive up to 30 of these ad hoc requests and surveys from different departments with often similar content at any one time. The preparation of these reports often involves not only the compliance and accounting departments, but other relevant business departments, particularly offshore parent banks, which makes it very difficult to reach the extremely short deadlines. The Working Group recommends that regulators centralise reporting requests (e.g., business continuity plans, audit-, control-, data reports) from the different regulators to avoid duplication of work, and that only formal (written) reporting requests are submitted with deadline periods in line with international standards.

The Working Group would like to advocate more effective coordination among financial market regulatory bodies and looks forward to the prompt implementation of any institutional infrastructure that would encourage greater alignment and coordination in the decision-making processes. This issue has been monitored by the Working Group for some years with little progress evident.

Example cases: Difficulties arising from the lack of coordination between financial regulatory bodies

- The programs facilitating international RMB settlement have been characterised by a lack of coordination between PBOC and SAFE, with it being unclear as to where authority resides for certain issues.
- In one city, the local PBOC office issued a circular in March 2011 in which it assumed regulatory functions that previously had been solely covered by other regulators. This led to a duplication of approval processes that in the best case increases the workload for the applicant, and in the worst case results in the application being caught and delayed between two conflicting regulators.
- Maintaining capital adequacy for banks through foreign-funded capital contributions for Chinese operating entities is hindered by strict controls from SAFE over additional foreign exchange inflow into China.
- PBOC imposed an RMB lending quota on banks (which was communicated verbally only) at the start of 2011 which amounted to an effective reduction on the amount of lending that could be done. Then in March 2011, CBRC communicated that 80% of all loans had to be made in the form of entrustment payments within three months (by June). Many banks had great difficulty in meeting this target, in particular because the time difference between the issuance of the two regulations meant that banks that had been doing non-entrustment lending in the 1st quarter of 2011 simply did not have enough lending quota left to issue more loans as entrustment payments to bring the share up to 80%. Greater coordination between CBRC and PBOC with both instructions being issued together at the start of the year would have allowed for sufficient planning by the banks.

Recommendation

- Increase cooperation between the different government and regulatory bodies with responsibility for financial services and establish an authorised government body to coordinate.
- Centralise reporting requests from different regulators and submit these in formal (written) format with deadline periods in line with international standards.
3. Allow Greater Ownership and Business Scope for Foreign Players

Concern
Foreign banking, securities and fund management companies are subject to a number of rigid and long-standing market access restrictions in terms of ownership and business scope.

Assessment
Foreign banks in China are subject to rules that set a 20% ownership limit imposed on any single foreign investor into a Chinese bank (with a cap of total foreign ownership at 25%). These limits have been long-standing since 2001 and restrict the capacity of foreign banks to grow in the Chinese market. In contrast, according to the 2010 CBRC Annual Report, the five largest Chinese commercial banks had acquired or invested in 10 foreign banks by the end of 2010.

Foreign involvement in the securities and fund management business is restricted to involvement in a joint venture with a Chinese partner, with ownership capped at 33% for Securities Joint-Ventures (SJV) and 49% for Fund Management Joint-Ventures. The scope and amount of securities business conducted by the existing SJVs established since China’s World Trade Organization entry is negligible.

The business scope of an SJV is limited to underwriting and distributing securities. For brokerage services, SJVs are restricted to B share trading (which would also be subject to 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, margin financing are all inaccessible for SJVs.

Recommendation
- 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.

4. 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 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, or of the implementation rules and guidelines being ‘classified’. 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 goes against 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 this risks causing unplanned delays to their expansion strategies in the eastern provinces.

While the Working Group understands the need for detailed submissions, it would like to recommend 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.

Recommendation
- 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.
5. 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 which are not always transparent.

Assessment
Chinese Government Bond (CGB) underwriting is under the scope of MOF, PBOC and CSRC. There are about 60 members of CGB underwriting in total, and of which only three are foreign banks. Since the first foreign bank obtained the CGB underwriting membership in 2004, only two others have been granted this (in early 2008). Specific requirements are given in written form for membership, but regulators also apply stricter criteria - which are not disclosed - to choose members and to keep the total number within 60.

The PBOC bills underwriting market is only open to players with Primary Dealer (PD) certification. It has been stated that the total number of PD would not change as the current number - around 50 - 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 and unclear to applicants. Also the requirements, though not expressly stated, are even stricter for foreign banks than for domestic ones. Currently of the 50 members, only two are foreign banks.

The National Association of Financial Market Institutional Investors (NAFMII) has recently issued new underwriting rules for corporate bonds. The new rules categorise the related members into “Lead Underwriter”, “Underwriter” and “Intended Underwriter”. As far as we know, no foreign banks have been approved as “Lead Underwriter” for corporate bonds and very few have been appointed “Underwriter”. The “Lead Underwriter” qualification has always been held by local commercial banks since 2005. Similarly, only one foreign bank underwrote a financial bond, this was in 2009 and has not been followed by any others.

Working Group members welcome the efforts made so far by financial authorities to establish a strong liquid domestic bond market. The Working Group further understands and supports the government in its step-by-step approach, but at the same time, would like to encourage regulators to proceed more quickly with the reform once it has gained confidence with the initial steps taken.

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 choice, leading to more cost-effective options, lower funding costs and expanded distribution channels, as well as encouraging foreign banks to accelerate the required transfer of know-how.

Recommendation
- Provide clear application and screening rules for approval and grant foreign banks equal rights with local banks.
- Accelerate the approval of foreign banks and securities companies to underwrite CGB, PBOC bills, and financial and corporate bonds in the PBOC market.
- Build the basic framework of a normal liquid government bond market:
  - with disciplined issuance programs to support large benchmarks.
  - with liquid classic repo market.
  - with active and liquid government bond futures markets.
  - with broad range of liquid OTC.
  - with broad and active investors base – both onshore and offshore.
  - with competitive tax rates.

II. Operational

1. Increase Foreign Debt Quotas

Concern
In recent years SAFE (and NDRC for the medium/long term quota) has significantly cut short-term foreign debt quota limits and stabilised (or slightly reduced) them for 2011. The trend for quota reduction goes against a trend of increasing FDI that is the core activity of foreign banks.

The access to liquidity given by foreign currency interbank international markets is of paramount importance for proper and prudent asset/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 tenor above the week.
Assessment
The Working Group recognises the government’s priority to balance China’s short-term and long-term foreign debt, it recognises the value of several regulations in stemming the potential speculation on RMB appreciation, and understands SAFE’s objective of moving away from offshore funding and towards onshore funding. The Working Group also commends the regulations that have been promulgated to remove lending for less than 90 days from the quota for trade-related uses. Banks are also willing to move towards onshore funding (the introduction by the tax bureau of the withholding tax and the thin capitalisation rule provide an “incentive” for this). 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.

Recommendation
- Increase, and ultimately remove, the short-term debt quota for genuine trade-related uses.
- Deepen onshore liquidity by putting in place market-based means of funding, with PBOC acting as lender of last resort, using international rates as a benchmark.

2. Enhance Communication and Emphasis of Regulatory Policies

Concern
The financial industry is still very much dependent on government intervention regarding the growth and allocation of credit. The use of direct quantitative targets, along with the imposition of policy targets with little advance notice, generates some uncertainty in bank management and does not foster the development of strong, autonomous risk management practices.

Assessment
As part of its focus on restraining inflationary pressures, the government imposed strict limits on loan growth for 2011. In mid-February 2011, the PBOC gave banks their first-quarter loan quotas, which in many cases were lower than the amount of new lending by the banks up to the time of the announcement. As a result, banks had to curtail and in some cases draw back lending to their customers, which in turn put the liquidity of their customers under stress. As of late April, banks had not been notified of their lending quotas for the second quarter, which in turn leads to some uncertainty about how management should allocate the previously announced full-year quotas.

The Working Group fully supports the government’s priority on maintaining macroeconomic stability, but we believe that stability could be further reinforced by providing more advance notice of significant requirements affecting core bank businesses, and by giving banks more opportunity to prepare for their implementation.

Similarly, under measures announced in January 2011 to amend the regulation of the derivatives business by financial institutions, the CBRC announced that the standard-model market risk of non-hedging derivatives would be capped at 3% of bank core capital. The tight level of the cap meant that a number of banks had existing risk exposure that was already above the cap level. This led to some confusion among financial institutions about their future ability to conduct derivatives business in China. The Working Group believes that a period of advance consultation for such regulations would benefit the CBRC as well as the banks, by allowing a productive exchange of information about current market conditions and practices and reducing the need for the CBRC to respond to numerous, urgent bank queries after regulations are announced.

The intent of these policies is indeed to reinforce sound bank management practices, a goal the Working Group fully supports. However, when policies are prescriptive rather than principle-based and are announced without prior consultation, they can lead to unnecessary confusion for banks and their customers.

In previous Position Papers, the Working Group has questioned the oral communication method used and the lack of transparency that this process entailed. More fundamentally, the Working Group believes China should rely more on market driven lending practices. Indeed, the
current practices could lead to moral hazard. Due to the relatively underdeveloped financial market, banks do not have a wide range of investment opportunities. They can lend to corporations or households and buy securities (primarily from the PBOC and MOF). In a competitive environment, banks have a strong incentive to meet their profit targets by increasing lending rapidly. As a result, banks tend to use the time without quotas to lend as much as possible, in order to grow their asset base before new quotas are introduced. This pressure to lend quickly may undermine the ability of banks to conduct careful pre-loan assessments of borrowers and loan proposals, carrying risks for future asset quality.

In addition, the use of prescriptive measures such as loan quotas may be less efficient from a macroeconomic perspective than using market-based tools to restrain lending. Demand for credit has remained very strong in part because real interest rates remain very low or even negative after accounting for inflation. This gives borrowers a natural incentive to borrow as much as possible and also encourages banks to lend more to maximise their interest revenues. This, in turn, forces the regulator to impose quantitative limits on credit growth. However, quantitative limits cut off the flow of credit to high-return projects as well as to those with low returns. The use of market price signals – in particular higher interest rates – to restrain the growth of credit could be more economically efficient by requiring borrowers and banks to reassess marginal investment projects and postpone those that do not generate adequate income. This would benefit the quality of investment in the Chinese economy, supporting its advancement and transformation as well as further strengthening its long-term growth.

Recommendation

- Increase two-way communication between regulators and banks about key targets and upcoming policy announcements, to enhance mutual understanding and increase the stability of China’s banking environment.
- Encourage the use of market driven tools to regulate loan growth and enhance the quality of bank decision making and credit evaluation.

3. Review Prudential Ratios

Concern

The net of long-term borrowings financed from overseas branches are treated as current liabilities. This 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 rely on overseas intra-group funding, including long-term borrowing.

However, in China, the net of long-term borrowings from overseas branches is treated as current liabilities. This reduces the liquidity ratio, although no immediate demand for repayment is given.

Recommendation

- Remove the net of long-term borrowings from overseas branches from current liabilities, to compare assets and liabilities with the same tenor.

4. Review Loan Growth Restrictions

Concern

In early 2011, foreign banks were verbally advised by PBOC that they would have an RMB lending quota imposed for the year 2011. This has amounted to an effective reduction in the amount of lending foreign banks can do, resulting in a further reduction in market share as well as potentially impacting businesses with critical financing needs in China.

Assessment

The PBOC RMB loan growth restrictions were announced at the start of 2011 and included some intermediary growth targets to be met already by the first quarter of the year. This quota would be equivalent to the increase of loan assets registered in 2010, with monthly and quarterly reviews.

Local Chinese banks do face similar constraints, however as foreign banks are still at an early development stage in China (accounting for under 2% of market share in 2010), they are at a competitive disadvantage. Those banks which have recently invested in China are immediately constrained in their development while they are at the same time asked by CBRC to generate profitability, which in turn will allow them to access more licenses.

As a result of this sudden reduction in lending from foreign
banks, corporations with genuine financing needs can face difficulties in supporting their own growth plans in the China market, and worse, face critical financial issues, with a direct impact on the economy.

Recommendation
• Improve regulatory coordination on the topic between PBOC and CBRC so as to take the particular situation of foreign banks into account when assigning such quotas - the impact of the foreign banks will be minimal on the macroeconomic picture.
• Incorporate some granularity in relation to the industrial sectors so as to favour the sectors the government wishes to promote, and discourage sectors where, for instance, there may be overcapacity problems.
• Increase transparency so as to supply all players with the same information.

5. Remove the Loan-to-Deposit Ratio Requirements

Concern
The ratio level of 75% between balance of loans and balance of deposits will come into effect at the end of 2011 for all locally-incorporated banks. While the Working Group acknowledges that this ratio is also applicable to the local Chinese banks, the adverse effect of this ratio on the operations of small and medium-sized, locally-incorporated foreign banks, as well as on newly locally-incorporated foreign banks is particularly serious, as they only have a small branch network and thus a very limited ability to gather deposits from the broader public.

Assessment
Article 39(2) of the Commercial Banking Law sets the loan to deposit ratio at 75% and this will apply to locally-incorporated banks once the grandfathering period expires at the end of 2011.

This ratio is uncommon in international practice as other ratios are considered more effective for controlling banks’ operations, for example, 8% capital adequacy ratio and 25% liquidity ratio. The Working Group observes that this ratio incentivises highly cash-collateralised lending that can lead to misallocation of funds and increased cost for the economy as a whole, and would therefore recommend that it is abolished and replaced with other, more effective means.

If the ratio is to remain, as a minimum measure to mitigate the impact, the Working Group would recommend that the start of the five-year grandfathering period is applied as per date of incorporation instead of having a fixed deadline for all players. The current status quo results in a comparative disadvantage to those banks that entered the market only recently and is a significant obstacle to those planning to enter in the future.

Recommendation
• Replace the 75% loan to deposit ratio with an alternative measure based on international best practices, or at minimum allow the five-year transition period to start from the date of incorporation for each bank rather than at a fixed date applicable for all.

6. Address Funding Limitations in the CFETS 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 as their capital is kept at head office level. Therefore foreign bank branches are impacted heavily by this regulation.

Assessment
The two times capital restriction is blocking many foreign banks from more active participation in this market. Lifting the restriction would result in a more active and liquid RMB interbank market which will benefit all banks.

Recommendation
• Remove the two times capital limitation for all banks in China.
### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>CBRC</td>
<td>China Banking Regulatory Commission</td>
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<td>CFETS</td>
<td>China Foreign Exchange Trade System</td>
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<td>CGB</td>
<td>China Government Bonds</td>
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<td>CNAPS</td>
<td>China National Advanced Payment System</td>
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<td>CNY</td>
<td>Chinese Yuan (currency)</td>
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<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>IPO</td>
<td>Initial Public Offering</td>
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<td>SCLAO</td>
<td>Legislative Affairs Office of the State Council</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<td>NAFMII</td>
<td>National Association of Financial Market Institutional Investors</td>
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<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>OTC</td>
<td>Over-the-counter</td>
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<tr>
<td>PBOC</td>
<td>People’s Bank of China</td>
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<tr>
<td>PRC</td>
<td>People’s Republic of China</td>
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<tr>
<td>PD</td>
<td>Primary Dealer</td>
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<tr>
<td>QDII</td>
<td>Qualified Domestic Institutional Investor</td>
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<tr>
<td>QFII</td>
<td>Qualified Foreign Institutional Investor</td>
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<tr>
<td>RMB</td>
<td>Renminbi</td>
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<tr>
<td>SJV</td>
<td>Securities Joint Venture</td>
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<tr>
<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
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<tr>
<td>SAT</td>
<td>State Administration of Taxation</td>
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Key Recommendations

1. Consumer Finance Companies (CFC)
   1.1. CFC Business Development: Expand Geographically and Number of Participants
   • Transform the CFC pilot into standard national operations as quickly as possible, thus allowing all existing and newly qualified players to operate consumer finance in China without regional limitations.

   1.2. Products Portfolio Expansion: Adjust Existing Portfolio of Consumer Finance Products with More Flexible and Mature Products
   • Allow CFCs to issue consumption purpose loans as a first-credit product to consumers without the need for durable-goods loans first.
   • Adjust the maximum loan amount of five-times monthly income to monthly maximal loan-repayment amount.
   • Allow CFCs to offer an extended product portfolio including Private Label Cards (PLC), cards with revolving credit and credit cards.

2. Auto Finance Companies (AFC)
   2.1 Improve Competitive Landscape
   • Enable AFCs to automatically use the guarantee funds from their dealers and Original Equipment Manufacturer (OEM) as a source of funding.
   • Enforce legislation that would reduce the refinancing cost for AFCs, which would also enable them to access the interbank market.
   • Take the business plan as a reference for the authorisation of credit-outstanding levels for newcomers, and consider sales seasonality in the monthly credit-outstanding quotas for existing players.
   • Enforce locally the current legislation for vehicle and real estate mortgages. Mediate with local administrations of industry and commerce to accept the common and legally correct operational procedures of AFCs.

   2.2. Improve Coordination between Regulators
   • Recognise the initially-approved commissioning schemes as the standard process since they have been used for more than five years.
   • Enable AFCs to operate auto-leasing businesses in the cities where they offer credit services.

2.3. Insurance Products
   • Allow AFC to sell auto insurance without having to set up local sales agencies.

3. Supportive Critical Services
   3.1. Consumer Debt Collection Outsourcing
   • Design clear operational rules for the use of external consumer Debt Collection Agency (DCA) by banks and financial institutions, and align these operational rules with the Ministry of Commerce (MOFCOM) Business Licence at a national level.
   • Adopt at national level a unique wording for the business scope for debt collection.
   • Support and enforce the creation of an industry code of conduct for the DCA to protect final consumers from
inappropriate and potentially harassing practices, and to protect the bank’s own reputation.

3.2. Point of Sale (POS) Payment Services and Internet Payment Services (Third Party Payment Services Licences)

- Issue the relevant implementation rules or regulations allowing foreign-owned companies to apply for this licence and to operate under the same conditions and requirements as Chinese companies.

4. Licence Expansion

4.1. Further Develop Non-Banking Financial Institutions (NFBI)

- Allow the creation of credit card companies and mortgage companies spun off from banks. Allow foreign banks and non-banking credit card specialists to manage their own, wholly-invested credit card companies, or to form joint ventures with Chinese banks. Eventually allow CFC to operate credit cards.
- Issue relevant implementation rules or regulations allowing foreign or foreign-owned companies apply for prepaid payment card licences and to operate under the same conditions and requirements as Chinese companies.

4.2. Allow Existing NBFI to Enter Banking Operations

- Allow NBFI to set up commercial banks in China.

Introduction to the Working Group

The Consumer Finance & Non-Banking Financial Institutions (NBFI) Sub-Working Group was established in 2008. It includes leading European consumer finance specialists who operate in China through consumer finance companies (CFC), auto finance companies (AFC), retail banks, small loan companies and other entities engaged in consumer finance services in cooperation with third parties (e.g. guarantee companies). The establishment of a Sub-Working Group (under the Banking & Securities Working Group) focused on the consumer finance industry is a strong reflection of the emerging consumer finance industry in the Chinese market as well as its relevance for major policy objectives of the State Council and the attention that European players attach to this agenda.

Recent Developments

The consumer finance market in China has seen noteworthy developments in the past few years. Not only traditional products such as mortgages and car loans, but also new credit products offering unsecured small loans for daily consumption purposes, are on the rise. It is a clear reflection of increasing demand for modern, easy-to-access credit financial services designed to support the daily consumption needs of mass consumers, in particular emerging middle- to low-income consumers who represent a significant portion of domestic consumption power. It is not only traditional commercial banks, but non-banking-based consumer finance specialists that are building their business presence in the emerging consumer finance market across China with the objective of serving the middle- to low-income market segment that has not been the focus of the mainstream banking sector.

It is a strategic goal of the government of the People’s Republic of China (PRC) to shift the economy from a primarily export- and investment-oriented model into a more consumption-driven model, reaching a more balanced proportion between key economy-growth drivers. Consumer finance growth is expected to reach a Compound Annual Growth Rate of 20 to 30% for the period 2010 to 2014 for North Asia (China, Japan, South Korea) with China being the major driver and contributor of this trend. As a result, emerging markets are expected to take a quarter to a third of a share of the global consumer finance market in the next five years, with China becoming the global leader in this segment.
A further major regulatory breakthrough in the building of a sustainable consumer finance industry in China was achieved in July 2009 when the China Banking Regulatory Commission (CBRC) issued “The Administrative Measures for Pilot Consumer Finance Companies” (Measures) which established the major framework for the future development of consumer finance services on the basis of non-banking financial institutions — consumer finance companies. According to the Measures, CFCs will operate under the supervision of the NBFI regulatory department of the CBRC and its core business activity will include “consumption loans for the purchase of durable goods, consumption needs as well as other consumer finance services”. These consumption loans and services are making CFCs an innovative platform to serve the daily consumption needs of emerging middle- to low-income consumers alongside the more complex products offered by commercial banks. Four cities were selected to participate in the pilot, namely Beijing, Tianjin, Shanghai and Chengdu. Four CFCs, with diversified backgrounds and expertise, have been approved by the CBRC in these cities, including those invested by leading local commercial banks as well as those invested by international consumer finance specialists.

While the Measures have provided a solid framework for consumer finance operations to start up in the Chinese market, continuous development of consumer finance raises new challenges in the key areas of business expansion, product, operations, funding, as well as other areas. These challenges may require further adjustments to existing policies, reflecting the long-term development needs of the industry.

Meanwhile, consumer finance plays a crucial role as an overall driver of domestic individual consumption and retail sales. In some markets, nearly half of all retail sales of consumer items are purchased through some form of consumer finance, leading to a substantial increase in sales volumes that is beneficial not only to retailers, but also to manufacturers and the whole national economy. The steadily growing consumer finance industry in China can lead to similar achievements and represent a significant contribution to overall national economic growth. Assuming there are supportive policies in place, it is estimated that consumer finance could represent up to 25% in overall retail sales volumes in the next five years.

The Working Group would like to contribute to the development of this industry in China, providing recommendations based on the observations and assessments of its members, all the while objectively sharing the experience and opinions of the European financial services on this emerging and important segment of China’s economy.

At the same time, members are further addressing in this document other important issues related to AFCs and other supporting services that are critical to the proper and sustainable development of consumer finance services in the wider sense of the words in China.

Key Recommendations

1. Consumer Finance Companies

1.1. CFC Business Development: Expand Geographically and Number of Participants’ Concern

While the Measures have provided a solid framework for consumer finance operations to start up in the Chinese market, continuous development of consumer finance raises new challenges in the key areas of business expansion, product, operations, funding, as well as other areas. These challenges may require further adjustments to existing policies, reflecting the long-term development needs of the industry.

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At the same time, members are further addressing in this document other important issues related to AFCs and other supporting services that are critical to the proper and sustainable development of consumer finance services in the wider sense of the words in China.
Recommendation

- Transform the CFC pilot into standard national operations as quickly as possible, thus allowing all existing and newly qualified players to operate consumer finance in China without regional limitations.

1.2. Adjust the Existing Portfolio of Consumer Finance Products with More Flexible and Mature Products

Concern

There are several concerns in relation to a CFCs’ product portfolio: 1. A CFC has to serve each new customer with a consumer durable goods loan prior to offering general consumption purpose loans; 2. The maximum loan amount of five times the monthly income is yet another limiting factor for providing longer-term consumption loans of a higher amount (such as household reconstruction); 3. The existing loan scale including durables consumption loans and general consumption purpose loans may not cover properly the development needs of the modern CFC, which, typically, can further provide products such as Private Label Cards (PLC), revolving credit cards or even credit cards.

Assessment

1. Non-durable Loans as A First Credit Product to Consumers

There is a considerable number of customers who have non-durable needs such as home decoration, weddings, travel and other similar daily consumption activities. However, currently, CBRC requires that a customer’s first consumption loan must be made towards a durable good. As long as there is proper risk management in place, there should be no principal obstacle in allowing general consumption purpose loans to be the first product offered to new customers. This would bring higher efficiency to the sales network, thus further optimising overall profitability and the financial performance of CFCs.

2. Maximum Loan Amount of Five Times Monthly Income

The current maximum loan amount limits the provision of certain types of consumption loans such as home decoration loans or the purchase of more expensive transportation vehicles. It also does not support loans with longer-term maturity and higher loan amounts. This limit should be adjusted to monthly maximal loan repayment of not more than 50% of the disposable monthly income. In this way, there will still be an efficient preventative measure to avoid consumers from becoming “over-indebted”, while at the same time this approach will provide CFCs with greater space to respond to consumers’ credit needs. Meanwhile, CFCs should at the same time implement corresponding risk-control measures to ensure that they have full control of the risk exposure of such loans.

3. Extended Product Portfolio

The sustainable development of consumer finance requires that in addition to basic “sales finance” products, CFCs can offer more sophisticated products such as cards with revolving credit and credit cards. This will ensure CFCs will not see their development reduced to simplified sales finance platforms but will indeed be encouraged to become sophisticated financial entities establishing more complex relations with consumers over time. Obviously, each CFC should have a corresponding support system as well as risk control tools to support such products. The CFC business scope could be adjusted to allow qualified CFCs to offer credit cards. This practice can be observed in many international markets as a proven model leading to the building of healthy, sustainable and profitable credit card businesses.

Private Label Cards (PLCs) are a means of payment carrying the name of a retailer, but which are issued and managed by a third party processor — such as a CFC. PLCs offer a revolving capability on installment credit that can only be used exclusively at some designated stores or retail chains not like bank cards that can be swiped anywhere.

PLCs are extremely important for retailers in generating loyalty and increasing retention, as customers are using revolving credit to purchase within store chains. While the card is active, the customer can pay for all or part of the purchases, or opt to spread out repayments by using the credit that comes with the card. The cost of using the credit is taken from an interest rate based on the amounts used. This revolving credit gives the consumer flexibility. It is up to the customer to decide when to use the credit. At the same time, PLCs can be viewed as an education tool through the implementation of credit limits, which contributes to limiting the risk for the CFC. In summary, PLCs present important advantages to consumers, issuers and retailers.
PLCs create a win-win situation between retailers and the issuer, mostly CFCs, as they enable retailers to focus on their core business (to explore ways of attracting cardholders), and to experiment with more ambitious reward and loyalty programmes. In the meantime, most of the third-party issuers increase their investment in services for their retail card partners, offering more assistance with everything from marketing and advertising to rewards administration and customer service. PLCs, therefore, are fully in line with the CBRC guidelines, as they offer a loan designed for specific purposes, and are an efficient way to monitor risk through the implementation of credit limits that provide a good knowledge of the customer.

Recommendation
- Allow CFCs to issue consumption purpose loans as a first-credit product to consumers without the need for durable-goods loans first.
- Adjust the maximum loan amount of five times monthly income to a monthly maximal loan repayment amount.
- Allow CFCs to offer an extended product portfolio including PLCs, cards with revolving credit and credit cards.

2. Auto Finance Companies (AFC)

2.1 Improve Competitive Landscape

Concerns
1. Funding price given to AFCs is currently distorted by domestic banks, as an AFC can only refinance through domestic banks.
2. Arbitrary credit lending quotas set by the PBOC to curb inflation have been applied for the first time ever to AFCs.
3. Local land and vehicle registration offices use their own arbitrary interpretation of clear and transparent PRC laws on mortgage registration for real estate and cars.

Assessment
1. Although AFCs are in theory entitled to access the interbank rate market with PBOC approval subject to meeting certain conditions, AFCs in practice can only refinance through domestic banks.

Funding is a key issue for AFCs as higher pricing for consumers is driven by the refinancing rate that AFCs receive from the banks. Indeed, banks, who see AFCs as competitors, oblige them to refinance at higher rates with the reference rate of the PBOC, instead of the SIBOR\(^1\).

The issuance of bonds has been authorised within limits set by the regulator. Yet, asset-backed securities issues were stopped during the financial crisis and no agreements have so far been obtained by parties requesting issuance of such instruments (even though they had fulfilled criteria requirements).

AFCs were then urged to adopt a high pricing policy in order to remain profitable, which has affected their competitive position vis-a-vis banks. AFCs are pressing for funding conditions similar to local banks. Better access to a more diversified source of funding would enable them to improve their pricing and related services ultimately to the benefit of their customers.

2. Credit outstanding quotas have been established for AFCs as part of the measures implemented to reduce inflation. However, the ways the measures are monitored do not take into account the seasonality but a compounded annual incremental growth factor. Rules are also not monitored in the same way across cities. For instance, quotas are provided on a monthly basis in Beijing but quarterly in Shanghai, providing more flexibility to the AFCs headquartered in Shanghai. A more systematic approach implemented nationally would create a more predictable environment.

3. The regulations on mortgage registration and renewal are not implemented by local land registration offices. They use arbitrary and non-transparent rules with higher complexity and without any legal security for the mortgagor.

Local vehicle registration offices also add arbitrary rules to the national regulations, favouring related public notaries or charging additional illegal fees. Mortgage de-registration can often be executed only with a lender physically present, which poses huge logistical challenges for AFCs without local branches.

Recommendation
- Enable AFCs to automatically use the guarantee funds from their dealers and Original Equipment Manufacture (OEM) as a source of funding.
- Enforce legislation that would reduce the refinancing cost for AFCs, which would also enable them to access the

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\(^{1}\) Singapore Inter Bank Offered Rate
interbank market.

- Take the business plan as a reference for the authorisation of credit-outstanding levels for newcomers, and consider sales seasonality in the monthly credit-outstanding quotas for existing players.
- Enforce locally the current legislation for vehicle and real estate mortgages. Mediate with local administrations of industry and commerce to accept the common and legally correct operational procedures of AFCs.

2.2. Improve Coordination between Regulators

Concern

1. Commercial bribery
   - Since September 2010, the commissions paid by the AFCs to dealers are considered as commercial bribes by some Administrations of Industry and Commerce (AIC). However, the CBRC approved the first AFC processes, which included Commissions, as early as 2005.

2. Leasing
   - The CBRC Administrative Measures for Auto Finance Companies authorize AFCs to offer financial leasing. Nevertheless, Transit Authorities require the setting up of branches in order to proceed to auto leasing activities. Given that AFCs are financial institutions that are permitted to operate nationwide with a single headquarter branch, these additional requirements create an unnecessary additional burden.

Assessment

1. Some industry players have been reportedly investigated by AICs for conducting commercial bribery in China when paying financing or service fees. However, the scheme was approved by the CBRC in 2005 and is a common international industry practice. Some other European players have also been facing similar issues. An example of this is the case of Hangzhou AIC commencing an investigation under the 1993 Anti-Unfair Competition Law.

The difference between local banks and AFCs comes from the marketing and service provided to the client and the retailer. Traditionally, interest rates offered to retail clients through AFCs are generally higher than those offered through local banks. The service is also rewarded through a commission as an incentive paid to the dealer. This commission is a common European market practice which has never been attacked under those terms. The most surprising point is the principle of the commissioning was approved since the creation of the first AFCs by the financial regulator that is in charge of licensing this type of company.

2. In 2008, the administrative measures governing the AFCs were adjusted in order to enable them to offer to their clients auto financial leasing services. Nevertheless while willing to implement the new services; AFCs have been stopped by local Transit Authorities regulations which require leasing companies to have branches in cities where they are operating. AFCs have been blocked from developing auto financial leasing outside their headquartered city because they are entities with a national licence limited to a single branch in the city where they are headquartered.

Recommendation

- Recognise the initially approved commissioning schemes as a standard process because they have been used for more than five years.
- Enable AFCs to operate auto leasing businesses in the cities where they offer credit services.

2.3. Insurance Products

Concern

AFCs can only sell insurance products if they receive their commissions through local branches. The establishment of such branches is subject to the CBRC’s approval, and represents huge costs that cannot be covered with the commission generated from insurance sales.

Assessment

AFCs are technically allowed to conduct agency business relating to auto purchase financing, such as auto insurance. However, AFCs need to open a local sales branch to meet the requirement of the China Insurance Regulatory Commission (CIRC) in order to collect the commissions linked to the sale of contracts. This requirement is not financially sustainable and generally not in line with the business model of AFCs, who finance their clients throughout China from their company headquarters. It is not sustainable as such, for AFCs to set

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2 Administrative Measures for Auto Finance Companies China Banking Regulatory Commission, 24 January 2008
4 Anti-Unfair Competition Law of the People’s Republic of China, Standing Committee of the National People’s Congress, 09 February 1993
5 Administrative Measures for Auto Finance Companies, China Banking Regulatory Commission, 24 January 2008
up local agencies in each province to distribute only auto insurance.

Recommendation
• Allow AFCs to sell auto insurance without having to set up local sales agencies.

3. Supportive Critical Services
3.1. Consumer Debt Collection Outsourcing

Concern
Consumer debt collection agencies (DCA), while currently employed by retail banks and financial institutions are still not equally and clearly regulated at national level.

Assessment
Consumer debt collection is one of the key operational tools that banks and finance institutions use to effectively manage the credit risk for retail banking and enforce the Non-Performing Loans (NPL) controls. Banks and finance institutions, facing increased operational costs, are increasingly looking for opportunities to reduce fixed costs in this area, relying on qualified external DCA.

The CBRC issued in July 2009 the “Notice on Further Regulating Credit Card Business” (Notice N.60). It recognised (Clause 13) that banks and financial institutions are currently relying on external DCA for consumer debt. The notice invites banks and financial institutions to define internal procedures to “qualify” these suppliers, but gives no further specific details on that.

While the Notice is specifically related to credit cards, in the absence of other information, retail banks may choose to apply the notice also to the personal loan departments, thus effectively defining “selection criteria” for DCA for the whole retail bank area.

At the same time, banks and financial institutions may face difficulties in defining the selection criteria at national level, as one of the most commonly defined selection criteria is the business licence. However, as previously mentioned, the consumer debt collection business is not clearly regulated at national level by the MOFCOM and different provincial AIC allow different business licence registration for the same debt collection business.

Shanghai AIC is currently under-going the process of issuing a new permitted business scope wording registration for the debt collection agencies, but the actual words used⁶ might be not fully accepted by some retail banks as selection criteria for being a supplier since there is not a clear Business Scope wording shared among the banking industry or the provincial AIC.

Recommendation
• Design clear operational rules for the use of external consumer DCA by banks and financial institutions, and align these operational rules with MOFCOM Business Licence at national level.
• Adopt at national level a unique wording for the business scope for debt collection.
• Support and enforce the creation of an industry code of conduct for the DCA to protect final consumers from inappropriate and potentially harassing practices, and to protect the bank’s own reputation.

3.2. Point of Sale (POS) Payment Services and Internet Payment Services (Third Party Payment Services Licences)

Concern
There are no implementation rules or regulations yet allowing foreign companies to operate and apply for this license under the same conditions as local players.

Assessment
POS procurement and internet payment activities will be handled under a licence for which Chinese companies are requested to meet the criteria of the newly issued regulation⁷ before September 2011. The regulation provides that such application is not open to foreign-invested, foreign-controlled or wholly foreign-owned enterprises, which will be dealt with separately.

As there are no such separate regulations published for foreign or foreign-owned entities to date, the foreign-owned entities currently issuing prepaid cards, be it financial, service, consulting or retail companies, are threatened to with unfair competition bias should they not be allowed to operate under a clear regulatory status at the same time as Chinese parties.

Recommendation
• Issue promptly relevant implementation rules or regulations allowing foreign or foreign-owned companies to apply for this licence and to operate under the same

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⁶ 行缴费通知等金融外包服务
⁷ Administrative Rules for the Payment Services by Non-financial Institutions, PBOC, promulgated 14 June 2010, effective September 1st 2010
conditions and requirements as Chinese companies.

4. Licence Expansion

4.1 Further Develop Non-Banking Financial Institutions (NFBI)

Concern
Credit card licences are reserved for banks only, and are not open to non-banking financial institutions. There are also no specialised mortgages entities in China. Prepaid payment cards activities licences are not open to foreign-owned entities.

Assessment
In many Asian and Western markets, credit cards are frequently spun off from banks and managed by independent companies. Many of them remain controlled by banks via the shareholding structure and their assets are clearly identified from the overall assets of a bank. This legal structure forces credit card companies to better manage their risk and to develop niche skills to better adjust to consumer needs. The absence of specialised credit card companies in China does not permit the development of specialised know-how and skills.

There are also no specialised mortgage entities existing in China, which similarly inhibits the development of specialised niche know-how and skills.

The creation of a specific status with lower minimum capital and foreign parent ownership asset size requirements would enrich Chinese financial markets with such skills.

Prepaid payment cards activities will be in the future conducted by companies requested by PBOC regulations\(^8\) to register before September 2011. The regulation, which invites prepaid card actors to apply for relevant licences, provides that such application is not open to foreign or foreign-owned entities, which will be dealt with separately.

As there is no such separate regulation published for foreign-owned entities to date, the foreign-owned entities currently issuing prepaid cards are threatened with unfair competition bias should they not be allowed to operate under a clear regulatory status at the same time as Chinese parties.

Recommendation
- Allow the creation of credit card companies and mortgage companies spun off from banks in order to ensure fair competition. Allow foreign banks and non-banking credit card specialists to manage their own, wholly-invested credit card companies, or to enter into joint ventures with Chinese banks. Eventually allow CFCs to operate credit cards.
- Issue promptly relevant implementation rules or regulations to allow foreign or foreign-owned companies apply for prepaid payment card licences and to operate under the same conditions and requirements as Chinese companies.

4.2 Allow Existing NFBI to Enter Banking Operations

Concern
There are certain barriers to NFBI (i.e. AFCs) establishing foreign-funded banks at both regulation level and supervision level.

Assessment
According to the Regulations on the Administration of Foreign-funded Banks, the sole shareholder or the controlling shareholder of wholly foreign-funded banks must be a commercial bank. Although foreign NFBI (i.e. AFCs) are financial institutions with rich international experience in banking, and hold and operate one or more banks around the world, they cannot directly invest to establish a local bank under the above restriction. In addition, it is unclear that why the CBRC would not accept an application for establishing a bank by the NFBI or its affiliated bank. According to an unofficial reply from the CBRC, only one financial institution can be established by an auto financial service group. If an AFC has already been established by an auto financial service group, no other application to establish a financial institution can be accepted.

Recommendation
- Allow NFBI to set up commercial banks in China.

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\(^8\) Administrative Rules for the Payment Services by Non-financial Institutions, People's Bank of China, promulgated 14 June 2010, effective September 1\(^{st}\) 2010
### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>AFC</td>
<td>Auto Finance Company</td>
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<tr>
<td>AIC</td>
<td>Administration of Industry and Commerce</td>
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<td>CBRC</td>
<td>China Banking Regulatory Commission</td>
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<td>CIRC</td>
<td>China Insurance Regulatory Commission</td>
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<tr>
<td>CFC</td>
<td>Consumer Finance Company</td>
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<tr>
<td>DCA</td>
<td>Debt Collection Agency</td>
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<td>MOFCOM</td>
<td>Ministry of Commerce</td>
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<td>NBFI</td>
<td>Non-Banking Financial Institution</td>
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<td>NPL</td>
<td>Non Performing Loans</td>
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<td>OEM</td>
<td>Original Equipment Manufacturer</td>
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<td>PBOC</td>
<td>People's Bank of China</td>
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<td>PLC</td>
<td>Private Label Card</td>
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<td>POS</td>
<td>Point of Sale</td>
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<td>PRC</td>
<td>People's Republic of China</td>
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<td>SIBOR</td>
<td>Singapore Inter Banking Offered Value</td>
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Key Recommendations

1. Improve Geographical Network Expansion
   - Implement approval of concurrent branch applications for foreign insurers who wish to extend their geographical distribution network into several provinces and large cities at the same time.
   - Delegate market admission competencies to local CIRC for branches at and below province level for foreign insurers that are already licensed in China.

2. Remove Market Access Restrictions
   2.1 Enterprise Annuity Business
   - Include foreign insurers in the group of companies licensed to conduct enterprise annuity business.

   2.2 Market Access Restrictions on Compulsory Lines
   - Eliminate any restrictions that hinder foreign insurers’ access to compulsory lines of business, such as underwriting compulsory Motor Vehicle Third Party Liability.

   2.3 Broaden Scope for Foreign Brokers
   - Remove the license restrictions for foreign brokers so that they can operate on the same basis as local brokers and make a full contribution of their capabilities to clients in all areas of the insurance market.

3. Increase the Flexibility for Foreign Owned Organizations’ Structures
   3.1 Reduce Joint Venture (JV) Restrictions
   - Discontinue the formal obligation for foreign life insurers to establish their own market presence in form of an equity JV.
   - Liberate the level of foreign shareholding within JVs beyond 50%; likewise, liberalize the option of taking more than one domestic investor into the JV sharing the Chinese investment participation.
   - Liberate the level of permitted equity investment by foreign insurers in existing domestic insurance companies.

   3.2 Capital Requirements for Trade Credit Insurance Companies
   - Consider licenses for foreign trade credit insurers who can justify their expertise and long-term sustainability and, in particular, reduce minimum capital requirements for these insurers with an official international rating.
   - Issue licenses for the coverage of all China.
   - Abandon the monopoly of Sinosure and allow local insurers to provide short-term export trade credit insurance.

   3.3 Health Insurance
   - Treat health insurance as a distinct category of insurance. In this way, regulations can be developed to address the specific needs of the health insurance sector. A company should be able to hold both life insurance and health insurance licences since they will be of separate categories.
   - Allow foreign specialist health insurers’ ownership beyond the current 50% foreign ownership restriction.

4. Ease Restrictions in Foreign Capital Conversion
   - Revise foreign exchange regulations to enable licensed foreign insurers in China to have prompt access to paid-up capital injected in foreign currencies.
• Allow insurance companies to buy foreign exchange swaps.
• Permit insurance companies to borrow RMB on the basis of the foreign exchange deposit.

5. Representative Offices
• Simplify, for foreign insurance representative offices, the annual business-license review process based on an annual report to CIRC and waive the home country business existence certificate, annual external audit for foreign insurance representative offices.

6. Brokers
   6.1. Broker Appointment Letters
   • Implement strict guidelines enforcing a rule that a letter of appointment remains valid unless the appointed broker has failed to meet his contractual obligations under that letter.

   6.2. Unethical Behaviour by Certificated Brokers
   • Issue strict guidelines to forbid a broker or agent from working for a second company, unless specifically agreed in writing with all companies concerned. Where infringements occur, the regulators should punish the individuals involved by removing their certification to act as an insurance broker or agent for a period of time.

Introduction to the Working Group
The Insurance Working Group represents leading European insurers and brokers engaged in life, nonlife, 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 Chinese insurance. 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 practice and technical know-how.

Recent Developments
Combined industry premiums were CNY1, 453 billion (EUR159 billion) in 2010, a 30.44% increase over 2009. Foreign insurance enterprises account for 5.63% in the life insurance market and 1.06% in the property insurance market, compared with 4.92% and 1.09% in 2009.

The insurance industry can play an important role in “innovative social administration”. Foreign insurers can contribute to develop liability insurance and provide products in specific aspects such as agriculture-related insurance, health insurance, insurance for the floating population and the cultural industry.

The major development in 2010 is the promulgation of Social Insurance Law. It covers pension insurance, unemployment insurance, medical insurance, maternity insurance and work-related injury insurance. It’s designed to improve insurance fund management, increase the coverage for the 5 insurance schemes and eliminate the different treatment between urban and rural residents and between civil servants and enterprise employees. It defines the responsibilities of government, enterprises and individuals. This law will also provide great opportunities to commercial insurance.

In January 2011, the European Chamber submitted comments on the formulation of the 12th Five-Year Plan to the Chinese government. This is the first time foreign enterprises had the chance to express their opinions during its drafting. European companies responded to the call with enthusiasm, demonstrating their commitment to the social and economic development of China. The major concerns of European insurers include market access, the coverage of natural catastrophe insurance, environment liability insurance and enterprise annuity business.

In March 2010, the Insurance Working Group met with...
China Insurance Regulatory Commission (CIRC) Vice-Minister Li Kemu and, in 2011, Assistant Chairman Chen Wenhu. The Working Group appreciates CIRC's openness to a constructive dialogue that it considers will benefit European insurers, China’s insurance industry, and most importantly Chinese people.

In 2011, the Working Group also learned that the CIRC may accept concurrent branch licence applications from foreign insurers and that a consensus may have been reached on fully opening the auto insurance market7.

**Regulatory Environment**

The development of the insurance intermediaries market is a 2010 highlight. Premiums collected through the channels of insurance intermediaries account for 75.8% of the total collection8. In October 2010, CIRC promulgated the Opinions to Reform and Improve the Insurance Salesperson Management Mechanism9, which encourages various forms of capital, including foreign capital, to invest in establishing large insurance agencies and insurance sales companies and to carry on current sales models by establishing new insurance sales systems. CIRC also regulated the telesales of property insurance products10.

In March 2011, CIRC promulgated the Guidance for Supervision of Bancassurance Services of Commercial Banks11, which sets a regulatory framework for the insurance product sales channel for business agents.

**Broadened Investment Channels**

In August 2010, CIRC promulgated Tentative Measures for the Administration of the Use of Insurance Funds12, which eases the restrictions of investment in real estate and private equity and sets forth the requirements that insurance funds should meet. Also, in September 2010, CIRC promulgated Tentative Measures for Insurance Funds Invested in Private Equity13, according to which insurance funds would be permitted to invest in renminbi (RMB) funds and would allow direct private equity portfolio investments. In September 2010, Tentative Measures for Insurance Fund Invested in Real Estate permits insurance companies to invest in relevant industries such as healthcare, auto service and so on14.

**Key Recommendations**

**1. Facilitate Geographical Network Expansion**

**Concern**

Regulatory processes for admitting licensed foreign insurers into additional provinces continue to be centralised at national level rather than being decentralised to the provincial level. Additional provincial branches for foreign insurers are only approved consecutively with relatively long processing times between two approvals. This results in artificial administrative hurdles for geographical expansion without due regard to the actual operational or financial capacity of the applicant company.

**Assessment**

The insufficient geographical spread of commercial insurance has been a key concern of the Chinese Government as it would be one way to help reduce social and economic imbalances. Consequently, China has increased the number of admitted insurance companies during recent years, of which some have anchored their operations outside China’s few traditional financial centres. This indicates the growing interest of provincial governments in harbouring indigenous insurance companies, but also demonstrates the growing regulatory confidence in adequate supervision at provincial level.

Foreign insurers have been part of the Chinese market for more than a decade and China’s high level representatives have generally emphasised that foreign investors who have set up lawfully registered businesses in China would be treated as domestic companies.

Foreign insurers have learned to manage their operational

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capacities and grow at a sustainable speed. Therefore, given the increasing breadth and depth of insurance demand across China’s regions, their geographical expansion would contribute toward the faster spread of insurance coverage. There is no need for artificial regulatory admission hurdles so long as solvency and operating capacity of foreign companies are sound enough meet the speed of expansion they desire.

Recommendation
- Implement approval of concurrent branch applications to foreign insurers who wish to extend their geographical distribution network into several provinces and large cities at the same time.
- Delegate market admission competencies to local CIRC for branches at and below the provincial level for foreign insurers that are already licensed in China.

2. Remove Market Access Restrictions

2.1 Enterprise Annuity Business

Concern
Despite proven international experience in operating corporate and individual pension insurance business, foreign companies have so far not been admitted to this strategic commercial insurance market.

Assessment
The implementation of the new Social Insurance Law alone may not prove adequate to sustain consistently rising living standards beyond a relatively low replacement rate. Additional forms of pension provision need to be introduced at a significant scale, including a wider spread of enterprise annuity business.

Enterprise annuity arrangements have been on the Chinese market for some time, but their spread has not yet reached a socially desirable scope. This may be caused by a variety of factors – including insufficient demand among China’s domestic corporations, multiple regulatory authorities and insufficient financial incentives. In view of decades of experience in providing supplementary commercial pension insurance in a social security system that is structurally comparable to China’s forward-going model, European insurers may be well-equipped to contribute toward solving some of these issues, including modelling the system as well as the actual operation of enterprise annuity business.

Recommendation
- Include foreign insurers into the group of companies licensed to conduct enterprise annuity business.

2.2 Market Access Restrictions on Compulsory Lines

Concern
Foreign non-life insurers are not allowed to underwrite any compulsory insurance, including motor vehicle third party liability (MTPL) insurance. Under present circumstances, this excludes foreign insurers effectively from personal lines in non-life insurance, and keeps their market share at 1%.

Assessment
Compulsory insurance lines may become a rapidly expanding and a wide-ranging field in China given the low levels of insurance awareness, strong regional and social differences and the need to enhance basic insurance coverage in public liability, disaster recovery and environmental protection.

This has been the case for the compulsory MTPL introduced in 2006. Today, motor insurance in China accounts for about 77% of the total non-life premiums, of which about 35% is MTPL business. Besides the premium income, MTPL is considered as an effective front channel to contact individual clients. The prohibition on foreign insurers’ access to MTPL business limits their ability to develop downstream commercial networks capable of reaching individual clients, because the majority of clients would not use two insurers to cover the same vehicle. As a result, foreign non-life insurers find it difficult to underwrite enough business income to support the expansion of sales points and the creation of their own network of agents.

This fact becomes more relevant when considering the market impact of increasing the efficiency of product distribution and guaranteeing the correct assessment on products and covers for individual clients. While it was agreed during the negotiations for China’s accession to the WTO that foreign insurers in the non-life industry would be banned from writing statutory insurance lines, a limitation like this does not contribute toward improving the performance of the motor insurance business segment.

Recommendation
- Eliminate the restrictions that hinder foreign insurers’
access to compulsory lines of business, such as underwriting compulsory MTPL.

2.3 Broaden Scope for Foreign Brokers

Concern
Domestic and foreign insurance brokers should receive equal treatment for market access, as agreed between China and the WTO. However, the licences granted to foreign insurance brokers in China restrict them to working only with medium- and large-sized companies.

Assessment
The CIRC licence for foreign brokers restricts them to doing business with companies with an investment capital of more than CNY150 million (EUR 15.74 million) and more than CNY400,000 (roughly EUR 42,000) premium. Thus many of the companies in the SME sector would fall outside the scope of the business licence. From a marketing point of view, it is difficult for foreign brokers to target just the larger companies in this segment.

As a result, foreign brokers are prevented from using their global experience of developing SME business to contribute to the further development of the Chinese insurance market. It should be noted that foreign brokers will not normally be able to access this widespread market of very many customers alone, using their existing distribution strategy. This is because the SME business is both local in nature and very dependent on relationships. Furthermore, the foreign brokers have only a limited network of local offices, restricting access to clients and the ability to provide the necessary local servicing. They would therefore need, as elsewhere in the world, to work in cooperation with smaller, local brokers and make use of technology to access clients in this sector.

Recommendation
- Remove the licence restrictions for foreign brokers so that they can operate on the same basis as local brokers and make a full contribution of their capabilities to clients in all areas of the insurance market.

3. Increase the Flexibility for Foreign Invested Organizations’ Structures

3.1 Reduce Joint Venture (JV) Restrictions

Concern
The obligation for foreign life insurers to establish their own operations in China in the legal form of a JV with a maximum foreign shareholding of 50% imposes artificial limits for sovereign market participation and may even cause operational problems in managing such ventures. Likewise, imposing a ceiling below 25% in equity investment into existing domestic insurance companies may not facilitate sufficient management influence by the foreign investor to ensure operational improvements or the profitable strategic positioning of the company.

Confining domestic and foreign insurers to one single engagement in the same branch of business prevents a spread of service and long-term comprehensive market engagement as already permitted to domestic competitors.

Assessment
Currently, foreign financial services are categorized as “restricted” in their market access in China (cf. State Council Foreign Investment Catalogue). For foreign life insurance companies this policy is reflected in an obligation to establish their business – as opposed to investment into existing domestic companies – in the legal form of a separate equity JV in which their shareholding is capped at 50% of equity. In the light of historical experience since China’s admission into the WTO this formal restriction has not always proved advantageous either for the wider spread of international risk management standards or for consistent operational strategies in cases where JV partners failed to agree on longer term business objectives or capital funding. On the other hand, the concept of strategic partnerships between foreign and domestic investors may very well prove to be effective if the JV partners provide mutually supplementing competencies in developing sustainable business models, share common long-term objectives and are capable of consistently providing capital for funding organic growth.

There may be changing individual circumstances for either shareholder during the business development of their JV. If this cannot be reflected in adjustments of the shareholding structure it may cause inconsistencies and instabilities in managing the company.

While the market regulator has already admitted changes in the shareholding of foreign-funded JVs toward a higher equity participation of domestic partners, including splitting up the domestic investment among several Chinese shareholders, the same should in principle be applicable to foreign shareholders who wish – and agree with their partners – to increase their initial shareholding to an equity majority. Likewise, foreign life insurance investors should
be permitted from the inception of their JV to include several domestic partners while retaining equity majority.

Several domestic insurers have established multi-line engagements in the branch of personal insurance based on financial holding structures. Similarly, Chinese banks are permitted to establish insurance operations besides their original banking and securities businesses. These positive developments reflect a growing market maturity and provide improvements for consumers in choosing financial services according to their provider preferences. For foreign insurers, however, such comprehensive market engagement is not yet possible because they may only operate one insurance company in one branch of business. This imposes administrative limitations for foreign insurers that might not be justified in the light of widening opportunities for domestic market players.

Recommendation
- Discontinue the formal obligation for foreign life insurers to establish their own market presence in the form of an equity JV.
- Allow for the level of foreign shareholding within JVs to exceed 50%. Likewise, liberalise the option of taking more than one domestic investor into the JV sharing the Chinese investment participation.
- Liberate the level of permitted equity investment by foreign insurers in existing domestic insurance companies.

3.2 Capital Requirements for Trade Credit Insurance Companies

Concern
The current market access conditions and capital requirements prohibit the development of specialty insurers – particularly trade credit insurers – in China, who would bring many benefits to the industry.

Assessment
Under the current market access conditions and regulatory regime, there is no distinction between general property and casualty insurers and specialty insurers, who offer only one product.

The requirements of CNY 34.2 billion (EUR 3.59 billion) total assets and CNY 200 million (EUR 20.99 million) minimum registered capital are excessive for specialty insurers who are focused on only one main product within a niche market. These specialty insurers possess very specific technical know-how developed over many decades and maintain a very healthy solvency margin. This focus means their asset scale does not need not to be comparable with multi-line general insurers.

This particularly applies to trade credit insurance, which plays a crucial role in protecting Chinese companies and, in turn, brings stability to the economy. The Chinese State Council has recently announced measures to balance the economy and there is a policy shift toward domestic consumption. In order to achieve this goal, local companies will be trading with each other on open-account payment terms. Without credit insurance protection, these companies could face potentially irrecoverable losses, which in turn would result in companies failing, with the consequence of loss of jobs.

As a result of the global financial crisis, credit insurers paid a substantial level of claims thus preventing businesses from failing. This demonstrates the undoubted benefits of a company insuring their accounts’ receivables. Chinese companies do not have a wide choice of local insurers to provide this coverage.

Foreign trade credit insurers should be encouraged to contribute their expertise and knowledge not only of overseas companies but also to provide the protection against losses that may be suffered by Chinese companies arising from both export and domestic trade.

Recommendation
- Consider licences for foreign trade credit insurers who can justify their expertise and long-term sustainability and, in particular, reduce minimum capital requirements for these insurers with an official international rating.
- Issue licences for the coverage of all China.
- Abandon the monopoly of Sinosure and allow local insurers to provide short-term export trade credit insurance.

3.3. Health Insurance

Concern
Foreign specialist health insurers with significant expertise to offer have been unable to enter the market. They are encountering difficulties both due to the bundling of health insurance with life insurance and also because of the foreign ownership restrictions placed on health insurance.

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. 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 WFOE licence, foreign ownership of health insurers is restricted to 50%. European specialist health insurers are keen to share their expertise with China but are delayed in entering the market by foreign ownership restrictions and finding a partner similarly committed to the sector, while property and casualty insurers who have no particular expertise in health insurance are already offering health products.

Recommendation

- Treat health insurance as a distinct category of insurance. In this way, regulations can be developed to address the specific needs of the health insurance sector. A company should be able to hold both life insurance and health insurance licences as they will be of separate categories.
- Allow foreign specialist health insurers’ ownership beyond the current 50% foreign ownership restriction.

4. Ease Restrictions in Foreign Capital Conversion

Concern

Capital injections in foreign currency are subject to strict State Administration of Foreign Exchange (SAFE) control. Even if the CIRC has approved foreign capital injection, it takes a long time to get SAFE’s approval to convert it into RMB. This affects the cash flow of the company and exposes the company to exchange risk.

Assessment

Most foreign insurers will need to completely or partially finance their business expansion for a considerable period of time through capital increases based on foreign currency contributions. These foreign currency contributions need to be converted into RMB which requires approval from SAFE. In the context of China’s significant foreign currency reserves and governmental intent to reduce the inflow of speculative capital, SAFE introduced strict conversion limitations. However, while these controls may seem reasonable at a macro-economic level, they actually pose a serious threat to the liquidity of registered insurance businesses if they cannot make use of those parts of their paid-up capital that is injected into foreign currency. In the worst case scenario it prevents them from business expansion or even business continuity.

Recommendation

- Revise foreign exchange regulations to enable licensed foreign insurers in China to have prompt access to paid-up capital injected in foreign currencies.
- Allow insurance companies to buy foreign exchange swaps.
- Permit insurance companies to borrow RMB on the basis of the foreign exchange deposit.

5. Representative Offices

Concern

The new State Administration for Industry and Commerce (SAIC) regulation on representative offices imposes very heavy annual renewal administrative procedures on them (annual external audit report, annual report to SAIC, annual SAIC review) and penalises highly regulated sectors such as foreign insurers.

Assessment

A new SAIC regulation on representative offices came into force on March 1st, 2011. This regulation requires all representative offices to go through the annual SAIC review process in the same way as commercial companies, i.e. the submission of an annual external audit report, an activities report in a specific format released by the SAIC during the second half of March 2011 and evidence of head-office existence in the home country. This new regulation doesn’t take into consideration the existing industry specific regulation on representative offices, in particular in the financial services.

Having a representative office is one of the pre-requisites for foreign insurers willing to enter the Chinese market. Not only is the establishment of the representative office and the assignment of its chief representative subject to approval by the CIRC, but the daily activities of the
representative office are also under the permanent supervision of the CIRC (payment of the supervision fee, regular meetings, update of head-office major changes, an annual representative office activity report and the submission of the company annual report to the CIRC, the prohibition of commercial activities of all kinds…).

Under such circumstances, the new requirement of the SAIC implies heavy non-productive administrative procedures (i.e. the duplication of reports, extra costs for an external audit on expenses, re-issuing of the home country business-existence certificate and its legalization by various authorities, Chinese and foreign). A better coordination and sharing of information between the CIRC and the SAIC would surely allow them to better focus on their core mission.

Recommendation
- Simplify, for foreign insurance representative offices, the annual business license review process based on the annual report to CIRC and waive the home country business existence certificate and annual external audit for foreign insurance representative offices.

6. Brokers

6.1 Broker Appointment Letters

Concern
Clients who issue appointment letters to a broker authorising that broker to act formally on their behalf sometimes subsequently issue additional appointment letters to other brokers without informing the original broker of the fact.

Assessment
The practice of issuing multiple appointment letters creates confusion in the market because insurers are unable to identify the correct representative of the insured. It is also considered an unfair practice in other markets because the broker who initially receives the appointment letter may subsequently find that his position has been undermined. The overall result is instability, confusion and a lack of trust.

Recommendation
- Implement strict guidelines enforcing a rule that a letter of appointment remains valid unless the appointed broker has failed to meet his contractual obligations under that letter.

6.2. Unethical Behaviour by Certificated Brokers

Concern
Some individuals employed under an apparently exclusive contract to one broking company also have agreements with other broking companies to obtain business on their behalf.

Assessment
Some dishonest individuals in the broking industry are not respecting their employment contracts and bringing the broking market into disrepute by unethically acting on behalf of several broking companies. While it is possible to pursue redress through civil legal proceedings, there is also an issue regarding the reputation of the insurance broking industry for transparent and ethical behaviour, which should be addressed by the regulating authorities.

Recommendation
- Issue strict guidelines to forbid a broker or agent from working for a second company, unless specifically agreed in writing with all companies concerned. Where infringements occur, the regulators should punish the individuals involved by removing their certification to act as an insurance broker or agent for a period of time.

Abbreviations

<table>
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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CIRC</td>
<td>China Insurance Regulatory Commission</td>
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<td>CNY</td>
<td>Chinese Yuan</td>
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<td>JV</td>
<td>Joint Venture</td>
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<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
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<td>MOHRSS</td>
<td>Ministry of Human Resources and Social Security</td>
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<td>MTPL</td>
<td>Motor Third Party Liability</td>
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<tr>
<td>SAIC</td>
<td>State Administration for Industry and Commerce</td>
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<td>SCLAO</td>
<td>Legislative Affairs Office of the State Council</td>
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<td>SME</td>
<td>Small and Medium Sized Enterprise</td>
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<td>SOE</td>
<td>State Owned Enterprise</td>
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<td>WFOE</td>
<td>Wholly Foreign Owned Enterprise</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Key Recommendations

I. Clarify the Status of Foreign Private Equity (PE) Firms in China and Create a Level Playing Field (NDRC, CSRC, SAFE)
   · Clarify treatment of investment by Foreign-Invested Equity Investment Funds (FIE EIF) and Foreign-Invested Equity Management Enterprises (FIE EIME) outside of Shanghai and issue national-level regulations to provide consistency in approach and unify fragmented PE legislation.
   · Issue follow-up implementation rules to provide more details on how qualified FIE EIF and FIE EIME will be able to obtain foreign exchange quotas.

II. Clarify and Confirm Several Tax Measures Affecting Foreign PE Investment in Chinese Companies (SAT)
   · Clarify the tax treatment of PE funds by issuing new regulations closing the open tax questions mentioned in this paper and provide foreign investors with higher levels of certainty in estimating their Peoples Republic of China (PRC) tax costs.
   · Consider setting out a nationwide and unified tax preferential policy on RMB funds so as to promote the development and healthy competition of the PE fund industry.

III. Ease Operational Procedures for Foreign Private Equity or Merger and Acquisitions (M&A) Activities (MOFCOM, SAIC, NDRC, CSRC)
   · Secure M&A transactions by clarifying the scope of the Security Review and allowing investors to request a binding opinion from the Ministry of Commerce (MOFCOM), in order to avoid their past or closed transactions to be retroactively jeopardised.
   · Facilitate payment provisions by either (a) allowing the parties of an M&A transaction to reach a mutually agreeable payment schedule for consideration without any statutory restriction or alternatively by (b) maintaining a restriction of only three months to one year for the sale of state owned shares/assets to foreign investors.
   · Reduce the transaction and approval times in order to limit the price and closing uncertainties.

Introduction to the Working Group

The Working Group includes private equity (PE) and venture capital (VC) professionals; Mergers & Acquisitions (M&A) heads employed in large European corporations; Chinese or European fund managers from funds of European origin; and European professionals working for or with international PE funds. The Working Group also engages professionals in an advisory capacity on PE and M&A related matters.

The Working Group seeks to achieve a level playing field for all market participants, both Chinese and foreign. Secondly, the Working Group aims to provide a credible platform of exchange and expertise among active players in the PE and M&A sector.

Recent Developments

1. Market Overview

After the decline in 2009 in both the number of funds and money raised, the Chinese PE market is quickly recovering from the world-wide financial crisis. In 2010, 82 funds completed capital raising with EUR 20.8 billion (CNY 188.15 billion) being raised. This constitutes an increase of 113% compared with 2009. Furthermore, among these funds, 71 new funds were raised in RMB, signalling a clear shift towards domestic funds and investment activity.

The M&A environment has dramatically changed over the past year. This is partly due to the financial crisis, which forced both foreign and domestic enterprises to change...
their strategies toward market entry acquisitions for foreign firms and consolidations for the domestic ones. There were 521 deals concluded in the Chinese market in 2010, up 112%.

Domestic funds in China also expanded significantly in 2010, with more governmental, institutional, corporate, family and private funds wanting to deploy more capital into alternative investments such as PE. Examples of such funds are the National Social Security Fund and industry funds. The definition of a Limited Partner (LP) needs to be better understood. Otherwise, the risk is that the difference between LP investor and General Partner (GP) manager will become blurred, limiting the capacity of managers to deploy capital with a long-term, fund-life approach. This could otherwise ultimately result in lower returns.

2. Key Advancements

The Working Group welcomes the efforts made recently by several regulatory bodies in order to improve the legal framework of PE and M&A in China. The following are some of the key positive developments:

a) Creation of Foreign-Invested Partnerships

The ‘Administrative Measures for the Establishment of Partnership Enterprises in China by Foreign Enterprises or Individuals’ (hereinafter the ‘FIP Measures’) were released by the State Council Order [2009] No. 567 in November 2009 and effective as of March 1, 2010. The ‘Administrative Rules on the Registration of Foreign-Invested Partnership Enterprises’ (the ‘Registration Rules’) were issued by the State Administration of Industry and Commerce (SAIC) on March 1, 2010. Both measures allow for the creation of Foreign-Invested Partnerships (FIP), a new form of Foreign Invested Enterprise. The Working Group welcomes these measures as a major method to promote the formation of world-class domestic PE funds in China.

b) Foreign Invested VC Enterprises (FIVCE) status

The regulation that increased the threshold to USD 300 million (CNY 2,049 billion, EUR 226.16 million) for central Ministry of Commerce (MOFCOM) approval of foreign investments into China has been a positive move, especially for FIVCEs. The approval process for these funds, which are able to manage foreign funds with a domestic structure, should be considerably eased. This means, however, that such FIVCEs remain limited to venture or relatively small growth funds.

c) Insurance Investment in PE

The China Insurance Regulatory Commission (CIRC) issued the “Interim Measures for the Administration of Utilization of Insurance Funds”, which became effective on August 31, 2010. This new rule allows PRC insurance companies to diversify their investments into PE investments for the first time. CIRC also issued the ‘Interim Measures on Equity Investment of Insurance Funds’ (the ‘PE Regulations’) on September 5, 2010, which provide more detailed guidance on implementation.

Pursuant to the PE Regulations, an insurance company meeting certain qualification requirements may make PE investments in other insurance companies, financial institutions and other enterprises engaging in insurance related businesses, including for example pension funds, medical and pharmaceutical companies and automobile service companies. The regulations prohibit the insurance companies from investing in VC funds or establishing their own private funds or fund management companies.

d) Local Pilot Programs for Foreign Funds and Shanghai Qualified Foreign Limited Partner (QFLP) Regime

Various measures taken by local governments, such as in Beijing, Shanghai and Tianjin, have allowed several foreign-domestic fund managers to launch RMB funds, or have had the process for setting up foreign-invested funds eased.

At the forefront of QFLP regulatory development is the Shanghai pilot program set forth in The Circular Concerning the Publication and Circulation of the Implementing Measures for Carrying out the Pilot Scheme for Foreign Invested Equity Investment Enterprises in Shanghai issued by the Shanghai municipal government’s Financial Services Office, Shanghai Commerce Commission and Shanghai Administration for Industry and Commerce (Shanghai AIC) and effective as of January 24, 2011 (the ‘Shanghai QFLP Circular’). It sets out the requirements and procedures for setting up a Foreign-invested Equity Investment Fund (FIE EIF) and Foreign-invested Equity Investment Management Enterprises (FIE...
In addition, a special status known as the “Pilot EIF Enterprise” is introduced to free some restrictions on foreign exchange conversion, currently a major hurdle for PE funds investing in China.

d) National Security Review
On February 12, 2011, the State Council issued a notice announcing the establishment of a ministerial panel to review proposed foreign M&A involving local companies which could give rise to national security concerns. The notice lays the groundwork for a review process similar to that performed by the Committee for Foreign Investment in the United States. The Ministerial Panel will be established under the leadership of the State Council. The National Development and Reform Commission (NDRC) and MOFCOM will take the lead in conducting M&A security reviews and coordinating with relevant governmental authorities, depending on the industries and sectors involved. According to the notice, in assessing an M&A transaction’s national security impact, reviewers will consider the effect of the proposed deal on (i) national defence, including defence-related domestic product manufacturing capability, domestic service provision capability, facilities and equipment; (ii) the nation’s economic stability; (iii) “society’s basic order of life”, and (iv) research and development capability for national security-related key technologies.

e) NDRC PE Circular
In an effort to further regulate China’s PE industry, NDRC issued the Circular on Further Improving Administration of Developing and Filing of Equity Investment Enterprises in Pilot Areas (the “NDRC PE Circular”) on January 31, 2011, which is directed to six specified locations: Beijing, Shanghai, Tianjin, Jiangsu, Zhejiang and Hubei.

The NDRC PE Circular sets forth a best practice framework in respect of PE fund establishment, capital raising, investment restrictions, risk control, fund management entrustment and disclosure. In addition, the Circular requires PE funds with more than RMB 500 million of total committed capital (including both subscribed but unpaid and fully paid-up capital) to file certain information with NDRC. After successful filing, the names of PE funds and their managers will be published on the NDRC website. Such filed funds and managers also have ongoing disclosure obligations to provide NDRC or its local counterpart with their annual audited financial statements and annual business reports within four months following the end of each fiscal year, as well as information of certain material developments promptly upon such occurrences. The funds and managers which made filings with NDRC are also subject to the NDRC’s annual inspection. The NDRC PE Circular is silent on what benefits, if any, are available to the filed funds and managers, but the PE community hopes that obtaining the NDRC filing status will help the funds attract large state-owned LPs such as the National Social Security Fund.

f) VC Investment as an Encouraged Foreign Investment
On April 1, 2011 the Legislative Affairs Office of the State Council issued a call for public comments on the revised draft of the foreign investment catalogue, which was prepared by NDRC, MOFCOM and other relevant government agencies in order to optimise the utilisation of foreign investment in accordance with the State Council’s Several Opinions on How to Further Improve the Utilisation of Foreign Investment (Guo Fa [2010] 9). The current draft establishes three different catalogues for foreign investment: encouraged, restricted and forbidden. As a welcome revision, venture capital investment for the first time is listed as one of the encouraged sectors for foreign investment.

Key Recommendations

I. Clarify the Status of Foreign PE Firms in China and Create a Level Playing Field

Concern
There still lacks a uniform set of national rules for foreign PE investment.

Assessment
The Working Group sees the Shanghai QFLP Circular as a welcome milestone for adopting a more comprehensive regulatory framework, at least in Shanghai, for foreign PE investment. However, several important issues remain to be further clarified. One issue relates to the uncertainties

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4 Previously certain tentative rules for setting up FIE EIME were issued but only effective for the Pudong area. Those rules already expired in 2010.
5 A Pilot EIF Enterprise is a special status granted to some qualified FIE EIMEs or FIE EIFs, which meet the following requirements: a foreign investor in a pilot enterprise must, amongst others, hold assets worth no less than USD 500 million or manage assets valued at no less than USD 1 billion, have a sound governance structure and no record of regulatory sanctions in the last two years, and have, or its affiliate must have more than 5 years of investment-related experience.
7 Implementation Measures on the Pilot Program of Foreign Invested Equity Investment Enterprises, December 24, 2010
surrounding the recognition and treatment of Foreign-Invested Equity Investment Funds (FIE EIF) and Foreign-Invested Equity Management Enterprises (FIE EIME) outside Shanghai. In addition, the Shanghai Qualified Foreign Limited Partner (QFLP) Circular does not fully remove the restriction on conversion of foreign exchange funds into RMB imposed by the Circular on Relevant Business Operation Issues concerning Improving the Administration of the Payment and Conversion of Foreign Exchange Capital of Foreign-invested Enterprises issued by the State Administration of Foreign Exchange (SAFE) on August 29, 2008 (the “SAFE Circular 142”). Further, the Shanghai QFLP Circular is silent on the tax treatment of FIE EIF and FIE EIME, in particular whether the tax benefits previously conferred under the municipality’s earlier policies will still be available.

a. National Treatment Applicability outside of Shanghai

The Shanghai Pilot QFLP Program was jointly introduced by the Shanghai Financial Services Office, Shanghai Commerce Commission and Shanghai AIC to implement Shanghai Government Circular No. 25 which was issued in 2009 by the Shanghai Municipal Government. An obvious concern is the recognition and applicability of the Shanghai QFLP Circular when a FIE EIF invests in a portfolio company outside of Shanghai.

As a significant breakthrough, the Shanghai QFLP Circular under Article 24 allows an FIE EIME which has qualified as a Pilot Enterprise to invest up to 5% in foreign currency of total amount of the capital raised by the PE fund, and this limited funding in foreign exchange will not affect the underlying nature of the fund as a domestic fund. Therefore, the fund would be permitted to make investments in industries that are otherwise closed to foreign investment.

The question is, however, that if the target portfolio company is based outside Shanghai and is otherwise closed to foreign investment, will the local authorities outside Shanghai allow the fund to invest in the company on the strength of the Shanghai QFLP Circular? Ultimately, a national-level regulation may be necessary to clarify this point as it seems unlikely that local authorities outside Shanghai would apply Shanghai rules within their respective jurisdictions.

b. Conversion of Foreign Exchange

Since its promulgation, SAFE Circular 142 has been a major obstacle to the creation of a level playing field between foreign and domestic PE firms. While a GP qualified as a pilot enterprise may convert up to 5% of a fund’s total capital from foreign currency to RMB, there is no specific provision on how a foreign LP in a qualified FIE EIF is able to convert capital it contributed to the fund into RMB. Article 25 of the Shanghai QFLP Circular only generally provides that a FIE EIF qualified as a pilot enterprise may conduct equity investments onshore using foreign exchange held through a custodian bank. No specific conversion approval procedure is set forth.

In addition, the Shanghai QFLP Circular specifies that FIE EIF and FIE EIME which do not qualify for the pilot programme must make onshore equity investments in accordance with relevant laws and regulations relating to foreign investment under which the SAFE Circular 142 falls. Therefore, the relief from SAFE Circular 142 provided under Shanghai QFLP Circular is very limited.

Ultimately, obtaining the necessary quota for foreign exchange conversion is of paramount importance for FIE EIF and FIE EIME. An investment vehicle that does not have the ability to easily obtain the local currency and make downstream investments would be merely a shell. Without any further clarity as to how SAFE will allocate quotas to PE firms, the advantage of establishing an FIE EIF under the Shanghai QFLP Circular stops short of real progress in opening up PE investments to foreign players.

Recommendation

- Clarify treatment of investment by FIE EIF and FIE EIME outside of Shanghai and issue national-level regulations to provide consistency in approach and unify fragmented PE legislation.
- Issue follow-up implementation rules to provide more details on how qualified FIE EIF and FIE EIME will be able to obtain foreign exchange quotas.

II. Clarify and Confirm Several Tax Measures Affecting Foreign PE Investment in Chinese Companies

Concern

There is a lack of certainty on the tax treatment of PE funds at both the fund level and also GP/LP level. This uncertainty is a major tax risk faced by foreign PE funds
making or considering making investments in China that ultimately will hinder the development of the industry.

Assessment

a) Fund Level

1. See-through Treatment

In accordance with the Circular of Ministry of Finance and the State Administration of Taxation on Income Tax Issues of A Partnership and Its Partners (Caishui [2008] No. 159) ("Circular 159"), a fund structured in the form of a partnership is a tax flow-through vehicle therefore should not be subject to tax, and the partners in the partnership are liable for the relevant taxes.

However, Circular 159 does not clarify how the see-through tax treatment should be interpreted in a PE context. Partnerships are exempt from tax at the time of receipt and gains received by a partnership follow the principle of "distribution first, tax later", meaning that Tax is paid when the Partnership distributes to its partners. The Circular does not clarify whether or not the characterisation of income and gains derived from invested enterprises and received by a fund should be kept consistent at the time of receipt and at the time of distribution to the partners.

2. Income VS. Dividend (Return of Capital)

b) General Partner (GP)

1. Carried Interest

Taxation on carried interest received by GPs remains unclear. Carried interest is a return to the GP (that is performance related from the PE fund). However, unlike a management or service fee, carried interest is not a guaranteed fee; carried interest is only earned once all the initial capital that the limited partners contribute is returned along with some previously agreed upon rate of return. So like an investor into shares/equity the GP is not guaranteed, and the GP risks being left at a loss.

For general partners based in China, there are two general possible treatments either:
- it is deemed to be service fees and subject to both business tax at 5%, plus Corporate Income Tax on profit net of costs
- or regarded as dividend income/ capital gain derived from invested enterprises and exempt from tax

In countries such as UK and USA (the largest Private Equity markets) carried interest is regarded as a capital gain; this is because the GP has to achieve certain pre-agreed ‘hurdles’ for the LPs before receiving any carried interest return. Therefore it is viewed as more of a capital return in nature, and taxed like an ordinary capital gain on the sale of real estate or shares.

c) Limited Partners (LPs)

1. Application of Treaty

When a Fund is set up overseas (for investment into China), investors may be various institutions and individuals from different countries. The income distributed to investors sourced in China is subject to withholding tax in China. Such scenarios will create issues on which tax treaty should apply (the treaty signed between China and the country where LP resides or the one with the country where the overseas fund investors reside).

d) Tax Breaks

Local Variation

Currently, certain major cities set out tax preferential policies with respect to RMB funds established via domestic equity investment, including fund management companies, senior management personnel, and individual LPs. These policies vary by jurisdiction due to various enforcement dates governed by local government bodies.
Acquisition of Domestic Enterprises by Foreign Investors promulgated on August 8, 2006, the purchase price for the acquisition of a domestic company must be paid within three months of the issuance of the updated business license. This three-month limitation period, even when extended to one year, is an obstacle for many M&A transactions, especially, but not only, when PE investors are involved. For example, it prevents parties from agreeing on other arrangements aimed at ensuring alignment between price and value, such as the arrangements that provide for part payment of the purchase price based on future sales or profits of the company (‘earn-out’). Similarly, it prevents parties from agreeing to delayed payment of part of the consideration in cases where certain post-closing obligations need to be satisfied by the seller. The same is true for price-adjustment and warranty schemes. These restrictions of payment arrangements, in particular from a timing perspective, are unusual in the context of M&A transactions in many other countries and are ultimately detrimental to Chinese sellers, as foreign investors are likely to adopt a more prudent pricing approach.

Recommendation
- Clarify the tax treatment of PE funds by issuing new regulation closing the above open tax questions and provide foreign investors with higher level of certainty in estimating the PRC tax costs
- Consider setting out a nationwide and unified tax preferential policy on RMB funds so as to promote the development and healthy competition of PE fund industry

III. Ease Operational Procedures for Foreign Private Equity and Merger and Acquisitions Activities

Concern
A number of operational issues affect foreign investors’ ability to invest in China.

Assessment
a  National Security Review
The level of discretion left to the authorities as to the definition of Foreign M&A Transactions subject to Security Review and as to the base on which a foreign M&A transaction might be terminated is a source of legal uncertainty for foreign investors. Given the broad and uncertain scope of the activities falling within the review, this must be specified. Comfort may be afforded by the implementation of further regulations and/or from a consistent practice by the authorities in the future of this matter. In particular, systematic submission of each M&A transaction that may fall within the scope of the Security Review to MOFCOM should be avoided. Although first instances witnessed in practice seem to show that local authorities do not systematically call for national authorities’ jurisdiction in order to assess whether a projected transaction falls within the scope of the National Security Review, this clarification is all the more necessary given that the validity of completed transactions may be retroactively challenged, whether by PRC authorities or other third parties, on the ground of a breach of the provisions of the Circular. Finally, it remains unclear how the National Security Review will be combined with Anti-Monopoly procedures. Such a framework generates a very high and unusual level of legal uncertainty for foreign investors.

b  Payment Provisions
In accordance with Article 16 of the Provisions on
As a result, the parties usually choose to err on the side of caution by taking into account a very conservative estimate of the net debt for the determination of the price. The value offered for the Target will therefore be reduced accordingly.

**Recommendation**

- Secure M&A transactions by clarifying the scope of the Security Review and allowing investors to request a binding opinion from MOFCOM, in order to avoid their past or closed transactions to be retroactively jeopardised.
- Facilitate payment provisions by either (a) allowing the parties of an M&A transaction to reach a mutual decision on a commercially agreeable payment schedule for consideration without any statutory restriction or alternatively by (b) maintaining a restriction of only three months to one year for the sale of state owned shares/ assets to foreign investors.
- Reduce the transaction and approval times in order to limit the price and closing uncertainties.

**Abbreviations**

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<tr>
<th>Abbreviation</th>
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<tr>
<td>AIC</td>
<td>Administration of Industry and Commerce</td>
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<td>Anti-Monopoly Law</td>
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<td>China Securities Regulatory Commission</td>
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<td>Euro</td>
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<td>FIE</td>
<td>Foreign Invested Enterprises</td>
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<td>MOFCOM</td>
<td>Ministry of Commerce</td>
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<td>National Development and Reform Commission</td>
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<td>P/E</td>
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<td>Private Equity</td>
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<td>Private Equity/Venture Capital</td>
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<td>PRC</td>
<td>People’s Republic of China</td>
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<td>QFLP</td>
<td>Qualified Foreign Limited Partner</td>
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<td>CNY/RMB</td>
<td>Renminbi Yuan (Currency)</td>
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<td>VC</td>
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Section Six: Local Focus
Since its establishment in Beijing in 2000, the European Union Chamber of Commerce in China has expanded nationwide to encompass seven active Chapters in nine cities across China. Besides Beijing, the Chamber is represented in Shanghai, Nanjing, Chengdu (also serving businesses in Chongqing), Guangzhou and Shenzhen (these two offices form the Pearl River Delta Chapter), Tianjin and Shenyang. These regional Chapters either have their own dedicated Government Affairs teams or they work closely with the Government Affairs team in Beijing. Thus the European Chamber’s national network not only engages with local government, but also contributes to national lobbying efforts.

This year’s Position Paper “Local Focus Papers” highlight recent developments and business environment information for cities where the European Chamber has offices, and looks at specific issues faced by companies operating in these regions.

The bustling cities of Beijing, Chengdu, Chongqing, Nanjing, Shanghai, Shenyang and the PRD region epitomize the dynamism of modern China. Together they form an economic engine propelling China forward as a major global economic power. Although the Pearl River Delta region suffered in the wake of the global economic recession, the other cities have fared well compared to other centres of world trade and commerce. Though they have not escaped entirely unscathed, their already impressive GDP growth figures continue to rise. This can be credited to both the effective actions taken by the Chinese government, which took expansionary fiscal and monetary policies, and a relatively buoyant domestic investment environment.

Despite the relatively sound economic foundation in these cities and the progress made in recent years, there remains much that can be done to create a better operational environment not only for foreign enterprises, but for the business community in general.

In the papers that follow, European enterprises report that they are being hindered by a lack of legal and procedural transparency, for example, and indicate that it is essential that communication between governmental agencies be improved.

In all eight cities covered below, Foreign Direct Investment (FDI) has played a crucial role in generating growth over the past three decades. The large sums invested by foreign enterprises, and particularly European enterprises, have helped, and continue to help, to reshape and redevelop these cities into tertiary based economies. The European Union recognises the importance of developing sound trade links with these cities and the European Chamber aims to continue strengthening these bilateral relationships.

However, in order to retain existing investment and attract further European investment in the future, it is essential that local governments move to address these issues in the near future.
Introduction

The Beijing Chapter was established as the first Chapter within the European Union Chamber of Commerce in China when it was established in October 2000. Currently, the Beijing Chapter has more than 450 member companies, representing all industry sectors.

The Beijing Chapter liaises with the Chinese government at both central and local levels. Key activities at the municipal government level include an annual dinner with the Vice Mayor of Beijing, as well as regular meetings with the Beijing Financial Service Bureau (BFSB) and the Beijing Investment Promotion Bureau (BIPB). A dialogue with the Beijing Municipal Public Security Bureau has also been set up to clarify issues pertaining to visa and residency permit issues.

Recent Developments

The overall investment environment in Beijing has improved in recent years. In 2010, utilised Foreign Direct Investment (FDI) inflows reached CNY 43.06 billion, a 4% year-on-year increase. The Beijing municipal government continues to introduce policies to further promote and facilitate foreign investment into Beijing. In 2009, the Beijing municipal government released ‘Several Provisions to Encourage Multinational Companies to Establish Regional Headquarters in Beijing’, which gave notable incentives for Multinational Companies (MNCs). To date, 62 MNCs have established their regional headquarters in the capital. Among them, 30 belong to Fortune 500 companies. In 2010, the Beijing Administration for Industry and Commerce (BAIC) released ‘Several Opinions on the Further Promotion of Foreign Investment in Beijing’, a notice which introduced improvements related to market access and the annual inspection system. This document also reaffirmed Beijing’s intention to protect Intellectual Property Rights (IPR).

To better accommodate growing business interests in Beijing, the government has re-evaluated the proposed functions of different city districts in order to better utilise the allocation of resources. After a 10-year phase of development, the Central Business District (CBD) area now contributes to approximately 50% of the total retail sales of social consumer goods, Gross Regional Product (GRP) and the local taxes of Beijing’s Chaoyang District. In the west side of the city, the State Council (SC) approved Beijing’s plan in March 2011 to develop Zhongguancun as the National Indigenous Innovation Demonstration Zone (NIIDZ), where incentives and support will be given to promote indigenous innovation in information technology, green technology and the creative industries.

Within the municipal 12th Five-Year Plan, Beijing sees its role as a national innovation centre, international financial centre and international trade centre. Strategic new industries including IT, biomedicine, new energy, environmental protection and energy saving, new energy vehicles, advanced materials, high-end equipment and aerospace will be promoted. Importantly, the plan recognises the contribution which foreign investment makes to the development in Beijing and promises to improve the investment environment.

However, confusion still exists. For example, strong local competition among different regions in Beijing trying to attract foreign business can sometimes send confusing messages to potential investors and causes difficulties to existing companies. Streamlining these discrepancies in communication through a centralised Beijing government policy could prove extremely important in the coming years. Furthermore, unpredictability of regulations poses risks to business operations in Beijing. At the end of 2010, restrictions on car purchases in Beijing negatively impacted the automotive market. The business community should be given the opportunity to provide input to regulators and be informed prior to the introduction of such regulations which can have an impact on industry.

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1 The original figure was given in US Dollars. The conversion rate used was based on the average exchange rate for 2010 from the China Foreign Exchange Trade System, http://www.chinamoney.com.cn/fix/Channel/17383.
The European Chamber appreciates recent efforts made by the Beijing municipal government to improve the business environment for the international business community and would welcome the establishment of further communication channels with the Beijing municipal government to provide input towards policies to improve the environment for international business in Beijing.

Key Recommendations

1. Improve Registration Procedures

Concern
Although the business environment in Beijing is generally encouraging to foreign investment, companies still find themselves facing obstacles, both when trying to register or move their business in Beijing.

Assessment
The European Chamber welcomes efforts undertaken by the Beijing municipal government to improve the business environment for foreign companies operating in Beijing. The Chamber is aware that the Beijing government has simplified the procedures for approving foreign-operated retail stores and foreign-operated branch stores in Beijing. Despite this, foreign companies still face many problems when operating in Beijing. Such problems are especially cumbersome for Small and Medium Enterprises (SMEs) new to China.

Beijing, like other cities in China, requires companies to obtain approval from relevant authorities as an integral part of the incorporation process. Foreign companies face a great deal of uncertainty in the timeframe for approval of incorporation. The timeframe depends on both the type of project and where the business is located. On large and/ or complex projects, the approval process often involves extensive negotiations with various authorities whose approvals are required. Moreover, the capital requirements to start a company in Beijing are also very high, especially for capital intensive businesses like manufacturing. Local regulators also seem to apply fluctuating and discretionary standards on what constitutes adequate capital for approval of certain types of business activities. These numbers are not published and can only be determined through direct contact with the authorities and following the provision of a clear explanation of the project. This creates a very opaque and unpredictable business environment for companies looking to incorporate in Beijing.

Current regulations require that foreign invested companies must provide a leasing contract as a pre-condition for approval of the establishment of a company. This means that a foreign investor has to commit to financial obligations before it is known whether the approval will be given. In addition, it is not possible to pay for these pre-approval expenses through regular channels as a business licence is a pre-condition for opening a company bank account.

The taxation system in Beijing ties tax revenue generated from a company to the local tax authority of the district where the company is located. The lack of coordination between the local tax authorities of different Beijing districts makes it extremely difficult for companies to relocate their office from one district to another. In the current system, procedures to register a new office in another district require that companies effectively close down their operations for a considerable period of time while tax records are fully checked and signed off before they are able to relocate. This leads to a loss of revenue in the interim period.

Recommendation
- Create better coordination at the municipal level to smooth mobility between different districts.
- Harmonise registration regulations and their implementation in different districts.
- Provide better access to information for new investors as the lack of available English information available means that very often companies need to seek help from agencies or consultants.

2. Design and Implement a Sustainable and Green Urbanisation Plan

Concern
Rapid economic growth and urbanisation are posing severe problems in Beijing. The challenges for city administration when moving towards a low carbon city include controlling environmental pollution, rising Greenhouse Gas (GHG) emissions, diminishing natural resources, increasing domestic waste, and growing demands for energy.

Assessment
In 2009, China announced its commitment to reduce carbon intensity by 40-45% compared with 2005 levels by 2020. Since then, many provinces and cities have launched low carbon roadmaps and commenced the implementation of pilot projects. In July 2010, five provinces and eight cities were selected by the National Development and
Reform Commission (NDRC) to design and implement sustainable low carbon development pilot plans. In the 12th Five-Year Plan published in March 2011, China set the carbon intensity reduction target at 17% by 2015 as an intermediate step to achieve the 40-45% target by 2020; and overall targets for emissions reduction and energy efficiency were also reflected at the local level. The 12th Five-Year Plan for Beijing requires the city to meet the national government set target for Beijing. To realise the target, Beijing should firstly develop a comprehensive low carbon sustainable plan.

Beijing has shown its intention to move towards a green economy and was recently announced as one of the six emissions trading pilot areas in China. Beijing started relatively early to explore opportunities for emissions reduction through market mechanisms, especially in the carbon trade and green finance fields. In 2008, the China Beijing Environment Exchange (CBEEX) was launched for trading various environment equities, including Clean Development Mechanism (CDM) and Voluntary Emission Reduction (VER) projects. In 2009, the CBEEX introduced the Panda Standard for VER projects. With the help of the Asian Development Bank (ADB), Beijing is keen to develop the CBEEX as a major carbon trading platform nationwide. Local districts are also ambitious about their prospects to carbon financing. For example, Dongcheng district sees itself as a carbon finance district and as a hub for investment in China.

These movements in emissions trading should be recognized as positive steps to mitigate climate change and improve energy efficiency. However, at this initial stage, it is important that Beijing carefully designs the framework to avoid potential challenges in implementation. To do so, it would be highly beneficial if the private sector is engaged to participate in the design of the schemes. Member companies of the European Chamber have worked in the development of carbon mitigation projects under the CDM and voluntary markets, as well as those that have been actively involved in the development of domestic trading schemes in the United Kingdom (UK) and the European Union (EU).

Waste management is another issue of major importance in Beijing. Currently, more than 90% of municipal solid waste is buried in landfills, while around 2% is incinerated. Large amounts of scientific data now exists which show conclusively that many landfills present various environmental hazards, including soil, air and water contamination as well as damage to the surrounding ecosystem. Although properly designed and managed landfills equipped with modern technology can avoid such environmental pollution, most of Beijing’s landfills are of poor quality. One of the reasons for this is that the waste sources are not correctly managed. In 2009, Beijing started a pilot project for refuse sorting with the aim to half the amount of waste material which goes to landfills. However, in addition to reducing the amount of waste to go to landfills, it should be noted that there are many other solutions for waste management and treatment besides landfill or waste incineration that can contribute towards a ‘Waste to Resources’ approach.

Recommendation

- Design and implement a sustainable and green development plan to put Beijing on a low emissions pathway
- Involve the international business community in designing the framework for a GHG emissions pilot trading scheme in Beijing
- Implement large-scale awareness-raising campaigns within Beijing to better inform Beijing residents of the benefits of reducing, reusing and recycling to improve the recycling rate, as well as the need to properly sort waste
- Implement state of the art industrial plants that are able to convert ‘useless’ waste into valuable assets following a ‘Waste to Resources’ valorisation approach
- Encourage the separate collection of bio-waste, organic fractions and food waste with a view towards anaerobic digestion applications.

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9 Quote “in the absence of governmental regulations and economic stimulus, dumping in landfills would persist as an unsustainable method for getting rid of waste and incinerators would operate without pollution control. However, industrialized countries have adopted regulations to divert waste from landfills through recycling, treatment, and materials and energy recovery. In addition, economic conditions and regulated markets have stimulated the use of waste as a resource and a source of energy. Waste-to-energy (WTE) encompasses methods by which to extract the valuable energy entrapped in waste for the production of electricity and heat. Waste collected in cities contains a large amount of biological and renewable materials. It is therefore a source of renewable energy. As a consequence, energy-from-waste contributes to energy security and diversification, and matches the growing demand for renewable energy in a carbon constrained world.” Reproduced from “Waste-to-Energy Technology Markets”, Pike Research, 2011, viewed on April 26th 2011, http://www.pikeresearch.com/research/waste-to-energy-technology-markets
3. Develop the Required Framework and the Relevant Market Conditions to Attract Foreign Financial Services to Beijing

Concern
In general, International Finance Centres (IFCs) are destinations that are attractive to foreign financial services related investments. Beijing’s stated goal is to become an influential centre for international finance. However, neither the required regulatory framework nor the relevant market conditions exist yet in Beijing.

Assessment
In 2008, the Beijing municipal government released the ‘Opinions on Promoting Financial Services in Beijing’, which seeks further improvement to the regulatory framework for the sector. In 2009, the Beijing government followed up the 2008 Opinions with the ‘Opinions on Promoting Development of Equity Investment Funds Industry’ and the ‘Interim Measures on the Management of Establishing Foreign Equity Investment Funds in Beijing’. The Interim Measures took effect on January 1st, 2010, with a trial period of three years. It allows foreign companies to set up Joint Ventures (JV) or foreign wholly owned equity funds in the Zhongguancun NIIDZ.

Although this general pilot project framework is a positive step forward, to allow attractive financial markets to exist and further develop, regulatory factors including a coordinated supervisory approach by the regulatory authorities as well as a clear and transparent regulatory framework for the financial system are still required. A level market playing field which allows foreign investors to own or acquire control of domestic companies as well as establish 100% owned subsidiaries is also necessary, as is the need for a simple, transparent and effective tax system. The conditions for an open economy that allows transactions to take place in an efficient way are not yet seen in Beijing.

Many pioneer financial services projects, such as RMB Cross Border trade settlements, green and environmental finance, non bank finance (e.g. consumer finance), a developed Mergers & Acquisitions (M&A) environment, as well as the development of the fund industry (hedge funds, fund of funds, asset management) are within the central government’s focus. Beijing has the opportunity to take the lead and promote innovation to improve these financial services offerings for China, as well as to assist with the establishment of a comprehensive regulatory framework for the market.

Although domestic consumption is the major emphasis of the 12th Five-Year Plan for the national economy, only one consumer finance company - owned by the Bank of Beijing - has been allowed to operate in this field. Opening the market to more stakeholders, including international players, could better realise the potential of consumer finance and help restructure the economy towards consumption-driven growth. Another area which excludes foreign business, thus decreasing competition, is the insurance market. For example, although Beijing has about 4 million motor cars on the road, foreign insurers are still not allowed to provide compulsory third party motor liability. Another insurance-related need of Beijing is the enterprise annuity (private pension), which is an important issue for Beijing seeing as Beijing is the host of many large State-owned Enterprises (SOEs).

Recommendation
- Improve a regulatory framework for the financial services sector in Beijing
- Create further test pilots for pioneer financial services projects
- Provide a level playing field between foreign and domestic stakeholders in the financial services sector
- Allow more Consumer Finance players (either banks or non-banks) to participate in consumer finance company pilot projects
- Allow foreign insurers to provide insurance services in pilot projects

4. Design a Long-term and Sustainable Demographic Policy to Ensure a Strong Labour Force

Concern
In 2010, the total population of Beijing exceeded 22 million.10 The huge population poses severe and numerous challenges for the municipal government, including for traffic, housing, environment and social security policies. Within Beijing’s 12th Five-Year Plan, population control has thus been identified as a priority. Despite this, Gross Domestic Product (GDP) growth targets for Beijing over the next five years are 8% annually. To achieve such growth, a steady supply of labour forces in Beijing is

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required. Tightened population policies may therefore impose risks towards meeting GDP targets, as they serve to deter talented individuals moving to Beijing to join the workforce.

Assessment
Beijing has introduced various policies to attract high-end talents and experienced experts.

The registered population of Beijing municipality consists of people holding either Beijing Hukou permits (permanent residence), or temporary residence permits. Permanent residents enjoy benefits in education, medical services, housing, and social insurance; while temporary residents face strict limitations in many of these areas. Therefore, for many talents, Hukou is a key consideration factor for living in Beijing in the longer term.

Since 1999, Beijing has started to use Hukou as incentive to attract talents. For fresh graduates as well as for senior experts, if their employers can prove that their businesses are encouraged by Beijing, such as IT, biology, medicine, and other industries in line with the development of Beijing. In late 2003, Beijing introduced Working and Residence Permit System (WRPS), which allows applicants to enjoy most of the benefits for permanent resident in Beijing. In 2005, Beijing announced Measures on Incentives to Attract High-End Talents to Beijing, which allowed employers to provide financial incentives to experts.\(^\text{11}\) By 2010, around 500,000 applicants have obtained the Working and Residence Permit (WRP).\(^\text{12}\)

Since 2009, the allocation of Hukou as well as WRP has been tightened. In 2010, the quota for Hukou has been reduced significantly. At the end of 2010, to regulate the real estate market and to solve the traffic problem, Beijing announced restrictions on housing and car purchasing, which are linked to Hukou and WRPS.

The recent population regulations can deteriorate the labour market and lead to the loss of talents. Living in Beijing without Hukou or a WRP increases living costs and hampers people from benefitting from equal social and medical insurance systems. The restrictions on the purchase of housing and car further prevent the improvement in the quality of life in Beijing. In the long term, Beijing will lose its attraction for talents. While many foreign businesses predict greater workforce localisation and increased hiring in Beijing, the amount of qualified candidates entering into the labour market may decrease as the result of the strict population regulations. This will have a negative impact on the overall investment environment in Beijing.

Furthermore, as the quota allocation and the accreditation remain unclear and incoherent, it is difficult for foreign companies to facilitate their employees with the application. The criteria for eligibility of applicants have been listed in many official documents very generally and many different government institutions are involved in the accreditation procedure. All involving government institutions have their own definition or criteria. For some industries, indigenous IPR is considered as a requirement, which has created discriminating conditions against foreign businesses. In addition, requirement on registered capital, tax contribution, as well as size of company can lead to unfavourable conditions for SMEs, which are relying on local workforce.

Moreover, in order for Beijing to become a global city and attract more foreign expertise, the government should consider putting in place certain social infrastructures and flexibilities that allow expatriates to be comfortable in their personal lives.

 Recommendation
- Design a long-term and sustainable demographic policy to accommodate the need for economic growth and labour force market
- Provide clearer guidance for implementation of population control policies
- Provide opportunity for public consultation especially when policies can have impacts on the business community
- Allow expatriates to be paid in their home country and be allowed to transfer this income into China over and above the current threshold of USD 50,000 per year for the purposes of settling personal income tax and personal expenditures.
- Allow qualified foreign talent to participate in China investments (e.g. stocks and real estate)
- Create centralized and flexible procedures for VISAs and working permits


### Abbreviations

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<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
<th>Description</th>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<td>BAIC</td>
<td>Beijing Administration for Industry and Commerce</td>
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<td>BFSB</td>
<td>Beijing Financial Service Bureau</td>
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<td>BIPB</td>
<td>Beijing Investment Promotion Bureau</td>
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<tr>
<td>BMPSB</td>
<td>Beijing Municipal Public Security Bureau</td>
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<tr>
<td>CBD</td>
<td>Central Business District</td>
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<td>CBEEEX</td>
<td>China Beijing Environment Exchange</td>
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<td>CDM</td>
<td>Clean Development Mechanism</td>
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<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GHG</td>
<td>Greenhouse Gas</td>
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<tr>
<td>GRP</td>
<td>Gross Regional Product</td>
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<td>IFC</td>
<td>International Finance Centre</td>
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<td>IPR</td>
<td>Intellectual Property Rights</td>
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<td>JV</td>
<td>Joint Ventures</td>
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<tr>
<td>M&amp;A</td>
<td>Mergers &amp; Acquisitions</td>
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<tr>
<td>MNC</td>
<td>Multinational Company</td>
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<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<td>NIIDZ</td>
<td>National Indigenous Innovation Demonstration Zone</td>
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<td>SC</td>
<td>State Council</td>
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<tr>
<td>SME</td>
<td>Small and Medium Enterprise</td>
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<tr>
<td>SOE</td>
<td>State-owned Enterprises</td>
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<tr>
<td>UK</td>
<td>United Kingdom</td>
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<tr>
<td>UN</td>
<td>European Union</td>
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<tr>
<td>VER</td>
<td>Voluntary Emission Reduction</td>
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<tr>
<td>WRP</td>
<td>Working and Residence Permit</td>
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<td>WRPS</td>
<td>Working and Residence Permit System</td>
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Chengdu

Introduction
The Chengdu Chapter of the European Chamber was opened in 2005. It currently has over 100 members and Human Resources and Manufacturing Working Groups. The Chengdu Chapter has established close relations with various departments of the local government.

Recent Developments
Chengdu was ranked first as the ‘next decade’s fastest-growing cities’ by Forbes in 2010¹ and it has been positioned to play an extremely important role in the central government’s GO WEST policy.

The Chengdu government aims to develop the city into a ‘modern cosmopolitan garden city’, and is dedicated to developing five major strategic industrial functions: as an international and regional hub; an international and regional financial and headquarters destination; a location for high-tech and advanced machinery manufacturing; a major tourism destination; and a location for creative culture.

The State Council confirmed Chengdu to be developed into the logistics centre of Western China. With projections of the added-value revenue of the logistics industry in Chengdu to hit RMB 50 billion by 2012, at an annual growth rate of 18%, 43 foreign logistics companies have already settled in Chengdu. There are currently ten direct international flights departing from Chengdu and five container train routes established through Chengdu².

In recent years, the European Chamber Chengdu Chapter and the Chengdu government have established and solidified a mutual communication platform through two face-to-face meetings per year with the Chengdu Mayor and monthly meetings between European Chamber members and different Chengdu government departments.

This platform enables the Chamber to ensure that the voice of European industry is heard and to resolve various practical business issues. For example, regarding the taxation issues involved when unregistering a company for relocation purposes from one district to another district within Chengdu, the Chengdu Municipal Government published a policy on December 13th 2010 which clearly states the approval mechanism and procedures which have helped to resolve this issue.

Key Recommendations
General comment: There are few issues to be raised, because the Chengdu government is open, service-oriented and reactive to requests from foreign companies.

Develop Policies and Strategies to Fill the Talent Supply Gap

Concern
As more and more foreign companies are investing in and relocating to Chengdu, recruitment from the current local talent reserve has become a challenge for many companies. Two main issues have been raised to this regard: the difficulty to recruit suitable middle/upper level managers; and the high turnover rate for newly-employed graduates.

Assessment
The number of Fortune 500 companies that have established their presence in Chengdu rose from 139 in 2009 to 189 in 2010. Many of them have invested or re-invested heavily to launch R&D centers or manufacturing plants. This rapid growth of foreign investment into Chengdu has increased the demand for talent at all levels and has led to a gap between the demand and supply of suitable talent.

Local talent with work experience in foreign companies or specialists with adequate language skills are difficult to recruit. Companies are able to relocate middle or upper level managers from first tier cities to Chengdu; however this is an expensive and short term solution and does not tally with the fact that one of the most important reasons why companies chose to establish operations in Chengdu was for lower labour costs.

There are a high number of recently graduated college graduates in Sichuan. However, owing to a lack of proper

² Information source: 2011 Chengdu Investment Guide by Chengdu IPC
training in how to develop knowledge of the working environment prior to joining the marketplace, these graduates tend neither to have gauged their career expectations nor developed a career path. This leads to a tendency of these graduates to quickly change their jobs, especially when it is their first job.

The Chengdu municipal government could do more to attract talent through the provision of favorable policies and incentives to better align with provisions in first tier cities. Furthermore, as Chengdu aims to build itself into an internationalised city, the development of its citizens’ general English level will become increasingly useful.

Recommendation

- Provide tax incentives to managers to purchase automobiles and/or houses, as well as child education subsidies for the first three years following relocation into Chengdu for work.
- Develop a domestic social insurance system in line with first tier cities and create a voluntary social insurance system for foreigners in Chengdu to opt into, if desired.
- Provide high-quality living standards to attract talented individuals to live in Chengdu, such as free tickets for Sichuan tourist attractions during the first year following relocation.
- Build better coordination between universities and workplaces. To this regard, European Chamber member companies would be delighted to work together with tertiary education facilities to assist students in gaining knowledge of the post-academic workplace environment and to develop understandings of desired career paths.
Introduction

The members of the European Chamber in Chongqing have been active through the European Chamber Chengdu Chapter since 2005. In 2008, the European Chamber set up its own representation in Chongqing and today there are 24 member companies in Chongqing. In 2010, an Advisory Team composed of the member companies was created in order to develop the activities in the city; and in 2011, the European Chamber will form an official Secretariat presence in Chongqing.

Recent Developments

Chongqing has strategic importance for the central government’s GO WEST policy. The city has invested RMB 1 trillion to implement its ‘Five Chongqing’ strategy to develop Chongqing into a green, healthy and safe city with smooth traffic flows and comfortable living environs.

The Two Rivers Zone in Chongqing has been approved by the central government to be a unique comprehensive development zone, providing the same level of policies and opportunities as the Shanghai Pudong New Zone and the Tianjin Binhai zone. The Two Rivers Zone is expected to play an important role in advancing the development of not only Chongqing, but also China’s western region. With an area of 1,200 square kilometers, the zone is separated into the three administrative districts of Jiangbei, Yubei and Beibei; the Lianglu Cuntan Bonded Area; the economic & technological development zones; and the national level hi-tech development zones.

The European Chamber has established a good relationship with the Chongqing Vice Mayor, and close relationships with diverse department offices, including the Chongqing Foreign Trade and Economic Relations Commission, the Chongqing Council for the Promotion of International Trade, and the Two Rivers Zone.

Key Recommendations

1. Minimise Damage Due to Energy Shortages

Concern

The energy supply in Chongqing is insufficient as a result of the rapid development of the city. For many industrial companies, consistent supply of electricity and gas are vital to their business and, as such, energy shortages can have major impact on the performance of many companies.

Assessment

Chongqing is well-known for its attractiveness to industrial companies. Convenient transport systems are provided by its location at the heart of the Yangtze River and labour costs for blue-collar workers in Chongqing are much lower than in coastal regions.

This situation has led to an increasingly large number of multinational companies opening factories in Chongqing within the past decade. Increased industrialization has put great pressure on energy supply. As a result, Chongqing faces regular energy shortages from its mostly fossil-fuelled power stations. Power cuts have had to be implemented in some industrial areas to ensure energy supply for residential areas. This leads to lost production time and, ultimately, increased costs for manufacturers. The government is working to resolve this issue by importing surplus energy from the north-western region of China and through trying to foster an energy-saving mindset of companies and residents. Despite this, there are still a number of measures that the government could still take to improve the situation.

Recommendation

- Give an advance notice of any power cuts to companies to allow for planning and the rescheduling of production.
- Publish energy-saving standards and accreditations for the manufacturing industry whereby those companies ranked among the best for energy saving should be able to benefit from a ‘no power/gas cut’ policy, i.e., to reward their high energy saving standards through not being covered by the cuts. Likewise, those low-ranked companies should be the companies whose power is first to be cut, when cuts are necessary. This policy would encourage companies to improve energy efficiencies, thus allowing the root problem
of the energy shortages to be tackled.

2. Implement an Apprenticeship System

Concern
In Chongqing, manufacturers need a large amount of skilled industrial workers, yet it is becoming increasingly difficult to find suitable workers of this kind due to the number of companies establishing manufacturing facilities in the region.

Assessment
Manufacturing industries typically require a large percentage of skilled workers. As one of China’s major industry-intensive hubs, Chongqing is facing the problem of a lack of such workers. In the Chinese education system, academic learning and vocational skills remain completely separated, with no apprenticeships that can combine education with practical work. The apprenticeship system in Europe is very popular and useful for both companies and young people alike, as it allows student to gain essential skills prior to fully entering the workforce. Such apprenticeship systems assist with rapidly developing a large amount of technical workers to support industrial development and work as tools to lower city unemployment rates.

Recommendation
- Create an apprenticeship system in Chongqing.
- Create incentives to promote apprenticeships in Chongqing

3. Increase Government Service Efficiency

Concern
Official procedures for many business activities in Chongqing are unclear, with processes often being unnecessary and overly burdensome. This is often the result of a lack of coordination among government departments and a lack of efficiency of general government services.

Assessment
Although the government has been working hard to improve its services, especially with regard to foreign company registration processes, government information relevant to business is often not well communicated or is often not done so in a timely manner. In addition, the general efficiency of various government departments Chongqing could be improved. For example, it is not uncommon for two different departments to both claim that they lack the responsibility for particular tasks, redirecting companies to the other department.

Recommendation
- Develop processes to improve coordination between different government departments to avoid misunderstanding and the shirking of responsibilities.
- Improve communication with companies so that crucial policy updates, latest information and other notices are provided on time
- Improve communication with middle/lower level government officials to create a better common understanding of the needs of companies in order to ultimately improve responsiveness to issues arising from industry.
Nanjing

Introduction

The Nanjing Chapter of the European Chamber was established in April 2004 and currently has 115 members. Members consist of both large multinationals, as well as small and medium-sized enterprises and they represent a wide range of industries in the goods and services sectors. Regularly scheduled meetings offer members a platform to share information and experiences with industry experts and peers in the fields of Human Resources, Sourcing and Finance & Taxation, which all have formalised working groups in Nanjing.

With support from the local government, the Nanjing Chapter organises regular meetings with government departments at both the provincial and city levels. The goals of these meetings are to establish an ongoing information exchange between government and industry to facilitate the business operations for companies in Nanjing and also to contribute to the further development of Nanjing as an investment location. The main focuses of the dialogues were set by the Nanjing Chapter on issues of human resources and logistics, as well as on the investment and operational environment for smaller and medium sized companies.

Recent Developments

Not only is Nanjing famous for its role as a major manufacturing base, it is also one of the most developed cities in the Yangtze River Delta for the services sector. Currently, after a series of measures, the service sector accounts for over half of the total GDP of the city; furthermore, this proportion is expected to increase in the next five years, moving in the long-term towards a knowledge-based economy. Nevertheless, manufacturing still contributes towards the largest share of city tax income, thus the development of advanced manufacturing is expected to be emphasised.

Since 2005, Nanjing has prioritized the software industry and programmes including the creation of a special development zone have been launched to promote Nanjing as a software city. The rapid growth rate over the past five years has formed a new pillar industry composed of software services and service outsourcing, bringing a new dynamic into the city as well as job creation.

According to the 12th Five-Year Plan of the Nanjing Municipal Government, the city aims to transform into a regional high-tech innovation centre and integrated national transportation hub. Steps will be taken to realise the five main growth strategies: innovation-driven growth; increased household income; integrated development of the urban and rural areas; green growth; and the internationalisation of the city.

During the 12th Five-Year Plan period Nanjing has identified key tasks for its economic and social development. Technological innovation will be emphasised and supported by dedicated development zones and parks as well as human resources projects to attract innovative talents. The industrial structure will be modernized by further strengthening the pillar industries, emphasising modern services and developing emerging industry clusters. Foreign investment will also be guided towards supporting these goals. The set-up of research and development centres, distribution organisations and regional headquarters in Nanjing will also be encouraged.

Key Recommendations

1. Improve the Investment and Operational Environment for Small and Medium Sized Enterprises

Concern

Although Nanjing, through support from local authorities, generally provides a positive investment environment, the investment environment for Small and Medium sized Enterprises (SME) could still be improved through the provision of services tailored to the specific needs of these companies.

Assessment

SMEs are highly important to a city’s economy as they offer innovation, create jobs, generate tax income and generally provide modern working conditions. In addition, they are highly relevant for the operations of multinational companies which depend on smaller companies as part of

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1 Nanjing Investment Environment Report 2011, PriceWaterhouseCoopers
their supply chain.

Smaller enterprises in China are not only limited by the lack of foreign manpower and specialised personnel to initiate, guide and execute their investment strategy, but also by the language barrier in China, which can be an additional hurdle for investment. As the process for company registration in Nanjing lacks clarity, in combination with language hurdles, the paper work involved can be highly burdensome and time-consuming. This makes the approval of investments or adjustments of investment plans complicated and unpredictable.

SMEs typically have a gradual market entry strategy. They tend to start with assembly in rented premises to test product and operational suitability in the Chinese market. Once this is established, sizeable investments and the transfer of research and development activities follow. This approach generally does not suit development zones which target high initial investments.

Once operations are in place, both the lack of clarity as well as the lack of uniform implementation of newly issued regulations and policies make it difficult for SMEs to stay properly updated on requirements. Furthermore, implementation often occurs with little prior notice, making planning difficult. This can be especially challenging outside the larger development zones where the quality of the services provided may be lower.

Recommendation
- Facilitate ‘on time’ information for company registration processes by publishing flowcharts in English.
- Implement further the ‘one-stop service’ desks to further assist investing companies in their day to day operations.
- Establish areas within development zones that cater to the gradual market entry strategy of SMEs, through offering standards created for SMEs to rent factories as well as multilingual service desks for all aspects of enterprise operation.
- Provide reasonable prior notice before implementing new regulations or policies.

2. Reduce the Increasing Burden of Human Resources Costs

Concern
Nanjing is home to one of the nation’s top universities, generating an ample stream of highly qualified graduates. Nevertheless, it can be a challenge for foreign invested companies to attract and retain qualified white collar specialists to work in the development zones. Concerns continue to exist regarding the increase in human resource costs.

Assessment
Due to high salary expectations, it can be difficult to attract qualified white collar specialists from first tier cities to come to Nanjing. This is becoming a particular challenge for foreign invested companies which are sometimes viewed as less attractive because they are considered less stable and less able to offer privileges compared to jobs within government departments and state-owned enterprises.

Nanjing's labour costs have reached levels close to those in first tier cities, meaning that Nanjing, on average, has higher labour costs than other second tier cities. Last year, the increase in the local baseline for social security contributions also led to an additional increase in labour costs. Three years ago Nanjing had a much lower social security baseline than Beijing and Shanghai, whereas now it is nearly the same. Furthermore, the implementation of the new social insurance law may potentially increase benefit costs for employers. High turnover rates in some smaller foreign invested companies can further increase costs, and may potentially, in the near future, have a negative impact on the production quality in Nanjing.

Recommendation
- Increase the relative attractiveness of Nanjing for employees through the introduction of tax rebates for employee benefits such as supplementary pensions and subsidies for personnel development programmes.
- Provide clearer guidelines for how the local government defines the social security baseline for company contributions.

3. Further the Development of Nanjing as an International Logistics Centre for China

Concern
With investments in transportation infrastructure and facilities under way, incorporating for the port, airport, railways, and highways, Nanjing offers an attractive logistics set-up. However, in order to fully take advantage of the established infrastructure, port and customs authorities should intensify their efforts to further the development of Nanjing as an international logistics centre for China.
Assessment
Nanjing is located downstream of the Yangtze River harbour, which is one of the larger inland harbours on the river and an important junction connecting rivers in eastern China. To further position Nanjing as a logistics centre, the local government has invested in dredging the Nanjing harbour to a minimum depth of 12.5 metres and a project which will allow ocean ships to access the port is expected to be finalised within the next three years. In addition, the Nanjing South Railway Station, which opened in mid 2011, is expected to be the largest passenger railway station in Asia. Taken together with the Nanjing-Beijing railway, it can be seen that the city is situated within an east-west water transport network and a south-north land transport axis which provides Nanjing access to a considerable cluster of cities in the surrounding area.

Despite this advantageous infrastructure position and the investment into Nanjing’s logistics network, Nanjing has not yet developed into an international logistics centre owing to various operational and policy weaknesses. The short opening hours of the Nanjing’s customs office and its restrictions on customs clearance for certain commodities; the low frequency of international flights and sailings on air and shipping routes; the existence of different taxation along the river and in the port; as well as lack of clarity and a lack of uniform implementation of criteria for commodity and quarantine inspection are all causes for concern for foreign invested companies in Nanjing. These issues should be addressed to position the city as an international logistics centre.

Local traffic conditions within Nanjing itself are also of additional concern. Frequent traffic jams on the Yangtze River Bridge, which hinder access to the industrial parks located in the northern part of the city, makes working in these areas less attractive. There is also additional work to be done towards synchronising means of transportation locally, such as in adapting bus schedules to train arrival times.

Recommendation
- Extend the opening hours of the customs office.
- Expand international shipping and air routes, as well as the frequency of flights and sailings.
- Ease restrictions on customs clearance for certain commodities.
- Provide access for vessels larger than 1000 twenty-foot equivalent units (TEU).
- Harmonise taxation along the river and in the port.
- Enforce transparent and uniform implementation of commodity and quarantine inspection criteria.
- Increase the visibility of Nanjing as an international port among both shippers and buyers.
- Improve the city transport system into development zones and synchronise means of transport locally.

Abbreviations
SME Small and Medium sized Enterprises
TEU twenty-foot equivalent units
### Introduction

The Pearl River Delta Chapter (PRD Chapter) of the European Chamber was established in 2006, first in Guangzhou and a year later in Shenzhen. The PRD Chapter covers the geographic and economic area of the Pearl River Delta Region which expands across nine major cities in mainland China – Guangzhou, Shenzhen, Dongguan, Foshan, Jiangmen, Huizhou, Zhuhai, Zhongshan and Zhaoqing and also includes the Special Administrative Regions of Hong Kong and Macao. In less than four years since its establishment, the PRD Chapter has grown rapidly, and today has approximately 300 members constituting mainly European companies in the secondary and tertiary sectors spanning across various industries including electronics and telecommunications, machinery and equipment, automotive components, household electrical appliances, logistics, healthcare, trading activities, financial, legal and tax services. The Shenzhen and Guangzhou offices are operating under the supervision of seven local board members and organize regular meetings with government officials at provincial and municipal levels.

### Recent Developments

The GDP of Guangdong Province, which ranked first nationwide for the 22nd consecutive year among all provinces and municipalities, accounted for 11.4% of the country’s total GDP. The GDP of Guangdong has already overtaken Hong Kong and Taiwan and is on pace to quickly overtake that of Korea. The 12.2% annual GDP growth in 2010 is a confirmation of the continuous and sustainable growth of the PRD region.

All the main cities (Shenzhen, Guangzhou, Dongguan, Zhuhai and Foshan) contributed to this growth with a range from 10% to 13%. The growth is mainly due to traditional boosters such as FDI, international trade and domestic consumption (a 25-30% growth of imports and exports is noted in each main city). The FDI, which was originally motivated by labour cost advantages, is now oriented towards higher added value in production and services and is increasingly driven by the domestic market which represents a growing proportion of foreign companies’ revenues.

An important step in seeking long term sustainability according to the Guangdong’s 12th Five-Year plan is lowering of the expectations of the annual GDP growth rate to 8 percent and a focus on an increase in per capita GDP, aiming at a domestic demand driven economy.

Thanks to the 2010 Asian Games, Guangzhou’s transportation system has significantly improved. Between 2005 and 2010, RMB 54.7 billion was invested in the construction of new underground railways and RMB18.5 billion was spent on roads, bridges and other transportation infrastructure. Guangzhou became the first Chinese city to be granted the International Sustainable Transport Award in 2011 where past winners include New York, Paris and London. Shenzhen has also made huge infrastructure improvements (i.e. a new subway line opened) thanks to the Universiade Shenzhen in August 2011. These successful government initiatives are well in line with the ‘Happy Guangdong’ policy to promote a better sharing of the region’s growth which will continue to be implemented in the frame of the 12th five-year plan.

Thus, the Guangdong government investment plan targets four major areas– 1) infrastructure (RMB 1.52 trillion); 2) modern industry (RMB 536 billion); 3) urban and rural residential communities (RMB 124 billion), and 4) greenery projects (RMB 123 billion); which are a complementary step towards improving the infrastructure, securing a shift in the industry and developing an eco-friendly environment in the province.

Throughout the next five years, industrial comprehensive quality and competitiveness is expected to be greatly improved. The projected increase in the proportion of tertiary industries to 48% of the provincial economy and the completion of the main structure of modern industry will shape a renewed and encouraging business environment not only for the existing companies but, more importantly, for new types of investment. Such transformation on the economic growth will open new business opportunities for companies and will boost the image of Guangdong Province as an economy of high-value added growth, a magnet for talents and an attractive market for new businesses.
Key Recommendations

1. **Brand PRD Image as a Fully Integrated Region with Transformed Economic Growth**

**Concern**
European investors overlook many cities in PRD which tend to stand in the shadow of Hong Kong, Shanghai and Beijing.

**Assessment**
The major reason for this is that historically, PRD has been internationally recognized as a hub for low-end production. There is strong wish from the government to change this image and the rebranding of PRD is meant to show the region as an economy of services, information technology and high technology. To facilitate a change in focus and to attract high-tech and service companies, it is necessary to provide facilities and incentives to channel this transformation.

The access to information is difficult for non-Chinese speakers and there is no clear evidence that the government really intends to share this information to foreign investors. In the PRD, municipal government information on website of key trade and investment agencies are not translated into English, except for Zhuhai.

In addition, PRD municipalities seem to compete instead of being complementary to each other. Shenzhen always has built its image as being a high-tech city and continues to reinforce this image. Guangzhou, in the aim of changing its image from low-end manufacturing industry to a more eco-friendly city, also communicates on the city as being attractive for the high-tech industry in a more or less similar way.

**Recommendation**
The provincial and municipal governments should:
- Play a coordinating role to help the cities in Guangdong Province have a more specified image. This entails developing competitive incentive policies and setting up a benchmark with other first-tier cities such as Beijing, Shanghai and Hong Kong which remain to be main competitors for Guangdong cities.
- Ensure that central and provincial policies are similarly implemented by the authorities of the same level in the different cities in PRD in order to improve the business environment.
- Optimise the customs operations and procedures involved in the logistics functions. In contrast to other regions in China, Guangdong Province has 7 different customs regions, as well as the customs offices operating in the Free Trade Zones. This leads to different local implementations of laws and regulations often subjectively interpreted rather than following common implementation rules. As a result, this causes companies to face different cases for each transaction.
  - **Example:** The handling of personal effects through different customs houses in Shenzhen and Guangzhou is processed differently which forces service providers to avoid certain customs offices in favour to others with more cooperative attitude.
- Provide up-to-date information in English on the websites of the investment promotion bureaus, customs, human resources and social security bureaus and of other administrations. (An exception to this is the Invest Zhuhai website, which provides the most up-to-date information in English)

2. **Prosecute IPR Offences and Improve Transparency of IPR Enforcement Decisions**

**Concern**
Despite clear legislation on the criteria with reference to the prosecution of criminal offences of counterfeiting, it appears that administrative authorities in the PRD are sometimes reluctant to transfer cases to the PSB for criminal investigation even where these criteria are clearly met.

Transparency is an important element in creating a consistent law enforcement regime. There is a general lack of publication of IPR enforcement decisions by administrative and judicial authorities in the PRD. This is in contrast with some cities, such as Beijing, which have recently decided to routinely publish various judicial and administrative decisions.

**Assessment**
There have been regular cases reported in the PRD where administrative authorities, during action for trademark infringement which clearly meet the threshold for criminal liability, have been reluctant to transfer cases to the PSB for prosecution.

Given the low deterrence of administrative penalties, and the clear legislation on criminal liability thresholds,
European Industry is concerned that commercial-scale counterfeiting is not being properly penalized. It is common for counterfeiters to continue infringement after they have been penalized by the administrative authorities, undermining China’s own laws, the efforts of law enforcement authorities, the State Council’s Special IPR Campaign and the image of China’s IPR enforcement amongst European companies.

Amongst administrative authorities in the PRD, there is generally no publication of IPR decisions.

This means that companies that have a record of multiple IPR infringements are not brought to light. Likewise for the civil and criminal courts, in the PRD there are very few published judgments from the IP trial chambers – for example, in the database www.ciela.cn, which records all published IP civil decisions, 49% of the records are from Beijing Courts, nearly 10% are from Shanghai Courts, but Guangzhou courts disproportionately account for less than 7% of records and Shenzhen Courts less than 3%.

The lack of publication of IPR decisions also has an effect of causing variance in the penalties and fines between cities in the PRD, meaning that for similar cases, there may be different outcomes in different places.

Publication of IPR infringement may in itself form a deterrent to companies that do not wish to attract a reputation as an infringer. Publication of IPR decisions would generally not require any legislative changes and is largely a policy decision.

Recommendation

- Ensure that regulations, policies and incentives for administrative and criminal law enforcement agencies are aligned to effectively implement the existing laws on criminal liability for counterfeiting.
- Promote policies of transparency of IPR enforcement decisions from administrative and judicial organs to improve the consistency in application of the law and improve confidence in the existing systems of enforcement.

3. Develop a More Transparent and Talent-oriented Labour Market

Concern

Recently labour dispute cases are becoming a daily challenge for many European companies in PRD. The insufficient clearness in interpreting the Labour Contract Law has often led to the more frequent cases of bad intentioned employees taking advantage of the protection of the Law.

On the other hand the lack of talent with engineering and technical background becomes a serious obstacle for the economic growth of innovative enterprises with long-term investments.

The old-fashioned “hukou” system is hindering mobility and motivation of the workforce.

Last but not least, the lack of transparency on wage adjustments implemented in the middle of the year put companies in the situation of financial difficulties, which could have been avoided by simply releasing an advance notice on the expected wage increase and the parameters affecting the adjustment.

Assessment

For many years, European companies have made continuous efforts to develop a good environment for workers in the PRD and to comply with the social and labor regulations. In the same way, they have worked positively in implementing the new Labour Contract Law, but they note today the abuse of some employees in the application of this Law that uses its insufficient clearness to take unfair advantages. In any case, it is difficult for a foreign employer to win a labour dispute case in Guangdong Province, which - led by the good motivation to protect the rights of the employee as the weaker party - often remains indifferent to his abusive actions.

As the production added value chain goes higher, there is an increased demand for highly qualified senior engineers by the hi-tech industry, including the R&D centers and advanced manufacturing. Currently PRD cannot provide the skilled labour needed. The shortage of human resources with sufficient technical and engineering background and experience requires a proactive approach from the local government in establishing incentives for companies which are able to provide the necessary knowledge and training to their employees.

One major reason for the decreased interest of the migrant workforce in the coastal territories of the PRD is the inflexibility of the “hukou” system, which restrains migrant workers’ rights in various ways. A good example is often the difficulty for migrant working parents to ensure equal education rights of their children in the new city as a result of the “hukou” system regulations.
In addition, the European companies would benefit very much from more transparency on the minimum wage increase. Knowing in advance the projected increase by the government will allow enterprises to plan the next year budget accordingly and avoid financial stress during the year.

**Recommendation**

- Ensure transparency on the labour dispute cases and fair treatment towards employers as much as to employees (i.e. by publishing the labour arbitration awards on the local government official website). Such information will improve the awareness of both employers and employees when solving labour disputes.
- Develop incentive regulations for companies able to develop and provide technical training for their employees and ensure retention stability in the return on investment period.
- Ensure equal rights for migrant workers and employees during their work assignment away from their home by implementing a flexible “hukou” system that will enable migrant workers and their children to live, work and study independently of the “hukou” registration. For more details, please also have a look at the Human Resources Forum Paper.
- Improve the transparency on the wage adjustments implemented by the provincial and municipal government authorities by efficiently communicating the necessary implementation parameters, the size and the frequency of the wage adjustments.

4. **Integrate Various Logistics Functions in the PRD and Urgently Optimize Customs Operations and Procedures**

**Concern**

The PRD logistics industry lags behind competing Asian markets. Various means of transportation are not well connected and inter-PRD planning does not meet the needs of the logistics industry. Customs operations and procedures are not optimized according to international best practices and do not take into account the needs of companies importing and exporting through the PRD ports and the FTZs.

**Assessment**

Management of the various means of transportation, including air, railways, roads, and water ways, lacks coordination.

Road transportation accounts for approximately 70% of all carried goods in the PRD, resulting in heavy congestion and inefficiency.

The development of logistic facilities is not fully balanced in PRD with the northern and western parts of the PRD region that lag behind the other regions. Municipalities decide and execute the investment into and the construction of infrastructure projects, basing them on local considerations and aiming to meet local needs. This results in a development that may not necessarily meet the needs of the PRD industry as a whole. For example, Guangzhou takes up a central position in the rail and road network of the PRD, which does not reflect the importance of the Hong Kong – Shenzhen axis in the flow of goods.

Customs procedures pose a constant challenge to many businesses in the PRD. A region with an intense flow of international goods depends heavily on efficient customs processing. In contrast to other regions in China, Guangdong Province has seven different customs regions, as well as the customs offices operating in the FTZs. This leads to different implementation of laws and regulations and is a cause of concern for companies dealing with more than one customs office. As a result for many European companies, in terms of efficiency, Hong Kong remains a preferable customs stop for handling both import and export cargoes as well as cargoes destined to mainland FTZs.

**Recommendation**

- Improve the coordination of various means of transportation and decrease the percentage of goods transported on roads by improving rail links
- Better meet the logistics needs of companies by taking a macro approach to transportation in the PRD
- Unify customs procedures throughout Guangdong Province
- Improve the efficiency of the FTZs by simplifying the import/export operations from mainland China to FTZs and vice versa

5. **Communicate Clearly and Efficiently the Newly Implemented Rules on the Control of Foreign Employees Residing in PRD**

**Concern**

The Guangdong Provincial People’s Government has adopted the “Interim Provisions of Guangdong Province on
Management of and Service for Foreigners”, which entered into force on May 1st, 2011. It reinforces the control on Foreigners working in the Guangdong Province.

Any entity shall not provide any bank account, invoice, place of operation, transportation, or warehousing services to foreigners who operate without a business license. The lack of coordination between administrative authorities, the intervention of lay persons in the control of residence and of businesses operated by foreigners may lead to a system of arbitrariness.

**Assessment**

According to the “Interim Provisions of Guangdong Province on Management of and Service for Foreigners”, operators such as landlords, property agencies, employers, banks, transportation companies, etc, may suffer heavy penalties if they do not regularly check the validity of passports and visas of foreigners. In addition, lay persons and anyone without police authority may even be awarded for finding and reporting a foreigner whose visa has expired or whose working permit has not yet been obtained.

Regarding the apartment or house rented by a foreigner, even after due registrations of the foreign leaseholder and his/her roommates, if the landlord is found to rent his property to foreigners with expired passports or visas, the rent fee shall be confiscated and the landlord shall pay a penalty of 3 times the rent, with no provisions if this rule will apply on foreigners who are in the process of obtaining a working permit or renewing an expired visa.

The Guangdong regulation provides that the labour bureau or, other relevant administrations, may require the employer to provide a financial guarantee for the invited foreigners during their stay in China, which poses additional financial burden for employers hiring foreign employees, even though, in accordance with national regulations, the employers have already proven that the foreigners they want to hire will hold a post where no Chinese citizen is qualified.

In addition, a more severe measure will take place when the circumstances are considered serious. The foreign affairs department may even revoke the employers’ qualifications of employing foreigners. In practice, this means foreign invested enterprises may legally be prohibited from recruiting foreigners.

**Recommendation**

- Ensure that policies, regulations and incentives in general are enforced in a consistent manner by administrative and police enforcement agencies
- Clarify the penalties in accordance with the seriousness of visa violations
- Limit the role and responsibilities of individuals and parties which are neither directly concerned nor qualified to check foreigners’ residence certificates
Introduction

The Shanghai chapter of the European Union Chamber of Commerce in China (European Chamber) was opened in 2003. It is currently the largest chapter in terms of number of member companies (over 600) and has over 30 active Working Groups. The chapter has strong relations with various branches of the local government including regular strategic dialogues with the Shanghai Development and Reform Commission (SDRC), the Shanghai Municipal Commission of Commerce (SCOFCOM), and the Shanghai Customs Bureau.

Recent Developments

In addition to the release of the national 12th Five-Year Plan, a Shanghai-specific 12th Five-Year Plan was also released by the SDRC. This included targets to increase the reform and opening up of the city’s economy to a greater degree and to become an international centre in four areas – economy, finance, trading, and marine transportation. 1

In relation to Shanghai’s ambitions to become an international financial centre by 2020, there have been some progressive steps in relation to the greater internationalisation of the RMB – including the growing scope of cross-border RMB trade settlement schemes, the initiation of a Shanghai Insurance Exchange, and the Pudong area-specific private equity pilot scheme for Qualified Foreign Limited Partners.

In April 2011, the European Chamber launched its first ever ‘Asia-Pacific Regional Headquarters Study’. 2 In this study a key finding was that Shanghai was ranked marginally ahead of the closest competitors (Singapore and Hong Kong) in terms of being viewed as the overall most favoured location for Asia-Pacific regional headquarters in 2011. The study found that the main strength of Shanghai was its proximity to the mainland Chinese market. However, it ranked behind Singapore and Hong Kong on 4 of the 5 most important criteria (‘legal & regulatory environment’, ‘political environment’, ‘business environment’, ‘tax environment’), highlighting the areas where Shanghai can improve.

The hosting of the 2010 Shanghai World Expo (May to October 2010) was a catalyst for improvements to the city’s infrastructure and overall services provisions and the success of this huge project should be recognised. During the Expo, the city also witnessed dramatic improvements in both the air quality in the city and the enforcement of intellectual property rights laws (where outlets for counterfeit goods all but disappeared). However, these improvements were seemingly only temporary as they have not been continued since Expo finished (in relation to the air quality, please see ‘Improve the Air Quality and the Enforcement of Health and Safety Standards’ below in this paper).

European companies in Shanghai are committed to the city and to contributing to its development. The European Chamber is grateful for the progressive and ambitious approach of its governmental authorities and offers the constructive recommendations in this paper to aid this process.

Key Recommendations

I. Business Environment

Improve aspects of the business environment to bring Shanghai in line with the expectations of a developed international economic centre.

1. Improve the Regulatory Environment

Concern

The business environment in Shanghai is perceived by foreign businesses to have low levels of predictability and transparency in the regulatory environment as well as high levels of bureaucracy and administrative burden. 3

Assessment

Shanghai has ambitions to develop into an international centre for economy, finance, trading and maritime transportation. Its governmental authorities are also striving to make the city a more viable location for foreign enterprises to establish Asia-Pacific regional headquarters.

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1 The “Four Centres” are mentioned in the Outline of the Twelfth Five-Year Plan for National Economic and Social Development in Shanghai (Chapter Three Implementing “Four Centers’ National Strategy) http://www.shanghai.gov.cn/shanghai/node2314/node25307/node25455/ (viewed 26th July 2011)
2 European Union Chamber of Commerce in China, 2011, ‘Asia-Pacific Regional Headquarters Study’
3 European Union Chamber of Commerce in China, 2011, ‘Asia-Pacific Regional Headquarters Study’
and offer various incentives to encourage this. However there are serious concerns regarding the regulatory environment and treatment of foreign enterprises. European Chamber member companies report that regulations can often be unclear, contradictory between different governmental bodies, and subject to sudden changes without advanced notice.

In addition, regulatory power overwhelmingly resides in Beijing, with the Shanghai branches of the regulators often having limited capacity to act. Greater decentralisation of regulatory power to Shanghai would help improve the business environment in the city by improving the speed of various approval processes.

To illustrate this point, Shanghai is China’s financial capital and is working towards a central government-endorsed target to become an international financial centre by 2020. However, even though the stock exchange and capital markets are already located in Shanghai, the China Securities Regulatory Commission (CSRC), the China Banking Regulatory Commission (CBRC) and the People’s Bank of China (PBOC) are all headquartered in Beijing. All other leading international financial centres have their national financial regulatory bodies located within them even if they are not national capitals (e.g. Frankfurt, New York).

Recommendation
- Improve transparency and predictability in regulatory affairs by giving more notice and detail regarding impending changes, and by improving the consultation process with relevant parties
- Improve coordination between different regulatory bodies where guidance may be unclear and/or contradictory
- Increase coordination of decision-making and approval processes between Beijing and Shanghai, and further decentralise power to Shanghai Governmental bodies where appropriate
- Improve transparency and predictability through greater communication with consolidated foreign investment bodies (such as the European Chamber)

2. Encourage New Drivers of Growth for the Shanghai Economy

Concern
Shanghai faces challenges in terms of its goal of propelling economic growth in the upcoming Five-Year Plan period.

Assessment
The city’s development has reached a stage whereby its sustainable development can no longer rely on export and labour intensive manufacturing. Factors such as high investment intensity, a rapidly aging population, negative natural population growth, and land constraints should push Shanghai to take the lead in shifting its drivers of growth by developing services and encouraging innovation.

European companies remain committed to supporting the development of the city and region. Their strengths and experience match the goals set by the Shanghai Government in its 12th Five-Year Plan in areas such as sustainable urban development, services, environmental and energy-saving technologies, and innovation.

Recommendation
- Pursue a balanced economic structure with services and innovation as the driving forces of growth

3. Reduce Corporate Taxation

Concern
The corporate income tax rate is very high in comparison to other major centres in the region, making it a less attractive location to conduct business.

Assessment
Shanghai levies a corporate income tax rate of up to 30% for foreign invested enterprises, which is significantly higher than in Hong Kong (16.5%) and Singapore (up to 17%).

The European Chamber understands the need for a fair and progressive tax system and also recognises that tax levels are set nationally by the central government, however the current taxation levels are a key obstacle to Shanghai’s development as a viable location for international businesses to operate in.

The international competitiveness of the city would therefore benefit from either straightforward reduction in the corporate tax rate or by the implementation of pilot programmes to reduce the burden.

Recommendation
- Reduce the corporate tax burden
4. Promote Further Integration with the Neighbouring Regions

Concern
Shanghai should work to harness the strong growth of the whole Yangtze River Delta region through greater economic integration. In addition, current transportation links to other cities in the region could be improved.

Assessment
The growth of the Yangtze River Delta region as a whole is complementary to the development of the city of Shanghai. The relevant authorities should look to harness this through greater harmonisation of regulatory and administrative systems, and a reduction of barriers with regards to labour and capital mobility. In a positive step, the National Development and Reform Commission (NDRC) issued the ‘Yangtze River Delta Regional Development Plan’ in June 2010.

The transportation infrastructure in Shanghai is continually improving and the new high-speed rail link with Beijing is a welcome step forward. However, the growing regional and international importance of Shanghai requires a corresponding level of good aviation links and frequently direct links to other Asian or European cities often do not exist - requiring indirect flights via places like Hong Kong and Singapore and even Guangzhou.

Recommendation
· Enhance harmonisation of the various regulatory and services systems, and reduce barriers for labour and capital mobility within the Yangtze Delta Region
· Improve transport links to other cities in China and abroad

5. Increase Investment in Human Capital

Concern
Both foreign and domestic businesses in Shanghai face problems regarding the hiring of individuals with the necessary professional skills and experience, as well as rising labour costs.

Assessment
European Chamber members nationally reported growing concerns with regards to labour costs in early-2011. 66% of surveyed European companies in China stated that they are “pessimistic” in this regard, which was a large increase from 52% in 2010 and 28% in 2009. Such sentiments are particularly strong in Shanghai with its emphasis on developing its service sector and attempting to position itself as a primary location choice for multinational companies’ regional headquarters. Local and multinational companies alike are forced to compete fiercely for talent and face high salary expectations which must improve year on year in order to retain talented staff. In addition there is concern that the introduction of the new Social Insurance Law on 1st July 2011, will increase labour costs for both local and international employers and employees with limited or difficult access to benefits.

A number of European businesses have initiated sponsored training programmes at local universities in Shanghai. However, it has been reported that these companies have received little support from the Shanghai government which is in contrast to certain neighbouring cities where the local authorities have provided incentives to encourage businesses to provide such training programmes.

With regards to the visa process for foreign employees, the Exit-Entry Administration Bureau of the Shanghai Public Security Bureau has launched a new English-language website to apply for visas. It has also been reported in the media that it is now possible to obtain two-year Residence Permits (increased from one-year) in Shanghai. The relevant authorities should be congratulated for these developments, but the process for foreign individuals to obtain a visa for employment (or study or travel) remains overcomplicated - particularly when compared to other places, like Hong Kong. In addition, the Hukou system discourages talented Chinese who are non-Shanghai residents from relocating to the city to work.

Recommendation
· Adopt measures to counter growing labour costs
· Offer incentives for companies to invest in training their workforce
· Simplify the visa process for foreign individuals and the Hukou system for non-Shanghai PRC nationals

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6 See more details about the impact of the new Social Insurance Law in the HR Forum Position paper.
7 Exit-Entry Administration Bureau of Shanghai Public Security Bureau, http://114.228.108.16/wents_tylc/jk_type_e.jsp, viewed 19th May 2011
Shanghai

Section Six: Local Focus

6. Improve Internet Speed

Concern
The internet speed in Shanghai is reported to be the slowest in China and significantly below global averages.

Assessment
Chinese media reported in early-2011 that Shanghai has the slowest internet speed in China and this should be taken in the context that China as a whole already ranks only 80th in the world in terms of internet bandwidth. This impacts on business performance in the city and should be remedied to bring this essential part of the infrastructure in line with expectations.

Recommendation
• Increase the speed of internet

II. Living Environment

Improve aspects of the living environment to make Shanghai more attractive to talented international and Chinese individuals by carrying on the successful developments of the 2010 World Expo.

1. Counter the Rising Cost of living

Concern
The rising cost of living and relatively high income tax rates create disincentives for both talented Chinese and foreign individuals to relocate to Shanghai for work.

Assessment
With an individual income tax rate of up to 45%, Shanghai compares unfavourably with other regional centres such as Hong Kong (up to 17%) and Singapore (up to 20%) as a place for international talent to locate and work.

The cost of living is rising in Shanghai and inflation is an ongoing concern. The city’s prices reached a record high for more than 2 years when the Consumer Price Index for the city grew 5.1 percent from a year earlier in April 2011. The price of housing is of particular concern and the national government has launched a series of tightening measures to counter rising home prices as of January 2011 – including an additional property tax in Shanghai. These steps are welcome and this focus should be maintained with additional drives to create more low-cost housing in the city.

Recommendation
• Reduce the individual taxation burden
• Provide more low cost housing and work to reduce the costs of renting and buying

2. Improve the Air Quality and the Enforcement of Health & Safety Standards

Concern
The quality of the environment in Shanghai is a significant deterrent to living and working in the city. Furthermore, a number of health and safety concerns exist in areas such as food standards and fire safety.

Assessment
During the six-month Expo period in Shanghai, its citizens were able to enjoy clear skies and clean air. However, the dramatic decline in the air quality following the end of the Expo period is apparent to its population and is reinforced by local media reports - with the air pollution index reaching a decade-long high of 370 on 13th November 2010.

The below chart, using information from a Shanghai government source, shows the air pollution index for Shanghai for the 6 months of the Expo and the 2 months after it finished (1 May 2010 until 31 December 2010).

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8 Shanghai Daily, 20th January 2011, ‘The Slowest Internet in China…’
10 Shanghai Daily, 13th May 2011, ‘Shanghai consumer price growth quickens in April’
11 China Daily, 25th November 2010, ‘Shanghai pollution reaches a new high’
Section Six: Local Focus

Over 2011 there have also been numerous food safety scandals exposed through the media in China – including the case in Shanghai of steamed buns contaminated with unsafe and illegal chemicals. Such cases raise serious concerns about the viability of Shanghai being a safe city for people (and their families) to live in.

Attention was drawn to fire safety when a centrally-located apartment block burned down on 15th November 2010, claiming 58 lives. Since then a Shanghai Government report was released which indicated that the city’s current firefighting facilities are not capable of meeting the needs of a city with a large number of high-rise buildings and a high population density. Since then media reports have indicated that funds have been allocated to attempt to remedy this deficiency.

Recommendation
- Improve the air quality
- Improve food safety standards and their enforcement
- Improve the capacity of firefighting services

3. Improve International Schooling and Healthcare

Concern
Certain aspects of the services provided at international hospitals in Shanghai need to be improved, whilst the international schools for children are expensive.

Assessment
International hospitals in the city are targeted at foreign professionals who have these costs covered as part of their employment packages, however not all foreign expats will have this coverage and in particular younger workers and students in the city would find it hard to find affordable international healthcare. In addition it is reported that, despite the high costs, the services provided at international hospitals are often unsatisfactory with complaints given about the level of service and hygiene.

International schools for the families of foreign workers in the city are also very expensive and the limited number of these does not create a competitive environment to drive them to reduce fees.

Recommendation
- Increase the number of international hospitals and work to reduce their cost
- Encourage the establishment of international schools and work to reduce their cost
Shenyang

Introduction
The Shenyang Chapter, launched in May 2006, is the youngest chapter nationwide. It has developed significantly since 2009, and in 2010 witnessed a 138% new membership rate and a 100% membership renewal rate. The Shenyang Chapter has 35 members, including all of the major companies invested in the region, including BMW, Michelin, Siemens, BASF, Jinbei Johnson Controls, Bombardier, Bekaert, Wuerth, and KPMG. Shenyang, as a major equipment manufacturing base and a rising economic powerhouse of China, has great potential to attract investment from more and more major European and foreign enterprises. The European Chamber acts as one of the most active platforms in the region to provide services for member companies and to mediate and promote their relationship with the government.

Recent Developments
In 2010, Shenyang’s nominal gross domestic product (GDP) amounted to RMB 501.7 billion. This represented 14.1% real growth year-on-year from 2010, and translated into an annual GDP per capita average of RMB 63,667, an increase of 13.1% compared to 2009.

Following the financial crisis, foreign trade in Shenyang has recovered remarkably. A sharp increase in both exports and imports year on year in 2010 of 15.7% and 24.0% respectively was witnessed, amounting to a total import and export value of RMB 53.6 billion. Shenyang is still the number one destination for foreign direct investment in Liaoning province. By the end of 2010, the number of newly approved foreign investment projects had climbed to a high of 473, with a total utilized FDI amount of RMB 34.4 billion. Investments and re-investments were also high throughout 2010. One major example includes BMW’s investment of RMB 5 billion into Brilliance Auto Group, bringing its supplier base up to hundreds of companies. Capacity will gradually increase to 200,000 units a year, a figure in line with growing market demand in the long term.

According to the Shenyang 12th 5-Year Plan, the annual GDP growth rate is expected to be greater than 12% and is likely to exceed RMB 1 trillion by 2015. Fixed asset investments are planned to continue to grow at over 10% and utilised FDI is expected to maintain growth above 15%. Import and export values are expected to increase annually at rates of over 10%.

In recent years many improvements have been witnessed in Shenyang, most notably in the areas of transportation infrastructure, environment and living conditions. Additional areas for improvement are listed below.

Key Recommendations

1. Attract Key Local Talent to Shenyang
Concern
Attracting key local talent is a major concern for foreign companies in Shenyang. As the number of invested companies and the amount of industry increases, it is becoming more difficult to find suitable local people to hold key positions.

Assessment
In order for Shenyang to maintain impressive growth, the issue of the availability of key local talent will need to be addressed. Foreign companies face increasing difficulty to fill positions in the required fields of expertise. While there are several universities in the surrounding area that are producing qualified candidates, the numbers are still not sufficient to meet demand.

Recommendation
- Determine employment needs for local talent by working together with foreign industry to assist universities develop their education programs accordingly.

2. Improve Living Conditions
Concern
A lack of adequate educational institutions for foreign students is becoming a bigger issue in terms of attracting foreign talent.

Assessment
As the upgrading of the industrial base to higher technology levels continues, there will remain for many years the need for expatriates to assist companies
located in Shenyang to install equipment and train local employees. While there is a certified international school for English speaking children following the American education system, there is no certified international school for European students. Therefore, European expatriates are less incentivised to move to Shenyang where there are few educational opportunities for their children.

Recommendation

• Work with foreign industry in the area to determine the need and the feasibility of establishing a certified international school for European students in Shenyang.
• Investigate the possibility to offer an incentive to establish an international school for European students.
Tianjin

Introduction
The European Union Chamber of Commerce in China is a not for profit, fee-based organisation which was founded by 51 member companies based in China on October 19th 2000. In 2005, the Tianjin chapter was founded. To date, it has 100 member companies and two discussion forums focusing on Human Resources and Finance & Taxation in Tianjin.

Recent Developments
Tianjin was the fastest growing autonomous region in China in 2010, with a GDP growth of 17.4%. Known as a strong industrial powerhouse, the city continues to rank highly in terms of investment and technology developments. In 2010, it became the host of the quickest super computer in the world with processing speeds of 2.507 petaflop per second. With a population of 12.9 million inhabitants, the local consumer market is developing very quickly, boasting a retail sales growth of 23.9% year on year in 2010. Major achievements in 2010 include the re-development of Heping Avenue and the opening of a new exhibition centre. There have also been major programs to develop markets, parks and recycling waste stations, which have all served to increase the standard of living for Tianjin citizens.

Tianjin has also significantly improved its image in both China and abroad in recent years. It has recently hosted several major international events, including ‘The World Economic Forum – Summer Davos’, and the ‘United Nation Climate Change Forum’, both of which were held in late 2010.

Although there have been no significant regulatory changes to the investment environment, the municipality has started a process of integration of the various investment zones into a wider body called the Binhai New Area. The objective is to further improve efficiency by reducing overlap and redundancy. Tianjin is known for its first-rate investment zone development which was formally known as the Tianjin Economic and Development Area (TEDA).

1. Improve Road Safety and the Transportation Infrastructure

Concern
With its strong economic development, Tianjin is facing growing pressure on the city’s transportation infrastructure. Although infrastructure hardware has improved significantly over the last few years, including connections with Beijing and other economic hubs in the region, and although Tianjin was one of the first cities to benefit from a reliable high speed train, more is needed in terms of infrastructure and organization software.

Assessment
Tianjin, like many Chinese cities, has witnessed a major increase in the number vehicles on the road, as well as newly-licensed drivers. This has led to severe traffic congestion as well as an increase in road traffic accidents. This not only has a direct impact on the safety and lives of Tianjin’s population, but is also detrimental to Tianjin’s efforts to increase its reputation as an attractive place to both invest and live.

In addition, interconnections between various major logistics hubs in Tianjin are inconvenient, including the airport and harbour, as well as transportation between the Binhai Area and downtown and between the Binhai Area and Beijing city. The underground train (metro) network is also currently not expansive enough, which is another reason why road traffic congestion is so high. The frequency of major transportation facilities is also too low. This includes transportation between Binhai and Beijing, for which there are only four train departures a day.

1. The project ‘Tianhe one’ of the National Defense Technology University.
2. According to the 6th Chinese census.
2. Improve Tianjin’s Air Quality

Concern
Although significant improvement has been witnessed since the 2008 Beijing Olympics Games in air pollution levels, it is still necessary that this trend continues as Tianjin suffers from poor air quality.

Assessment
Tianjin is a very successful industrial city; however it has a sad history of low air quality. This is due to both the natural environment as well as the huge number of construction sites, its intense traffic and its heavy manufacturing industry. The poor air quality is an important issue in the daily life of its residents and in the long run will have a negative impact on Tianjin’s ability to attract top talent, both domestically and abroad. The poor air quality has thus been mentioned as a limiting factor for the development of some high-tech industries.

Recommendation
- Select and publish air quality targets as key performance indicators for each year and for the period of the 12th Five-Year Plan, with the development of corresponding action plans.
- Enforce more regulations for greener construction and manufacturing and better manage construction sites.
- Improve bus and car emissions controls.

3. Improve the Awareness and Visibility of Development Plans and Enhance Coordination of Tianjin’s Pillar Industries

Concern
The pillar industries of Tianjin’s development are not well known and as such their development is not being optimally maximised.

Assessment
Increased awareness and a more focused development of Tianjin’s pillar industries would benefit companies by improving supply chains and increasing the number of qualified suppliers, as well as through better targeting education and creating more responsive public policies. Currently, there is a relative lack of high quality suppliers for each of Tianjin’s pillar industries as well as difficulties within the supply chain for the pillar industries, including for import processes, port handling, airport handling and customs clearance. To these ends, European companies would be willing to play a more active role and would be willing to join a body comprised of key companies in the pillar industries, research and education entities, as well as policy makers to improved coordination between all relevant bodies and to improve the development of Tianjin’s pillar industries.

Recommendation
- Create a body of key stakeholders in the pillar industries, including policy-makers, to devise a plan for the development of the pillar industries
- Form a group of high quality and reliable suppliers for each of the pillar industries
- Improve the supply chain of the pillar industries
- Improve the level and targeting of initial and continuous professional education to be more tailored to the skills required within each of the pillar industries
Recommendation

- Support the establishment in Tianjin of large-scale international business events and exhibitions, with related media campaigns both in China and abroad.
- Create the conditions to encourage small private enterprises to develop offering entertainment and other amenities.
- Continue to develop the concession areas into lively commercial centres based on small scale private business (A nice example is Chifeng Dao between Heping Lu and Nanjing Lu. Streets like that part of Chifeng Dao or Hami Dao could be carefully developed into pedestrian zones; however over-planning should be avoided, for example the Italian concession and Jiefang Beilu are attractive but quite quiet and uninteresting).
- Create attractive walking corridors between the concession areas to promote Tianjin as a city accessible for pedestrians.
- Plant more trees on the Haihe river banks between Jiefang Bridge and Chifeng Bridge.
- Terminate the sprawl of construction and waste of land in the outskirts of the city. In order to become a livable and lovable city, there should be green belts and nature near to the city centre.
Appendix
Abbreviations

3G  3rd Generation of mobile telephone standards and technology
3GPP  Third Generation Partnership Project
A&P  Advertising and Promotion
ACEA  Association des Constructeurs Européens d’ Automobiles
ACFTU  All-China Federation of Trade Union
AE  Adverse Events
AEL  Atomic Energy Law
AFN  Auto Finance Company
AHWP  Asian Harmonization Working Party
AIC  Administration of Industry and Commerce
AMEA  Anti-Monopoly Enforcement Authority
AML  Anti-Monopoly Law
API  Active Pharmaceutical Ingredient
AQSIQ  General Administration of Quality Supervision, Inspection and Quarantine
ATM  Air Traffic Management
BDRC  Beijing Development and Reform Commission
BL  Bidding Law
BT  Business Tax
CAAC  Civil Aviation Administration of China
CAFFCI  China Association of Fragrance Flavour and Cosmetics Industries
CAMDI  Chinese Association of Medical Device Industry
CATA  China Air Transportation Association
CAW  City Average Wages
CBM  Coal Bed Methane
CBM  Condition-Based Maintenance
CBRC  China Banking Regulatory Commission
CCAA  CPC Central Cryptography Administration Authority
CCC  China Compulsory Certification
CCFH  Codex Committee on Food Hygiene
CCHP  Combined Cooling Heating and Power
CC-IS  China Compulsory Certification for Information Technology Security Products
CCNFSDU  Codex Committee on Nutrition and Foods for Special Dietary Uses
CCRA  Common Criteria Recognition Agreement
CCS  Carbon Capture and Storage
CCSA  China Communications Standards Association
CCUS  Carbon Capture, Utilization and Storage
CDM  Clean Development Mechanism
CEC  Commercial Encryption Code
CEIBS  China–Europe International Business School
CEN  European Committee for Standardization
CENELEC  European Committee for Electrotechnical Standardization
CEPA  Closer Economic Partnership Arrangement
CEPRI  China Electric Power Research Institute
CER  Certified Emission Reduction
CFC  Consumer Finance Company
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>CFETS</td>
<td>China Foreign Exchange Trade System</td>
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<tr>
<td>CFL</td>
<td>Compact Fluorescent Lamp</td>
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<tr>
<td>CFL-I</td>
<td>Self-ballasted Lamps for General Lighting Service</td>
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<tr>
<td>CFL-NI</td>
<td>Compact Fluorescent Lamps without Integrated Ballast</td>
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<tr>
<td>CFR</td>
<td>Code of Federal Regulations</td>
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<tr>
<td>CGAC</td>
<td>China Quality Supervising and Test Center for Gas Appliances</td>
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<td>CGB</td>
<td>China Government Bonds</td>
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<td>CHC</td>
<td>Community Health Centre</td>
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<td>China WEEE</td>
<td>China Waste Electrical and Electronic Equipment</td>
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<td>CHP</td>
<td>Combined Heating and Power</td>
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<td>ChP</td>
<td>Chinese Pharmacopoeia</td>
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<td>CIAA</td>
<td>Confederation of the Food and Drink Industries in the EU</td>
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<td>CIETAC</td>
<td>China International Economic and Trade Arbitration Commission</td>
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<td>CIQ</td>
<td>Entry-Exit Inspection and Quarantine Bureau of People’s Republic of China (Local bureau of AQSIQ)</td>
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<td>CIRC</td>
<td>China Insurance Regulatory Commission</td>
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<td>CIT</td>
<td>Corporate Income Tax</td>
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<td>CMDE</td>
<td>Centre for Medical Device Evaluation</td>
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<td>CME</td>
<td>Coordinating Managing Entity</td>
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<td>CNAF</td>
<td>China National Aviation Fuel</td>
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<td>CNAPS</td>
<td>China National Advanced Payment System</td>
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<tr>
<td>CNCA</td>
<td>Certification and Accreditation Administration of People’s Republic of China</td>
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<td>CNIS</td>
<td>China National Institute of Standardisation</td>
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<td>CNR</td>
<td>China Northern Railway</td>
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<td>CNTA</td>
<td>China National Tourism Administration</td>
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<td>CNY</td>
<td>Chinese Yuan</td>
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<tr>
<td>CNY/RMB</td>
<td>Renminbi Yuan (Currency)</td>
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<tr>
<td>CO</td>
<td>Carbon Monoxide</td>
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<tr>
<td>CO₂</td>
<td>Carbon Dioxide</td>
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<tr>
<td>CO₂e</td>
<td>Carbon dioxide equivalent</td>
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<tr>
<td>COCIR</td>
<td>European Coordination Committee of the Radiological, Electromedical and healthcare IT Industry</td>
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<tr>
<td>COMEX</td>
<td>New-York Commodity Exchange, a Division of the New-York Mercantile Exchange (NYMEX)</td>
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<td>CPA</td>
<td>China National Aviation Fuel</td>
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<td>CPC</td>
<td>Communist Party of China</td>
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<td>CPCIF</td>
<td>China Petroleum and Chemical Industry Federation</td>
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<tr>
<td>CPP</td>
<td>Certificate of Pharmaceutical Product</td>
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<td>CQC</td>
<td>China Quality Certification Centre</td>
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<td>CRC</td>
<td>Chemical Registration Centre</td>
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<td>CRS</td>
<td>Computer Reservation Systems</td>
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<td>CSG</td>
<td>China Southern Power Grid</td>
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<td>CSRi</td>
<td>Corporate Social Responsibility</td>
</tr>
<tr>
<td>CSRii</td>
<td>China Southern Railway</td>
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<tr>
<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
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<tr>
<td>CT</td>
<td>Computed Tomography</td>
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<td>CTA</td>
<td>Clinical Trial Application</td>
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<td>CTMO</td>
<td>China Trademark Office</td>
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<td>CWEA</td>
<td>Chinese Wind Energy Association</td>
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<td>DCA</td>
<td>Debt Collection Agency</td>
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<td>Abbreviation</td>
<td>Definition</td>
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<tr>
<td>DG</td>
<td>Directorate General</td>
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<tr>
<td>DNA</td>
<td>Designated National Authority</td>
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<tr>
<td>DOE</td>
<td>Designated Operational Entity</td>
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<tr>
<td>Draft Catalogue</td>
<td>The Draft of the Catalogue for Guiding Foreign Investment in Industry 2011</td>
</tr>
<tr>
<td>DRG-PPS</td>
<td>Diagnosis-related Group – Prospective payment System</td>
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<tr>
<td>EAC</td>
<td>Expert Advisory Committee</td>
</tr>
<tr>
<td>EB</td>
<td>Executive Board</td>
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<tr>
<td>EBL</td>
<td>Enterprise Bankruptcy Law</td>
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<tr>
<td>EC</td>
<td>European Commission</td>
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<tr>
<td>ECE</td>
<td>Economic Commission for Europe</td>
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<tr>
<td>ECVAM</td>
<td>European Centre for the Validation of Alternative Methods</td>
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<tr>
<td>EDI</td>
<td>Electronic Data Interchange</td>
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<td>EDL</td>
<td>Essential Drug List</td>
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<td>EDS</td>
<td>Express Delivery Service</td>
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<tr>
<td>EEC</td>
<td>European Economic Community</td>
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<tr>
<td>EEE</td>
<td>Electrical and Electronic Equipment</td>
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<tr>
<td>EFMC</td>
<td>European Feed Manufacturers’ Code</td>
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<tr>
<td>EFPIA</td>
<td>European Federation of Pharmaceutical Industries and Associations</td>
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<tr>
<td>EHI</td>
<td>Association of the European Heating Industry</td>
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<tr>
<td>EIA</td>
<td>Environmental Impact Assessment</td>
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<td>EIP</td>
<td>Electronic Information Product</td>
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<tr>
<td>EIT</td>
<td>Enterprise Income Tax</td>
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<tr>
<td>EJV</td>
<td>Equity Joint Venture</td>
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<tr>
<td>EMC</td>
<td>Electromagnetic compatibility</td>
</tr>
<tr>
<td>EMR</td>
<td>Electronic Medical Record</td>
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<tr>
<td>EMS</td>
<td>Express Mail Service (offered by the postal-administration members of the Universal Postal Union)</td>
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<tr>
<td>EoL</td>
<td>End-of-Life</td>
</tr>
<tr>
<td>EPB</td>
<td>Environmental Protection Bureau</td>
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<tr>
<td>EPC</td>
<td>Engineering Procurement and Construction</td>
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<tr>
<td>E-Procurement</td>
<td>Electronic Procurement</td>
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<tr>
<td>EOV</td>
<td>Equally Adopted (in relation to international standard adoption)</td>
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<td>ESS</td>
<td>Express Service Standards</td>
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<td>ETS</td>
<td>Emission Trading Scheme</td>
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<td>ETSI</td>
<td>European Telecommunications Standards Institute</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>Eucomed</td>
<td>European Voice of the Healthcare Technology Industry</td>
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<td>EUR</td>
<td>Euro</td>
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<tr>
<td>FAO</td>
<td>Food and Agricultural Organisation (of the United Nations)</td>
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<tr>
<td>FASCO</td>
<td>Foreign Aviation Service Corporation</td>
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<tr>
<td>FCM</td>
<td>Food Contact Material</td>
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<tr>
<td>FCPA</td>
<td>Foreign Corrupt Practices Act</td>
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<tr>
<td>FDA</td>
<td>(United States) Food and Drug Administration</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>FEDIAF</td>
<td>The European Pet Food Industry Federation</td>
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<tr>
<td>FEMAS</td>
<td>Feed Materials Assurance Scheme</td>
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<td>FIAS</td>
<td>Fertiliser Industry Assurance Scheme</td>
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<td>FIE</td>
<td>Foreign Invested Enterprise</td>
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<tr>
<td>FIE EIF</td>
<td>Foreign-Invested Equity Investment Fund</td>
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</table>
Abbreviations

FIE EIME  Foreign-Invested Equity Management Enterprises
FIP  Foreign-Invested Partnership
FISCE  Foreign-Invested Construction Services Enterprise
FL  Fluorescent Lamp
FRAND  Fair, Reasonable and Non-Discriminatory (obligation describing licensing terms associated with standard essential patents)
FSANZ  Food Standard Australia New Zealand
FTZ  Free Trade Zone
FYP  Five-Year Plan
GAC  General Administration of Customs
GAMS  Government Authority Meeting on Semiconductors
GB  Guo Biao (National Standard)
GCP  Good Clinical Practice
GDP  Gross Domestic Product
GDS  Global Distribution System
GHG  Greenhouse Gas
GHTF  Global Harmonization Task Force
GI  Geographic Indications
GLP  Good Laboratory Practice
GLS  General Lighting Service
GMO  Genetically Modified Organisms
GMP  Good Manufacturing Practice
GP  General Partner
GP  Government Procurement
GP  General Practitioner
GPL  Government Procurement Law
GPP  Green Public Procurement
GRI  Global Reporting Initiative
GRP  Good Refurbishment Practice
GW  Gigawatt
GWEC  Global Wind Energy Council
HAACP  Hazard Analysis and Critical Control Points
HCP  Health care professional
HED  High Level Economic and Trade Dialogue
HID  High Intensity Discharge
HPSL  High Pressure Sodium Lamp
HR  Human Resources
HS  Harmonised Commodity Description and Coding System
IAEA  International Atomic Energy Agency
IATA  International Air Transport Association
ICAO  International Civil Aviation Organisation
ICC  International Chamber of Commerce
ICL  International Competition Law
ICN  International Competition Network
ICT  Information and Communications Technology
IDL  Import Drug Licence
IDT  Identically Adopted (in relation to international standard adoption)
IEA  International Energy Agency
IEC  International Electrotechnical Commission
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>IECQ</td>
<td>International Electrotechnical Commission Quality Assessment System for Electronic Components</td>
</tr>
<tr>
<td>IECSC</td>
<td>Inventory of Existing Chemical Substances in China</td>
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<td>IFSPM</td>
<td>Infant formula for special medical Purposes</td>
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<td>IHE</td>
<td>Integrating the Healthcare Enterprise</td>
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<td>IIT</td>
<td>Individual Income Tax</td>
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<tr>
<td>IMDG</td>
<td>International Maritime Dangerous Goods</td>
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<td>IMO</td>
<td>International Maritime Organization</td>
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<td>IMS</td>
<td>IMS Health</td>
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<tr>
<td>IMT-Advanced</td>
<td>International Mobile Telecommunications Advanced</td>
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<tr>
<td>IP</td>
<td>Intellectual Property</td>
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<td>IPO</td>
<td>Initial Public Offering</td>
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<td>IPR</td>
<td>Intellectual Property Rights</td>
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<tr>
<td>IS</td>
<td>International Organisation for Standardisation</td>
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<td>ISCCC</td>
<td>China Information Security Certification Centre</td>
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<tr>
<td>ISO</td>
<td>International Organisation for Standardisation</td>
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<td>IT</td>
<td>Information Technology</td>
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<td>ITU</td>
<td>International Telecommunication Union</td>
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<td>IV</td>
<td>Intravenous</td>
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<td>IVD</td>
<td>In-vitro Diagnostic</td>
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<tr>
<td>IVDD</td>
<td>In-vitro Diagnostic Directive</td>
</tr>
<tr>
<td>JECFA</td>
<td>Joint FAO/WHO Expert Committee on Food Additives</td>
</tr>
<tr>
<td>JGJ</td>
<td>Construction Engineering Technology Code (Jianzhu Gongcheng Jishu)</td>
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<tr>
<td>JJJG</td>
<td>Jiliang Jianding Guicheng (China regulation of meteorological verification)</td>
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<td>JLV</td>
<td>Joint Law Venture</td>
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<td>JV</td>
<td>Joint Venture</td>
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<td>LCC</td>
<td>Life Cycle Cost</td>
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<td>LCL</td>
<td>Labour Contract Law</td>
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<td>LDC</td>
<td>Least Developed Country</td>
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<tr>
<td>LED</td>
<td>Light Emitting Diodes</td>
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<tr>
<td>LES</td>
<td>Local Education Surcharge</td>
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<tr>
<td>LME</td>
<td>London Metal Exchange</td>
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<tr>
<td>LNG</td>
<td>Liquefied Natural Gas</td>
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<tr>
<td>LoA</td>
<td>Letter of Approval</td>
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<tr>
<td>LP</td>
<td>Limited Partner</td>
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<tr>
<td>M&amp;A</td>
<td>Mergers and Acquisitions</td>
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<tr>
<td>MDER</td>
<td>Medical Device Expert Roundtable</td>
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<tr>
<td>MEP</td>
<td>Ministry of Environment Protection of People’s Republic of China</td>
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<tr>
<td>Mercosur</td>
<td>South American Common Market</td>
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<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
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<tr>
<td>MLBGP</td>
<td>Medium and Large Scale Biogas Plant</td>
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<td>MLPS</td>
<td>Multi-Level Protection Scheme</td>
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<tr>
<td>MLPS</td>
<td>Multi-Level Protection System</td>
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<tr>
<td>MNC</td>
<td>Multinational Company</td>
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<tr>
<td>MNCs</td>
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<tr>
<td>MOC</td>
<td>(formerly) Ministry of Construction of China</td>
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<tr>
<td>MOC</td>
<td>Ministry of Communication</td>
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<tr>
<td>MOD</td>
<td>Adopted with Modification (in relation to international standard adoption)</td>
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<tr>
<td>MOEW</td>
<td>Maximum Operating Empty Weight</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<tr>
<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>MOFCOM</td>
<td>Ministry of Commerce</td>
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<tr>
<td>MOH</td>
<td>Ministry of Health</td>
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<td>MOHRSS</td>
<td>Ministry of Human Resources and Social Security</td>
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<td>MOHURD</td>
<td>Ministry of Housing and Urban-Rural Development</td>
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<td>Ministry of Justice</td>
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<td>MOST</td>
<td>Ministry of Science and Technology</td>
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<td>MOT</td>
<td>Ministry of Transport</td>
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<tr>
<td>MPS</td>
<td>Ministry of Public Security</td>
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<tr>
<td>MRV</td>
<td>Measurable, Reportable and Verifiable</td>
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<tr>
<td>MSS</td>
<td>Ministry of State Security</td>
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<tr>
<td>MSW</td>
<td>Municipal Solid Waste</td>
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<tr>
<td>MTPL</td>
<td>Motor Third Party Liability</td>
</tr>
<tr>
<td>MW</td>
<td>Megawatt</td>
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<tr>
<td>NAFMII</td>
<td>National Association of Financial Market Institutional Investors</td>
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<tr>
<td>NAL</td>
<td>Network Access License</td>
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<tr>
<td>NAMAs</td>
<td>Nationally Appropriate Mitigation Actions</td>
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<tr>
<td>NBFI</td>
<td>Non-Banking Financial Institution</td>
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<tr>
<td>NCE</td>
<td>New Chemical Entity</td>
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<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<td>NEA</td>
<td>National Energy Administration</td>
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<td>NFM</td>
<td>Non-Ferrous Metals</td>
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<td>NGOs</td>
<td>Non-Government Organizations</td>
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<td>NID</td>
<td>National Identification</td>
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<tr>
<td>NIIP</td>
<td>National Indigenous Innovation Products</td>
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<td>NNSA</td>
<td>National Nuclear Safety Authority</td>
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<td>NOC</td>
<td>National Oil Company</td>
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<td>NOx</td>
<td>Nitrous Oxide</td>
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<td>NPC</td>
<td>National People’s Congress</td>
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<td>NPE</td>
<td>Non-Practicing Entity</td>
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<td>NPL</td>
<td>Non Performing Loans</td>
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<td>NRDL</td>
<td>National Reimbursement Drug List</td>
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<td>NRE</td>
<td>Non-Resident Enterprise</td>
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<tr>
<td>NSC</td>
<td>Nuclear Safety Centre</td>
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<tr>
<td>NSR</td>
<td>National Security Review</td>
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<td>NTPL</td>
<td>Nuclear Third Party Liability</td>
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<tr>
<td>NVOCC</td>
<td>Non Vessel Operator Common Carrier</td>
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<tr>
<td>O&amp;M</td>
<td>Operation &amp; Maintenance</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-Operation and Development</td>
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<td>OEM</td>
<td>Original Equipment Manufacturer</td>
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<td>OSCCA</td>
<td>Office of the State Commercial Cypher Administration</td>
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<tr>
<td>OTC</td>
<td>Over-the-counter</td>
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<tr>
<td>PAR</td>
<td>Project Appraisal Report</td>
</tr>
<tr>
<td>PB</td>
<td>Post Bureau</td>
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<tr>
<td>PBOC</td>
<td>People’s Bank of China</td>
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<tr>
<td>PBW</td>
<td>Public Bonded Warehouses</td>
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<tr>
<td>PCBs</td>
<td>Polychlorinated biphenyls</td>
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<tr>
<td>PCDM</td>
<td>Programmatic CDM</td>
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<tr>
<td>PCR</td>
<td>Petrochemicals, Chemicals and Refining</td>
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<tr>
<td>PD</td>
<td>Primary Dealer</td>
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<tr>
<td>PE</td>
<td>Permanent Establishment</td>
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</table>
PE
Private Equity

PE/VC
Private Equity/Venture Capital

PLC
Private Label Card

PMS
Post Market Surveillance

PNESD
Plan for National Economic and Social Development

PoA
Programme of Activity

POS
Point of Sale

ppm
parts per million

PPP
Public Private Partnership

PRC
People’s Republic of China

PRD
Pearl River Delta

PSB
Public Security Bureau

PSC
Passenger Service Charge

PSC
Production Sharing Contract

PUD
Pick Up Delivery

PV
Pharmaco Vigilance

QDII
Qualified Domestic Institutional Investor

QFII
Qualified Foreign Institutional Investor

QFLP
Qualified Foreign Limited Partner

QMS
Quality Management System

QS
Production Licence

R&D
Research and Development

RASFF
Rapid Alert System for Food and Feed

RFID
Radio Frequency Identification

RFP
Request for Proposal

RMB
Renminbi

RoHS
Restriction of Hazardous Substances

RTA
Radio Type Approval

SAC
Standardisation Administration of China

SAFE
State Administration of Foreign Exchange

SAIC
State Administration for Industry and Commerce

SARFT
State Administration of Radio, Film, and Television

SASAC
State-owned Assets Supervision and Administration Commission

SAT
State Administration of Taxation

SBA
Shanghai Bar Association

SC
State Council

SCIO
State Council Information Office

SCLAO
Legislative Affairs Office of the State Council

SDO
Standards Development Organisation

SDR
Special Drawing Rights

SDRC
Shanghai Municipal Development and Reform Commission

SEI
Strategic Emerging Industry

SEMB
State Encryption Management Bureau

SEPB
Shanghai Environmental Protection Bureau

SERC
State Electricity Regulatory Commission

SESAR
Single European Sky Air Traffic Management Research

SFD
State Food and Drugs Administration of People’s Republic of China

SFDA
State Food and Drug Administration

SGCC
State Grid Corporation of China

SGSPC
Smart Grid Standardisation Promotion Committee
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>SHFE</td>
<td>Shanghai Future Exchange</td>
</tr>
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<td>SHME</td>
<td>Shanghai Metal Exchange</td>
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<td>SIBOR</td>
<td>Singapore Inter Banking Offered Value</td>
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<td>SIL</td>
<td>Social Insurance Law</td>
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<td>SIM</td>
<td>Subscriber-Identity Module</td>
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<td>SIPO</td>
<td>State Intellectual Property Office</td>
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<td>SJV</td>
<td>Securities Joint Venture</td>
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<td>SME</td>
<td>Small and Medium-sized Enterprise</td>
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<td>SOA</td>
<td>State Ocean Administration</td>
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<td>SOE</td>
<td>State Owned Enterprise</td>
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<td>SPB</td>
<td>State Postal Bureau</td>
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<tr>
<td>SPC</td>
<td>Supreme People’s Court</td>
</tr>
<tr>
<td></td>
<td>Supreme People’s Procuratorate</td>
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<tr>
<td>SPF</td>
<td>Sun Protection Factor</td>
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<tr>
<td>SPS</td>
<td>Sanitary and Phytosanitary</td>
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<td>SSL</td>
<td>Solid State Lighting</td>
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<tr>
<td>T&amp;T</td>
<td>Tractor Trailer</td>
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<tr>
<td>TASCC</td>
<td>Trade Assurance Scheme for Combinable Crops</td>
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<tr>
<td>TAT</td>
<td>Turn-Around Time</td>
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<td>TBT</td>
<td>Agreement on Technical Barriers to Trade (WTO)</td>
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<tr>
<td>TC</td>
<td>Technical Committee</td>
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<tr>
<td>TCM_i</td>
<td>Trusted Cryptographic Module</td>
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<tr>
<td>TCM_ii</td>
<td>Traditional Chinese Medicine</td>
</tr>
<tr>
<td>TCMS</td>
<td>Train Control and Monitoring System</td>
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<tr>
<td>TD-LTE</td>
<td>Time Division Long Term Evolution</td>
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<tr>
<td>TEU</td>
<td>Twenty-foot Equivalent Unit</td>
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<tr>
<td>TNC</td>
<td>Terminal Navaid Charge</td>
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<tr>
<td>TPM</td>
<td>Trusted Platform Module</td>
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<td>TRAB</td>
<td>Trademark Adjudication Board</td>
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<td>TRIPS</td>
<td>Trade – Related Aspects of Intellectual Property Rights</td>
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<td>TW.h</td>
<td>Terawatt Hour</td>
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<tr>
<td>UDI</td>
<td>Unique Device Identifier</td>
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<td>UDX</td>
<td>Universal Data Exchange</td>
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<td>UFAS</td>
<td>Universal Feed Assurance Scheme</td>
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<td>UHT</td>
<td>Ultra High Throughput</td>
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<td>UHV</td>
<td>Ultra High Voltage</td>
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<td>UMCT</td>
<td>Urban Maintenance and Construction Tax</td>
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<td>UN/ECE</td>
<td>United Nations Economic Commission for Europe</td>
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<td>UNFCCC</td>
<td>United Nations Framework Convention on Climate Change</td>
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<td>US</td>
<td>United States</td>
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<tr>
<td>USD</td>
<td>US Dollar</td>
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<td>VAS</td>
<td>Value Added Services</td>
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<td>Value Added Tax</td>
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<td>VER</td>
<td>Voluntary Emission Reduction</td>
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<td>Vessel Traffic Services</td>
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<td>WAPI</td>
<td>WLAN Authentication and Privacy Infrastructure</td>
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<td>WCO</td>
<td>World Customs Organisation</td>
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<td>WEEE</td>
<td>Waste Electrical and Electronic Equipment</td>
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<td>WES</td>
<td>Wind Energy Standards Committee</td>
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<td>Abbreviation</td>
<td>Description</td>
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<tr>
<td>WFCC</td>
<td>Wholly Foreign-Owned Construction Company</td>
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<td>WFOE</td>
<td>Wholly Foreign Owned Enterprise</td>
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<td>WG</td>
<td>Working Group</td>
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<td>WHO</td>
<td>World Health Organization</td>
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<td>WLP</td>
<td>Wasted Lighting Products</td>
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<td>WOFE</td>
<td>Wholly Owned Foreign Enterprises</td>
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<td>WSC</td>
<td>World Semiconductor Council</td>
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<td>WSG</td>
<td>Worldwide Scheduling Guidelines</td>
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<td>WTG</td>
<td>Wind Turbine Generator</td>
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<td>WTO</td>
<td>World Trade Organisation</td>
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<tr>
<td>WTO TBT</td>
<td>World Trade Organisation Technical Barriers to Trade Committee</td>
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<td>WTO GPA</td>
<td>World Trade Organisation's Government Procurement Agreement</td>
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<td>XRF</td>
<td>X-Ray Fluorescence</td>
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<td>YY</td>
<td>Yi Yao (China medical device standards are classified as industry standards)</td>
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