European Business in China

POSITION PAPER

2019/2020
The *European Business in China Position Paper 2019/2020* represents the views of the European Union Chamber of Commerce in China. Our working groups, fora 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 this position paper will promote constructive dialogue between Europe and China, at both the political and business levels. We look forward to continued improvement in business cooperation, to the benefit of both Europe and China.
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Message from the President

In October 2019, China will mark the 70th anniversary of the founding of the People’s Republic of China. Undoubtedly, the scale of the celebrations will be commensurate with the country’s impressive development over the last seven decades, and the accomplishments of the last four in particular.

Meanwhile, another significant anniversary from much further back in China’s history is likely to slip by mostly unobserved: 2,100 years ago, the course of the Western Han Dynasty was set when China’s brightest minds were called upon to debate key aspects of the economic system of the time. The ensuing ‘Discourses on Salt and Iron’ boiled down to two different factions arguing over the state’s involvement in the economy. One side demanded the state remove itself from the market and end its monopolies on salt and iron production and distribution, while the other defended the importance of holding on to these industrial commanding heights.

Little has changed in the intervening twenty-one centuries.

China’s salt monopoly, which once employed a 25,000-strong salt police force to enforce its dominance, only saw the initial stages of liberalisation just two years ago. The steel industry, with a slow influx of private players taking up market share, is perhaps more advanced, but while China has six of the world’s ten largest steel producers by volume, only two are privately owned, and they only occupy the sixth and ninth rankings.

The contemporary discourse also encompasses a wide variety of sectors in addition to iron and salt, but the core characteristic remains unchanged, which is, as one debater put it in 81 BC, “the state competes with the people”. Indeed, in the European Chamber’s Business Confidence Survey 2019, 70 per cent of members reported that SOEs are present in their sector. In addition, there are many industries where SOEs enjoy exclusive access or their market domination effectively blocks international companies from competing.

This situation has been exacerbated by the profound changes that have taken place in recent years, with the government pursuing SOE reform with Chinese characteristics. Rather than cutting SOEs down to a manageable size, determining the industries that would be most appropriate for them to operate in and privatising the rest, the goal has been to make them “stronger, better and bigger.”

This has resulted in a truly resurgent state-owned economy, with SOEs impacting sectors way beyond those in which they have major presence. Financing flows to private firms have dried up, from 57 per cent of all non-financial corporate loans in 2013, to a measly 11 per cent in 2016, at the same time that Chinese SOEs have seized a much greater share of funding, jumping from 35 per cent to 80 per cent in the same timeframe. The screws have also been tightened on the private sector with SOEs imposing abnormally long payment periods in their agreements, which act as de facto loans from suppliers. This has unfairly impacted a great many European firms directly, but far more have suffered indirect effects, such as when their local partners have struggled to make ends meet as a result, leading to disruptions to both upstream supplies and downstream demand.

The benefits that many SOEs currently enjoy from their vertical monopoly position comes at the expense of sound market competition. This happens for example in the energy sector, where some of the same firms that produce

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1 A full text of The Discourses on Salt and Iron can be found at the following link: <http://www.8bei8.com/book/yantielun.html>
6 Lardy, Nicholas, The State Strikes Back, Peterson Institute for International Economics, January 2019, Washington D.C., Figure 4.1
energy also own the grid – a huge, unfair advantage over private energy companies that must pay their competitors to deliver their product to customers.

Conflicts of interest also occur, with SOE executives and regulators frequently switching hats over time, which adds another layer of unfairness for private companies to overcome. For example, the high thresholds that have been set for obtaining various operating licences in the financial services sector has seriously restricted meaningful participation of international finance companies in the markets they have only recently been allowed to enter.

From all this, it could be assumed that China’s current leadership has simply arrived at the same conclusions that the Western Han Dynasty came to 21 centuries ago. Fortunately, this is not the case: a robust debate is underway in Beijing, with different voices throughout the government periodically spilling out into the public forum.

‘Competitive neutrality’, the principle that the government should provide equal treatment to all enterprises, regardless of ownership, has been on the lips of some of China’s most important economic policymakers in recent months. Former and current People’s Bank of China governors Zhou Xiaochuan and Yi Gang both spoke on the concept in late 2018, followed by the new and powerful State Administration for Market Regulation, the State Council and even Premier Li Keqiang in his 2019 Work Report.

Competitive neutrality would put an end to China’s ‘economic caste system’, whereby it differentiates and favours state-owned over private first and foremost, and then local over foreign. The greatest benefit of abandoning such a system, and developing strong institutions to provide recourse when enterprises encounter unequal treatment, would be the resulting surge of confidence in China’s market and the accompanying boost in investment.

Those calling for these reforms recognise the need for greater efficiency in the economy that a strong private sector provides. The European Chamber has long added its voice to this chorus, having advocated relentlessly for a level playing field between all company types, regardless of ownership, and recognising that competitive neutrality and SOE reform are central to achieving this.

Having been in China since the earliest days of the reform and opening up period, European companies have witnessed how previous Chinese leaders have applied bold reforms aimed at economic liberalisation. There is now an increasing expectation that this can, and must, happen again, not just because of past accomplishments, but also because China has accumulated a wealth of experience, is much stronger than ever before and now possesses a far more sophisticated regulatory system.

Realising competitive neutrality and embarking on true SOE reform is key to achieving a variety of goals: ushering in a true market economy, making the most of China’s entrepreneurial potential and accelerating development. This would be an enormously positive next step for China’s reform agenda, while bringing a decisive end to a debate that has been rumbling on for 2,100 years.

Jörg Wuttke
President
European Union Chamber of Commerce in China
ABOUT THE EUROPEAN UNION CHAMBER OF COMMERCE IN CHINA

The European Union Chamber of Commerce in China (European Chamber) was founded in 2000 by 51 member companies that shared a goal of establishing a common voice for the various business sectors of the EU and European businesses operating in China. It is a member-driven, non-profit, fee-based organisation with a core structure of 33 working groups and fora representing European business in China.

The European Chamber has more than 1,600 member companies in seven chapters operating in nine cities: Beijing, Nanjing, Shanghai, Shenyang, South China (Guangzhou and Shenzhen), Southwest China (Chengdu and Chongqing) and Tianjin. Each chapter is managed at the local level by local boards reporting directly to the Executive Committee.

The European Chamber is recognised by the European Commission and the Chinese authorities as the official voice of European business in China. It is also recognised as a foreign chamber of commerce by the Ministry of Civil Affairs. The European Chamber is part of the growing network of European Business Organisations (EBO), which connects European business associations and chambers of commerce from 37 non-EU countries around the world.

As a member-based organisation, the European Chamber seeks several things:

1. To ensure greater market access and a level playing field for European companies operating in China.
2. To improve market conditions for all businesses in China.
3. To facilitate networking among members and stakeholders.
4. To provide specific, relevant information to its members on how to do business in China.
5. To update its members on economic trends and legislation in China.

Principles

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

Executive Position Paper
Competitive Neutrality: Reining in China’s Industrial Hegemons

Introduction

Coming out of the failure of the centrally-planned economic model used in the first three decades of the People’s Republic of China, Deng Xiaoping seized the opportunity presented by uncertainty to blaze a trail, undertaking bold and daring reform and opening-up measures, beginning in 1978.

When some in China began to question the merits of opening up, Deng further pushed China’s economic liberalisation with his Southern Tour in 1992, laying the foundation for a major wave of foreign investment into the market. Although Deng’s passing brought another moment of anxiety for the Chinese economy, Jiang Zemin and Zhu Rongji picked up the torch, launching extensive liberalisation and state-owned enterprise (SOE) reform in 1998, and setting up China’s accession to the World Trade Organization (WTO) in 2001.

This sent a clear signal to the international business community: China’s leaders are adept at handling moments of economic crisis and uncertainty, and using them to quickly advance economic liberalisation.

China now stands on the cusp of a new and different type of economic crisis, as growth slows while regulators attempt to rein in debt and policymakers seek to pull the appropriate levers to further boost productivity and innovation.1 This could be the moment for China’s leaders to emulate their predecessors, and again seize the opportunity presented by this crisis to take several large steps forward.

China’s internal debate

An internal debate has been going on for some time about how to best shore up China’s economic system as it heads into difficult waters. In 2012, now-Vice Premier Liu He led the drafting of the report China 2030: Building a Modern, Harmonious, and Creative Society with the World Bank,2 which lays out many of China’s underlying structural issues that need to be addressed. This was closely followed by the Decision document that resulted from the Third Plenum of the 18th Central Committee of the CCP in 2013, which seemed to signal to the rest of the world that China was ready to again advance along the road towards opening up.3 Unfortunately, the most critical structural reforms needed to rein in SOEs and advance market forces failed to materialise. Some hope was briefly restored following President Xi’s speech at Davos in 2017, but this too led to only limited results.4


After the Jiang Zemin administration handed off power to the next generation, SOEs retrenched themselves. Now, they have resurfaced to play a more decisive role in China’s economy: they are at the centre of many national strategies while President Xi exhorts them to become “stronger, better, bigger”. This has coincided with private firms, including foreign ones, coming under increasing pressure to formalise a role for the Communist Party of China (CCP) in their governance structures, casting serious concerns over how the party-state apparatus may distort the decisions of otherwise free agents in a market economy.

However, there is still a push for greater economic liberalisation coming from some in China, which is clearly having an impact on the business environment. This was recognised by the International Monetary Fund (IMF) in their 2019 Article IV Consultation with China, which noted, among other improvements, the release of a clearer Market Access Negative List that applies to both foreign and domestic enterprises; the strengthening of IP protection through the establishment of the IP tribunal in China’s Supreme Court and the revisions to the Patent Law; small reforms to the household residency registration system (hukou); and China’s rise up the rankings (up 32 places to 46th) in the World Bank’s Doing Business 2019 report.

A new focus for another surge in reforms?

The voice for reform has been heard clearest in the recent calls from Chinese leaders for ‘competitive neutrality’ to guide the relationship between the government and business. Meant to indicate that government provides no differentiated treatment between private and state-owned enterprises, the term was used by former People’s Bank of China (PBOC) Governor Zhou Xiaochuan in mid-September 2018. As Reuters reported:

“‘We should change the mentality. We should learn more about WTO rules. There could have been some inappropriate behaviour sometimes, but we are improving,’ Zhou told a seminar at Geneva’s Centre for Trade and Economic Integration. To deal with US accusations about China not being a market economy, he said Beijing aimed for OECD-style ‘competitive neutrality’ – a level playing field for state-owned and private enterprises. ‘We haven’t done enough, but we are moving in that direction.’”

On 14th October 2018, Zhou Xiaochuan’s successor and current PBOC Governor Yi Gang breathed life into the idea on the sidelines of the G20 meeting in Buenos Aires when he said:

“To solve the structural problems in the Chinese economy, we will accelerate domestic reform and opening up, strengthen intellectual property protection, and consider treating state-owned enterprises with the principle of ‘competitive neutrality’.”

6 Xi Calls for Furthering SOE Reform, Xinhua, 18th October 2018, viewed 6th August 2019, <http://www.xinhuanet.com/energy/2017-10/18/c_136688444.htm>
This led to a surprisingly public airing of the internal debate, with a response from Peng Huagang, then deputy secretary general of the State-owned Assets Supervision and Administration Commission (SASAC), being reported in the media:

“However, Peng Huagang […] said at a press conference in Beijing on Monday that Chinese SOEs shouldn’t be discriminated against. He stressed that SOEs have already been integrated into China’s ‘market economy’ and that they are already competing on an equal footing with privately owned firms in the market. His words are quite ironic as Chinese SOEs have always enjoyed an advantage in terms of government support.”

Not long after, the term was given play by the State Administration for Market Regulation (SAMR) in November 2018, the State Council in December 2018, and then during Premier Li Keqiang’s annual work report during the 2019 ‘Two Sessions’. 14, 15 & 16

**Where does European business stand?**

While European companies in China face problems unique to foreign companies, they also have a great deal in common with local private firms: European companies in China are Chinese companies – they pay taxes in China, hire Chinese staff and executives, and contribute to the country’s innovation and development. European businesspeople live and have families in China, serve in industry associations and non-profits and have communities throughout the country. The future of China is therefore integral to the future of European business, and the best way to secure its long-term success is by completing the process of economic liberalisation. Realising competitive neutrality is an important step in this process, and is essential for future development in this critical market.

With economic challenges arising from China’s structural problems and the global tensions ensuing from the government’s inadequate response continuing to grow, 17 the need for reform is amplified. These conditions echo the circumstances under which Deng and Zhu pursued opening up, and provide a perfect context for completing the SOE reform that began two decades ago, realising competitive neutrality across the country. 18

**Why is China having this discussion?**

**A defining moment**

Old habits are the hardest to break, and the predominance of China’s SOEs in the mixed economy runs deep and lies at the intersection of the country’s economics and politics. 19 Strong vested interests have

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stood against meaningful SOE reform in the past and they will certainly continue to have an influence in this respect. However, failure to address SOE reform and advance economic liberalisation will leave the market burdened by a bloated and inefficient state-owned sector that weighs the country down as it attempts to climb out of the middle-income trap.  

This is a defining moment for China.

**Do you want a stone and mortar castle, or a steel and glass skyscraper?**

SOEs were once the bedrock on which China's economic order was built. But just as you can only build a tower so high on traditional stone pilings before it starts to wobble, the Chinese economy can only develop so far without stronger foundations.

A gross misallocation of resources towards the state-owned sector, which also enjoys privileged access to the factors of production, has historically deprived the more vibrant and efficient private sector. It was only during the Third Plenum of the 18th Central Committee of the CCP in 2013 that the CCP determined that the market should play the “decisive” role in resource allocation. Yet, contrary to that commitment, China has since gone back on the decision to reduce the footprint of the state-owned sector by directing ever larger quantities of resources to SOEs, which subsequently expanded both in terms of assets and debt. Many are now categorised as 'too big to fail', meaning that, under the current model, SOEs will continue to soak up resources and deprive the private sector of the fuel it needs to propel China’s economy onwards and upwards.

**Growth of debt outpaces that of assets, revenues and profits**

“...as of end 2017, nonfinancial SOE debt reached CNY 118.5 trillion, for the first time exceeding 100 trillion in November of the same year. This is an increase of nearly fourfold compared to end-2007. During the same time, SOE assets grew 337 per cent, revenues 159 per cent and profits 60 per cent.”

The rudimentary foundations for further economic development are modern institutions and good governance, with the role of the state confined to that of regulator. The increased talk about competitive neutrality in the midst of the debate over China’s economic model is a hopeful signal that there is at least an understanding of the need for such foundations.

**A tale of two ’Shens’**

The effectiveness of the two respective economic models China could pursue can be most clearly demonstrated in the stark contrast between the North, represented by Shenyang, and the South, represented by Shenzhen. The two regions follow significantly different approaches to economic governance, with the North being more heavily reliant on SOEs and a state-led approach, and the South leaning towards private enterprises and market forces.

The results of these models? A struggling northern rustbelt and a thriving southern city on a hill.

Shenyang and the surrounding region were long referred to as the ‘eldest son’ of the Chinese economy, as state-led investment poured into the local heavy industry from the earliest days of the People’s Republic of China. As a result, a staggering share of China’s industrial output came from the area via the

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large SOEs that controlled the economy. When China’s national economic model adopted more market-based approaches after Deng Xiaoping began the reform and opening up period, the North struggled to adjust, preferring to stick to the old way of driving development instead.

Shenzhen’s story could not differ more. China’s first special economic zone (SEZ) was developed in Guangdong, the province that Shenzhen occupies, giving breathing space to an historically entrepreneurial region to do what it does best. The subsequent ‘economic miracle’ saw Guangdong outpace growth in the North within a decade, with businesses given the room to pursue their own ambitions and more foreign investors drawn in. Even after the province began to enter economic maturity, and expectations of a cooldown grew, it continued to see skyrocketing growth.

Since then, the South has advanced its market economy as far as the central government will permit it to, while the North’s inertia has led the government to dedicate extensive resources to the region just to prop it up. The Revitalise the Old Northeast Industrial Bases plan stands alongside the Rise of Central China and Great West Development plans in an attempt to push development beyond China’s more prosperous coastal regions. However, only in the SOE-dominated Northeast is the plan about bringing the economy back rather than pushing an initial phase of development forward.

The European Chamber has seven chapters spread across the country, and the concerns they put forward in their respective local position papers reflect the divide between the different regions. The differences between the most recent editions of the Shenyang Position Paper and the South China Position Paper could not be more evident.

For example, the biggest human resource concern raised in the Shenyang Position Paper is about the migration of talent from the region. Meanwhile, the South China Position Paper focuses on the insufficient number of skilled migrants to keep up with the region’s booming economy. Even the overall tone of the two papers demonstrates the contrast between the two regions. The Shenyang Position Paper focuses on consolidating and improving the economic situation to get things moving in the right direction. The South China Position Paper argues that Guangdong needs to stop measuring itself against the rest of China and start aiming to become the best place to do business globally.

**Growth woes: North versus South**

Aside from the 2008 financial crisis, China has little experience in mitigating a major downturn, and the response that it employed back then cannot be repeated: debt levels are already far too high and an aggressive monetary policy would bring on a whole slew of other problems. Fortunately, the government clearly understands this and has repeatedly clarified that massive stimulus should not be expected and will not be pursued.

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With the 2019 Q2 growth rate slowing to 6.2 per cent, one would expect China’s most developed regions to see even lower growth as they grow from larger bases. However, for the people who call the coastal South home, this is not the case. In 2018, Guangdong enjoyed a strong growth rate of 6.8 per cent while Liaoning—home to Shenyang—saw modest growth at 5.7 per cent.\(^\text{31}\) However, Liaoning’s growth rate is best interpreted as a recovery after it became the first province in years to report negative growth in 2015, with a 2.5 per cent dive from the previous year. Additionally, the province was found to be misrepresenting its economic data from 2011 to 2014, meaning that the downturn could have been going on longer than reported.\(^\text{32}\)

**Other metrics of growth**

To get a nuanced view of the situation, it is not sufficient to look at GDP rates alone. Such figures can be inaccurate—an historical problem in China’s northeast\(^\text{33}\)—misrepresent actual value-creation (for example, if the government pays someone Chinese yuan (CNY) 100 to dig a hole and then fill it back up, it technically counts as GDP growth, but produces no value) and fail to take into account important indicators like consumer confidence.

Applying a similar approach to the one that Premier Li Keqiang took when serving as party secretary in Liaoning Province from 2004 to 2007 can provide a better understanding of the economic situation. The ‘Li Keqiang Index’ ignored official growth numbers and instead looked at railway cargo volume, electricity consumption rates and bank loans.\(^\text{34}\) Using such different factors can help provide a more accurate comparison of different provinces’ economic outlook, as inputs and outputs are much harder to falsify than numbers in a report.

Automotive sales are one major indicator of consumer confidence, and reveal a pronounced discrepancy between the two Shens. In the first four months of 2019, car sales have generally slipped year-on-year across the country. However, while Liaoning Province saw an average decrease of 12.6 per cent, Guangdong only saw a 2.5 per cent drop, at least some of which likely came from ever-tightening restrictions on automobile ownership in the highly congested metropolises of the Pearl River Delta.

Migration patterns are also useful for determining which regions inspire the most confidence. People vote with their feet, and the number leaving the SOE-dominated North compared to those moving to the South demonstrates a notable vote of confidence in the latter.\(^\text{35}\) The migration patterns of young people reflects this particularly well, as many have yet to lay down roots that might otherwise keep them in a less promising location. Working-age people have moved en masse to places like Guangdong, which now has 9.7 workers per senior citizen; Liaoning, on the other hand, has a mere 1.8 workers per senior citizen.\(^\text{36}\)

**In conclusion**

The trends are quite clear, and the increasing gulf that is developing between North and South China is informing the debate on the country’s economic future. The numbers are clearly in favour of those arguing...
for the state to reconsider its role, and for SOE reform and adherence to market forces to be pursued.

Reinvigorating SOE Reform

‘SOE reform’ in contemporary China

During his tenure as premier, Zhu Rongji tackled the state-owned sector and pushed through privatisation as the government divested itself of much of the economy. Doing so freed up resources to flow to the country’s private sector. It did, however, lead to a difficult transition for many workers who found themselves without work, as firms that had been privatised suddenly had to answer to market forces, and trimmed down their operations.37 The process was undoubtedly disruptive to the lives of many, but it was a necessary step to lay the foundations for the explosive growth that China was soon to experience.

Unfortunately, concerns about stability led to complacency regarding SOE reform, which still exists today.38 The reform process first slowed to a standstill, until the idea of ‘SOE reform’ somehow mutated into the concept of reinforcing the state-owned sector at the expense of private enterprises.39 In recent years, SOE reform has focused on ‘mixed-ownership reform’ – the idea being that private investors will take on shares in SOEs to help boost efficiency. Unfortunately, this has not worked out as well as had been hoped. One state-private fund that was intended to facilitate this process, Siyuanhe Equity Investment Management Co Ltd, was established in early 2017, with between CNY 40 and 80 billion to invest. Zhou Zhuping, the CEO of Siyuanhe, said in January 2019 that attempts to combine SOEs and private sector management have only resulted in “a mix at the capital level”. He further explained that: “They have not carried out mixed reforms regarding the governance structure of companies and their internal operations, and still follow the old form of an SOE.”40

This shift, coupled with a worrying amount of talk from leaders about China’s need for self-sufficiency, raised understandable concerns from the private sector. These concerns were compounded when, in early 2018, Zhou Xincheng, a professor of Marxism at Renmin University, argued in the Qizhi column of the CCP Theory Journal Qiushi that private ownership should be abolished. This was followed in September 2018 by an alarming blog post penned by a former financier—which rapidly went viral—declaring that the private sector had accomplished its historic mission to provide growth, and that it should now be wound down.41,42,43

SOEs are everywhere and universally privileged

That President Xi has designated the goal of SOE reform in China is for them to become “stronger, better, bigger” has done little to inspire confidence among European companies.

In the European Chamber’s *European Business in China Business Confidence Survey 2019 (BCS)*, 70 per cent of respondents reported that SOEs were present in their industry, with 18 per cent saying that SOEs controlled at least half of the Chinese market share.\(^4^4\)

<table>
<thead>
<tr>
<th>Sector</th>
<th>SOEs control</th>
<th>Private control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction and Materials</td>
<td>45%</td>
<td>55%</td>
</tr>
<tr>
<td>Chemicals and Petrochemicals</td>
<td>38%</td>
<td>62%</td>
</tr>
<tr>
<td>Food and Beverage</td>
<td>29%</td>
<td>71%</td>
</tr>
<tr>
<td>Consumer Electronics</td>
<td>33%</td>
<td>67%</td>
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<tr>
<td>Automotive &amp; Aerospace</td>
<td>25%</td>
<td>75%</td>
</tr>
<tr>
<td>IT and Telecom</td>
<td>27%</td>
<td>73%</td>
</tr>
<tr>
<td>Financial services</td>
<td>31%</td>
<td>69%</td>
</tr>
<tr>
<td>Professional Services</td>
<td>28%</td>
<td>72%</td>
</tr>
<tr>
<td>Logistics</td>
<td>31%</td>
<td>69%</td>
</tr>
</tbody>
</table>

1) Selected industries are those with at least 11 responses

When asked to describe their outlook on the relationship between private business and the state-owned sector in China over the next two years, only 20 per cent of BCS respondents said that the private sector would gain opportunities at the expense of the state-owned sector, compared with 40 per cent who said the opposite.

European companies are by no means alone in their struggle against the surging tide of SOE ascendency. Chinese private companies in a wide range of sectors are similarly impacted by SOEs, which enjoy more beneficial treatment. When surveyed on whether SOEs or privately owned enterprises (POEs) hold the advantage in government interactions, BCS respondents found overwhelmingly in favour of SOEs.\(^4^5\)

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45 Ibid, p. 44.
Water flows to the least productive fields

Even in areas without an SOE presence, the private sector feels the tremors of the sector’s resurgence. Access to financing is by far the clearest example. State-owned banks have always preferred SOEs due to their implicit guarantee from the government: who wouldn’t bet on that level of certainty? This has led state-owned banks to become complacent, preferring to do business only with SOEs and large private firms. 46

Although always an issue, this became particularly pronounced in recent years due to the combination of the crackdown on shadow banking and the deleveraging campaign, both of which were necessary. However, the state-dominated banking sector has failed to fill the financing gap left by the shadow-banking system, leaving many companies in significant trouble and without a line of credit to manage daily operations. 47 Based on reporting by the Financial Times, the financing drought became so problematic that “[t]wenty-one privately owned groups have sold large stakes to SOEs since the start of 2018, according to stock exchange filings. Of these, 10 are de facto nationalisations because the SOE will become the formerly private company’s largest shareholder.” 48

A simple look at bank loan data makes the situation abundantly clear. As pointed out by Nicholas Lardy in the July 2018 Australian National University China Update, “the share of bank loans to nonfinancial corporations that went to private firms fell from 57 per cent in 2013 to only 19 per cent by 2015, while the share that went to SOEs almost doubled over the same period—from 35 per cent to 69 per cent.” 49 Lardy followed up with updated numbers in his recent book, The State Strikes Back, which indicate that this trend continued in 2016, with the share of bank loans to SOEs jumping to 80 per cent and the share going to POEs down to just 11 per cent that year. 50

While some positive change has been seen in recent months regarding financing the private sector—banks have been urged to increase loans to private borrowers by 30 per cent—the applied methods have been of limited effect and are, as the Asia Society/Rhodium Group China Dashboard put it, “a state-directed solution in lieu of a functional financial system.” 51

On top of China’s heavy reliance on subsidies to direct the economy in general, the dependence on subsidies that SOEs have developed in order to turn red balance statements black is particularly concerning. A reasonable chunk of total direct subsidies from the government go to private companies, but the bulk over the last several years has gone to SOEs. This in itself is an issue, but when coupled with the subsidy-like effect of cheap loans from state-owned banks, along with the de facto loans that SOEs generate by employing excessively long payment periods to suppliers, SOEs end up with heavily inflated bottom lines. A recent Gavekal Dragonomics report projected that without these three sources, SOEs would see a decrease in return on assets of 35 to 40 per cent on average. 52

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46 Wildau, Gabriel, and Jia, Yizhen, Why Banks are Wary of Beijing Plea to Back Private Companies, Financial Times, 20th February 2019, viewed 6th August 2019, <https://www.ft.com/content/aedef950-335b-11e9-bd3a-b82a211d9d5d>


48 Wildau, Gabriel, and Jia, Yizhen, China State Groups Gobble up Struggling Private Companies, Financial Times, 26th September 2018, viewed 6th August 2019, <https://www.ft.com/content/c3ebdf59-c09c-11e8-86b1-d399f018f8f8>


50 Lardy, Nicholas, The State Strikes Back, Peterson Institute for International Economics, January 2019, Washington D.C., Figure 4.1.


This is all happening at the same time that both the assets and debt of China’s industrial SOEs are exploding: from 2014 to 2018, SOEs’ assets went from United States dollars (USD) 15.3 trillion to USD 26.8 trillion; meanwhile, industrial SOEs’ debt rose from USD 10 trillion to USD 17.3 trillion over the same period. Return on assets dropped from six per cent to three per cent for SOEs, compared to a drop from 14 per cent to 10.5 per cent for private firms. This does not bode well for China’s efforts to escape the middle-income trap, which requires profitability and productivity, neither of which SOEs are displaying, even as they fatten up at the cost of private sector expansion.

The knock-on effect goes beyond the impact on growth. European companies that have systems for financing their operations may seem as capable of dealing with this challenge as well-funded SOEs. However, supply chain disruption is impacting European firms as their upstream suppliers and downstream purchasers struggle to find sufficient operational funding. At best, this requires European business leaders to adopt a more flexible approach to payment timelines, at worst it demands the reconfiguring of supply chains.

**State capital’s ascendency raises barriers abroad**

When Chinese state money went abroad in earnest, first eyebrows were raised, then barriers were: the purchase of the crown jewels of European technology with state-/party-backed capital drove the development of the European Union’s (EU’s) investment screening mechanism. Fortunately, the transparent due process of the screening mechanism allows for private Chinese companies that make market-based decisions when conducting mergers and acquisitions.

The negative impact of state-backed capital going abroad should not be underestimated, and nowhere is this clearer than with the ongoing US-China situation. The role of SOEs has been at the core of the arguments made in the US’ 301 investigation (the March 2018 report mentions SOEs 124 times), and scrutiny over state-backed funds have been central to the Trump administration’s application of the Committee on Foreign Investment in the United States (CFIUS). Alongside these factors is the continued mixing of politics and business, with the CCP insinuating itself into the governance structures of private companies. This blurring of the lines between business and the state means that even Chinese POEs that may have legitimate motivation for investing abroad are being placed under enhanced scrutiny by foreign governments.

**Actual SOE reform is called for**

A comprehensive examination of the role of SOEs in China’s economy is required, with a measured and steady approach that strips them of both their privileges and their excessive responsibilities. The aim should not be for complete privatisation of the economy within an unrealistically short timeframe: nobody wants China’s economy to look like Russia’s in the 1990s.

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Doesn’t the EU have SOEs?

SOEs play important roles in many EU Member States. Between the common rules across the entire union and varying practices from member state to member state, there are valuable lessons for China to learn from, both positives and negatives. At the centre of SOE governance in the EU is competition law, which applies to both private and state-owned firms. By providing clear definitions of the legitimate role and purpose of SOEs, establishing supportive regulatory frameworks to ensure that they operate appropriately, and ensuring sound corporate governance, the EU has helped facilitate a more balanced approach to development.

The legitimate role of SOEs

However, unlike in the EU, massive SOEs dominate in many Chinese sectors, with European companies in China in the agriculture, aviation, banking, chemicals, construction, energy, environment, insurance, shipbuilding, shipping, and quality and safety services (QSS) industries particularly impacted.

There are certainly sectors in which either an SOE or a heavily-regulated monopoly makes sense, such as the management of the energy grid, railways and roads. These resource-intensive sectors call for natural monopolies, as having multiple grids, railway tracks and roads alongside one another would be exorbitantly wasteful.

On the other side of the coin are the companies that produce energy, trains and automobiles. Far from natural monopolies, these sectors benefit from extensive private competition to develop new technology at cost-efficient prices. Yet still, energy production and train-making in China are both completely dominated by SOEs, and the automotive sector sees a high proportion of producers that are either SOEs themselves, hold major quantities of state capital or are engaged in a joint venture (JV) with an SOE.

In these areas, SOEs have disappointed: Chinese energy production is notoriously inefficient and dirty; high-speed train producers first copied foreign technology then grew in a protected market with a fifth of the world’s population, absorbing state support when going abroad; and Chinese SOE automotive manufacturers have yet to make models that meaningfully compete abroad, let alone against the consistently better vehicles produced by Chinese private-sector automotive manufacturers, even after the government forced foreign companies to partner with them.

Serious consideration therefore needs to be given to which sectors warrant the presence of SOEs, before China develops a steady and moderate path to privatisation in all other areas.

**Tight regulation for remaining SOEs**

The SOEs that remain would need to be more thoroughly regulated by new rules and the robust implementation of competition policy, as they would inherently enjoy a certain degree of privilege, especially those in a sanctioned monopolistic position.

One simple, yet damaging, example of SOEs taking advantage of their position is their practice of drawing out payment periods for suppliers. A long payment period means that private firms must retain large sums of cash to cover their accounts receivable while they wait for payment for goods or services already supplied to an SOE customer. This allows SOEs to float their payments while utilising what they are yet to pay for, freeing up capital for them to use elsewhere – *a de facto* loan from private suppliers.

This, coupled with the draining away of financing from POEs more generally, could significantly impact the future of the Chinese economy. As one China analyst put it, “If left uncorrected, this forced transfer of capital from the productive private sector to a relatively unproductive state sector bodes ill for the long-term trajectory of investment and economic growth in China.”\(^64\) Clear regulations are needed to rein in such behaviour and prevent SOEs from abusing their market position. Premier Li Keqiang followed up on this issue in late 2018, but the impact of the subsequent provisions remains uncertain.\(^65\)

**Both SOE privileges and responsibilities belong to history**

Chinese SOEs enjoy tremendous privileges, from monopoly statuses, implicit guarantees and cheap capital, to accelerated administrative approvals, favoured procurement bids and a seat at the policy-making table. These all need to go.

But SOEs also shoulder a great burden. While far from the old ‘iron rice-bowl’ model, they still provide extensive employment, insurance and benefits that generally go beyond those expected of a private company. In fact, it was not until the end of 2018 that SOEs were ordered to handover schools and hospitals to the local government for management,\(^66\) prior to which many had run their own for workers and their families. China should now look to other areas where SOEs bear similar responsibilities and follow suit.

The state also uses SOEs as a source of additional funds when necessary. For example, the government is gradually cutting back on certain taxes to try and support growth and consumption. To compensate for budget shortfalls, they have increased the amount of money that SOEs need to contribute back to the state.\(^67\) This, too, is an unfair burden on the state-owned sector.

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64 Ibid.
Corporate governance

At the centre of good corporate governance lies the need for clear separation of authority and responsibility between different bodies. Most commonly, there must be a divide between shareholders, the board and management, each of which have distinct roles to play and a clear relationship to one another. A similar division theoretically exists in China with the SASAC (and the state more generally) serving as shareholders, while the board and management fulfil similar roles to what is common internationally.

However, this structure is where the similarities end. The relationship between these three bodies is complicated by the connections between the personnel in each role: it is far from uncommon to see SASAC officials end up on the board of SEOs or in management roles, muddying the divisions between the tiers.68 As a March 2019 Caixin editorial rightly observed, “the relationship between the funders, the board of directors, and the management to the rights and responsibilities is still not clear enough.”69 This relationship cross-over is further complicated by, yet again, the role of the CCP. The presence of the Party within the decision-making process in SOEs often results in a bizarre situation in which Party roles conflict with state roles which conflict with corporate roles which conflict with board roles.

The division of responsibilities within the corporate governance of SOEs therefore needs to be clearer, with the scope of the role that the SASAC plays in need of serious reconsideration. A conversation on this topic has already begun in China, with a different Caixin editorial noting that “the supervision of state-owned assets should shift from ‘managing people, affairs and assets’ toward simply ‘managing capital’.70

In lieu of a precise solution, the fact that issues of corporate governance in China’s SOEs are being publicly discussed raises confidence that positive changes may be on the horizon.

No need to reinvent the wheel

As stated by the IMF in its 2019 Article IV Consultation with China, the Chinese Government's SOE reform needs to be reinvigorated in the following areas:71

- **“Limit SOE use of credit advantages.”** The flow of SOE borrowing should be constrained by hardening budget constraints. Dividend payments to the budget should be increased, while completing the transfer of social responsibilities to the government. Deleveraging goals should be set in terms of SOE debt/GDP ratio.

- **Support the removal of implicit guarantees to SOEs by allowing SOE and LGFV bonds to default.**

- **Complete classification/identification/zombie exit.** Classification of SOEs into categories (competitive, social, strategic) should be published, along with a timetable for moving SOEs out of competitive sectors. Progress on ‘zombie’ local SOEs should move forward with the publication and exit of local zombies, facilitated by a comprehensive amendment of the Enterprise Bankruptcy Law. Exits should not reduce competition through top-down mergers with other SOEs, but rather release resources to the

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private sector. Zombie exits should be facilitated by strengthening the social safety net.

- **Increase competition** by opening up non-strategic sectors to private and foreign enterprises, strengthening the role of the State Administration for Market Regulation and independent arbitration in dealing with SOE monopolies, and submitting a high-quality revised offer to join the WTO Agreement on Government Procurement.

- **Improve SOE governance.** The authorities should increase transparency of governance at the group level, by increasing information disclosure on group level board meetings, and promote the appointment of managers with international and private sector experience (e.g. by following the 2015 OECD guidelines on corporate governance of SOEs).”

**Competitive neutrality**

While SOE reform will help trim the fat from bloated firms, strong institutions are needed to ensure that SOEs are not only pared down to an appropriate role, but that they also exist and compete with the private sector on a level playing field. To achieve this, competitive neutrality must be embraced.

**What is competitive neutrality?**

**Australia, birthplace of competitive neutrality**

Throughout the 1990s, Australia underwent a series of microeconomic reforms to boost the efficiency and competitiveness of Australian companies. One of the most critical reforms was to create a level playing field between private and state-owned firms and rein in market distortions. As the Australian Treasury explained:

> “Competitive neutrality policy […] should be understood in the context of the economic reforms which have been implemented progressively in Australia and elsewhere over the past decade or so. A consistent theme in those reforms, whether in international trade, domestic regulation or public sector management, has been an increased reliance on market-based mechanisms and competition to promote efficiency and competitiveness.”

**A definition**

The Organization for Economic Co-operation and Development (OECD) Competition Committee introduces ‘competitive neutrality’ in competition policy as “a fundamental principle of competition law and policy that firms should compete on the merits and should not benefit from undue advantages due to their ownership or nationality […] Governments can affect the way markets function sometimes to the detriment of free competition. They can set procurement/tax rules or regulatory regimes putting private companies at a disadvantage compared to state-controlled or supported firms, or yet, they can participate in a market by providing services directly or through state-owned/controlled firms. Ensuring a level playing field is therefore key to enable competition to work properly.”

In other words, SOEs and POEs should be treated equally.

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What does competitive neutrality mean for foreign companies?

The concept of ‘competitive neutrality’ is most often referenced in relation to SOEs versus POEs, but the core concept is that ownership status should not impact how the government treats any company. In most mature economies, there is no legal distinction between ‘foreign’ and ‘local’ companies, beyond the limited purposes for national security and taxation. A Chinese private company that invests in the EU is legally treated as a private company alongside its local counterparts. It has therefore not been necessary to expand the definition of ‘competitive neutrality’ to incorporate the concept of a foreign/local divide.

However, China does maintain a different legal status for foreign companies invested in its market. This legal distinction will soon be simplified when the Foreign Investment Law comes into force in January 2020, but will remain nonetheless. As such, if China is to fully embrace competitive neutrality, the definition of differentiated legal ownership will need to be expanded to include both private versus state-owned companies and foreign versus local.

…but one cynical thought...

The timing of the discussions on competitive neutrality could point towards market reformers among China’s leadership seizing the opportunity to advance economic liberalisation. However, they could equally be the result of China’s profligate national champions being reined in abroad. If the concept of ‘competitive neutrality’ indeed becomes little more than empty rhetoric, used only to advance the interests of China’s SOEs in other markets, it may result in the EU developing ever stronger defences to protect against their distortive effects.

European businesses are not alone in these concerns

“It is worth noting that, as soon as the Chinese government began expressing firm acceptance of competitive neutrality, some officials and scholars began warning of so-called ‘reverse discrimination’ against SOEs. Their arguments are worrying and inconsistent with reality, reflecting stubborn prejudices. Private enterprises still don’t have access to fair competition – how would they even dare to engage in ‘reverse discrimination’? How can comparative neutrality be implemented if people sensationalise the risk of ‘reverse discrimination’?”

Why does China need competitive neutrality?

A vibrant private sector under siege

China’s private sector is its real engine of growth, yet it is struggling as the economy tightens, in no small part because resources continue to flow to SOEs.

Unfortunately, measures undertaken to support the private sector in the past few years have largely been incremental and piecemeal. As welcome as it is to see administrative procedures shortened by a few days, social security contributions lowered ever so slightly and marginal tax cuts, more is expected. Such steps are akin to a doctor providing medication to lessen the symptoms of an illness. While they provide some temporary relief, the illness will remain until the underlying causes are treated.

This is critical both for China’s future growth, employment and innovation, and for attracting further foreign investment. European businesses are tired of competing on an uneven playing field in general, but especially against SOEs. This is the structural issue at the core of China’s economic woes, and failure to deal with it will continue to dampen long-term confidence in the Chinese market.

**Don’t forget global tensions**

By making meaningful progress in creating a level playing field and realising competitive neutrality, China could significantly ease some of the tensions caused by the distortions emanating from its market. While the immediate justification for the US-China trade war may change from tweet to tweet, the core of the US’ complaints against China has long focussed on the Chinese state-planned economy with SOEs at its centre.

While widely recognised as an issue among many other countries, the EU in particular has begun to critically review China’s heavyweight SOEs and state-backed activity in the EU. More importantly, it has gone a step further and taken action. Tighter investment screening and potential tools to push back against subsidised Chinese national champions performing a variation on dumping in Europe’s public procurement markets are among the first tools the EU is sharpening to address this issue.

If competitive neutrality is realised, China can negate the justification for such protective measures and ensure that all of its entities have a place in the EU market. Without doing so, the chances of China encountering tighter scrutiny abroad will only increase.

**At least zombie SOEs are on the chopping block**

There are some indicators, at least at the central level, that there is a desire to see the most egregious examples of state-support-gone-wrong disappear. In July 2019, 13 ministries jointly released the *Plans for Accelerating Improvements of the Market Entity Exit System*, which include a critical section on cutting support for ‘zombie companies’ that already meet the conditions for bankruptcy. This plan explicitly forbids any level of government from providing support that perpetuates the existence of SOEs that meet these conditions.

This positive step is welcomed by the European business community, and shows that the government is at least ready to deal with SOEs that do nothing but drain from the system.

**How to implement competitive neutrality in China?**

While suggested models for effective overall implementation of competitive neutrality can be found with the likes of the OECD and the World Bank, the European Chamber has several specific examples to contribute to the conversation in China. These individual cases, raised by specific sectors, represent the
kinds of issues faced by the European business community in China related to unequal treatment and the need for competitive neutrality.

**Market access – beyond the negative list**

Competitive neutrality is especially important in China’s energy sector. Foreign energy companies have long faced a variety of barriers that inhibit them from meaningfully participating in the industry, which is saturated by SOEs. The 2019 revision to the *Foreign Investment Negative List* removed direct barriers to entry for natural gas exploration and exploitation; a move in the right direction.\(^83\) However, a wide range of other *de facto* barriers to entering the market also exist.

In order to have full access to the natural gas sector in China, foreign companies need to be free to operate in the upstream (exploration and extraction), midstream (transportation and storage) and downstream (processing) aspects of the industry. Currently, a wide variety of approvals must be obtained for those areas that are already ‘open’ thanks to revisions of the *Foreign Investment Negative List* and further restrictions are then found on China’s *Negative List for Market Access*.\(^84\) These result in foreign energy companies being left out of critical parts of the natural gas sector like natural gas liquefaction, transportation and storage management.

Furthermore, the domination of the natural gas industry by SOEs drives concerns that administrative approvals required for gas exploration and exploitation will favour state-owned companies. Embracing competitive neutrality would necessitate that a fair and transparent system for determining which companies are given access to gas fields is created to ensure equal opportunities for all firms, regardless of their ownership. This is also a critical step for China to show that national treatment, as legally guaranteed in the Foreign Investment Law, can be expected by foreign investors.\(^85\) As the government prepares for the implementation of the Foreign Investment Law at the start of 2020, ensuring that the regulatory groundwork exists to provide equal treatment for foreign energy companies and local SOEs, to ensure that they have fair access to natural gas deposits and the entire production, transportation and processing stream, is becoming more of a priority.

**Monopolies – Zhu Rongji undone**

During the late 1990s reforms of Zhu Rongji, China’s shipbuilding monopoly was split between the China Shipbuilding Industry Company (CSIC) and the China State Shipbuilding Company (CSSC), with the CSIC gaining control over shipbuilding assets north of the Yangtze River and the CSSC taking those to the south. Unfortunately, this reform appears to be coming undone, with the two having recently announced their intention to merge.\(^86\) Given the excitement about this prospect in state media, and the alignment of the planned merger with President Xi’s “better, stronger, bigger” approach to SOE reform, the European shipbuilding community anticipates that the merger will go through.\(^87\)

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\(^87\) China Plans to Merge Two Large Ship-building Corporations, Global Times, 2nd July 2019, viewed 7th August 2019, [http://www.globaltimes.cn/content/1156452.shtml](http://www.globaltimes.cn/content/1156452.shtml)
If so, it will create an industrial hegemon that controls 20 per cent of global market share. This behemoth will certainly be the beneficiary of extensive support from the state as policymakers have clearly designated the shipbuilding sector as a key industry under the China Manufacturing 2025 (CM2025) initiative. In December 2018, action plans were announced to advance development in the liquified natural gas carriers, luxury cruise liners, icebreakers and offshore engineering equipment sectors. European shipbuilders expect these areas to receive extensive state support, further distorting markets both in China and overseas.

Such monopolistic power within the market is bad enough, but the knock-on effect is likely to be similar to that experienced in the steel and solar panels industries, which saw overcapacity and dumping in global markets. Regulators urgently need to rein in such mergers and ensure that competition law is rigid.

**Public procurement – ‘Buy China’**

While winning a public procurement bid in China when competing against an SOE can be an incredibly difficult proposition for any company, the legal distinction drawn between foreign and domestic companies puts foreign enterprises at a further disadvantage. One of the clearest cases of legal discrimination experienced by European businesses in China is in the procurement of medical devices.

In recent years, the Chinese Government has promulgated several high-level policies in the name of creating a fair procurement market in China. State Council Document No. 5 (2017) clearly stated that products manufactured by foreign enterprises in China will be treated equally in public procurement bids. In December 2017, the National Development and Reform Commission (NDRC) led two other ministries in publishing the Notice on the Working Plan 2017/2018 to Abolish Anti-competition Policies, another document that touches on this issue very explicitly.

However, many local procurement policies include a provision that hospitals are encouraged to buy domestically-made medical devices as long as they meet quality requirements, and even explicitly stipulate the purchase of “domestic brands”.

This violates the principle of fair competition and equal treatment of registered companies in China, and is furthermore an insurmountable trade barrier for foreign-invested enterprises (FIEs). It also affects the fairness of procurement and greatly reduces the attractiveness of China as a destination for foreign investment in medical equipment manufacturing. Of no less concern is that it puts hospitals in a position where they have to consider something as arbitrary as the origin of a brand.

The allocation and use of medical equipment and instruments in public hospitals should be based on open
market competition, the needs of medical service providers and selecting the best clinical outcomes for patients. During the procurement process, the government should give priority to patients’ clinical needs, and conduct evidence and value-based procurement.

On 14th August 2018, the Shenzhen Health Commission released an approval list to local hospitals, on the allocation of Type-B large medical equipment (see Table 1).

<table>
<thead>
<tr>
<th>Total</th>
<th>46 Hospitals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approved type-B large medical equipment</td>
<td></td>
</tr>
<tr>
<td>CT</td>
<td>MRI</td>
</tr>
<tr>
<td>23 units</td>
<td>24 units</td>
</tr>
<tr>
<td>Must be domestic indigenous brands</td>
<td></td>
</tr>
<tr>
<td>Units</td>
<td>Percentage</td>
</tr>
<tr>
<td>7</td>
<td>30.4%</td>
</tr>
</tbody>
</table>

Ending such blatant discrimination against foreign companies and their JVs with local companies is critical to maintaining the efficiency of China’s procurement system. It is also an important step towards realising the full meaning of ‘competitive neutrality’ by ending the distinction between foreign and local ownership, and affording all companies in China a level playing field.

**SOEs suck up all the oxygen, leaving little for SMEs**

As discussed previously, China’s state-owned financial system has always provided extensive funding for other SOEs, with much less going to the private sector, and only a small portion of that going to SMEs. Historically, alternative sources of financing, like shadow-banking, grew to fill this need. The ensuing crackdown on the legally grey sources of financing in China has meant that many Chinese SMEs have recently had to go without. European SMEs, on the other hand, have always struggled to access financing in China, often having to rely on credit from original equipment manufacturers (OEMs), financing from European banks, or just operating on a shoestring budget to make ends meet.

The government has pushed banks to drastically increase the number of loans going to private firms, but this is merely addressing a symptom of the problem rather than its causes. In the long-run, the implicit guarantee of SOEs must be addressed, as well as the shortcomings of the country’s ratings and bankruptcy systems.

This imbalance is mainly driven by the fact that centrally-owned SOEs will be bailed out by the government if needed, and locally-owned ones often have the same relationship with their regional officials. Ending these implicit guarantees of SOEs is not just a critical part of realising competitive neutrality, it is also central to financial system reform. There must also be a demonstrable pattern of both local and central SOEs being held to the same fiscal discipline as the private sector, and that may mean forcing some SOEs to restructure, or even dissolve.

The second major cause of the shortage of financing for SMEs comes from China’s limited capacity for...
ensuring accurate risk assessment for firms, as well as the toothless and seldom used bankruptcy system. Fortunately, these are areas where reforms are either happening or are inbound. The ratings agency market was opened up to foreign investment in January 2019, which should help boost capacity for accurate ratings through competition, and an overhaul of the Bankruptcy Law was announced in March 2019. These are good starting points, but it will take time for their effects to be realised so that well-run SMEs are rated appropriately and given the financing they deserve, while also ensuring that failing companies are able to go through the bankruptcy process smoothly and free up capital for healthy investment.

The urgency of addressing these core issues has been increased by the emergence of a new trend. In recent months, companies have begun relying on ‘commercial acceptance bills’—an official form of an IOU, of which over USD 200 billion are in circulation in China—to make up for the shortfall in funding.

China has launched several measures to address this, but the effects have so far been less than what the situation demands. Measures such as the Law of the People’s Republic of China on the Promotion of Small and Medium-sized Enterprises, and the Guiding Opinions on Promoting the Healthy Development of Small and Medium-sized Enterprises, are welcome steps in the right direction, but the financing tools that were established subsequently are insufficient due to both limited scope and problems with execution.

The NPC sent inspection teams to assess the implementation of the SME Promotion Law—including financing-related measures—earlier this year. The European Chamber hopes that their findings lead to more effective implementation that produces meaningful results for SMEs, foreign and local alike, thus moving the market further towards competitive neutrality.

**Administrative support as protectionism**

The CCP and the Chinese Government are currently undergoing a process to define SOEs as either ‘commercial’ or ‘public welfare enterprises’. The idea is actually a good starting point for determining the legitimate roles of SOEs, as those that serve commercial roles beyond areas such as natural monopolies ought to be considered for privatisation. However, concerns arise over the potential misuse of this classification system, and the need for objective decisions to be made in the categorisation process.

The Testing, Inspections and Certification (TIC) industry is already heavily dominated by the nearly 11,000 SOEs that operate in the sector. There is considerable fear among European TIC providers that the administrative categorisation of many of these SOEs as ‘public welfare enterprises’ will result in them

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being given considerable advantages. This would significantly worsen the already limited amount of competition that this sector experiences in China and potentially result in an administratively supported monopoly driven by TIC service companies that are almost exclusively state-owned. At a time when Chinese companies are expected to produce higher-quality goods and services, the value of proper TIC services will only increase, making the monopolistic power of an industry dominated by SOEs particularly concerning.

**No ‘competitive neutrality with Chinese characteristics’**

Applying competitive neutrality in all cases except when it is not convenient to do so would result in the death of the principle. Like all sound institutions, it should be implemented in absolute terms, not only when it suits ‘special conditions’. A core part of the *Decision* passed on the Third Plenum of the 18th Central Committee of the CCP, to let market forces play the “decisive” role in resource allocation, fell victim to such an approach, and the Chinese economy remains one where market forces continue to clash with the state-led model as a result.

Adopting an absolute approach is challenging. It will require government to remove its grip from critical parts of the economy and make room for the invisible hand of the market to fill the void. Although this will entail accepting new risks, China has been at this point before under Deng Xiaoping, and later Jiang Zemin and Zhu Rongji, with the risks subsequently proven to be worth taking. The difference now is that China has that much more experience, strength and confidence.

**What can the EU do to advance Chinese SOE reform and competitive neutrality?**

If China intends to pursue SOE reform and competitive neutrality, it will find a productive partner in Europe. Between upholding the multilateral rules-based order and completing an impressive number of comprehensive free-trade agreements (FTAs) in recent years, the EU has shown pragmatism when dealing with like-minded governments.

It is in the interests of European business to cooperate with China in its efforts to bring about competitive neutrality and complete SOE reform, by providing expertise and consultation. Meanwhile, the EU and member-state governments can help to prepare the foundations for more robust and productive engagement with China.

**Results-based cooperation must be the aim**

Any cooperation must be pursued on a conditional basis, to provide a framework and clear goals for any dialogues that take place. Wherever engagement bears fruit, it should be pursued decisively. Capacity-building will be a critical area where the EU can make a difference, as most EU Member States have their own experiences with SOE reform and realising competitive neutrality. Sharing what worked well and what did not can help facilitate China’s own plans.

The EU-China Comprehensive Agreement on Investment (CAI) is a golden opportunity for engagement
that can produce results.\textsuperscript{97} A sufficiently ambitious CAI will act as a major source of confidence-building between the EU and China. Once brought into force, other avenues of cooperation will naturally present themselves. The agreement could even pave the way for discussions on an EU-China FTA.

**Bolstering the EU’s position**

Meanwhile, the EU can further strengthen its own tools to guard against potential market distortions caused by China’s SOEs, while also methodically setting the conditions for them to access the world’s largest common market. This would apply affirmative pressure, and could provide the additional incentive required for China to follow through with meaningful SOE reform.

The EU’s new investment screening mechanism is a good starting point.\textsuperscript{98} It is important to keep the system up to date, and to refine and improve it to deal with any future challenges. It is also important to coordinate better between member states, to ensure that a common approach is taken and that each has the capacity to investigate suspect investments.

**The International Procurement Instrument (IPI)**

The IPI is another tool the European Commission has at its disposal.\textsuperscript{99} The IPI allows the Commission to launch an investigation into the government procurement practices of other markets. If significant barriers exist that affect companies from the EU that want to bid on government procurement projects in that country, the EU will enter into consultations with that country to attempt to resolve the issue. If changes are not made, the IPI would then allow the Commission to restrict the access of companies, goods and services from the relevant country.

China is by no means the only country that protects its public procurement market while enjoying wide access to the EU’s. However, it does so with national champions that are beefed up with cheap loans and subsidies, while enjoying an economy of scale from their vast and heavily-protected home market. Meanwhile, many European companies have all but given up on China’s government procurement market due to the unfair treatment they face under bidding and tendering processes. The IPI would put pressure on China to reform its SOEs and public procurement system by potentially impacting the bids of the country’s national champions in EU public procurement tendering for as long as China delays its own reforms.

**A stronger common market**

The EU should also further strengthen the common market to prevent exploitation of individual member-states or their segmented nature. One key example comes from the International Liner Shipping Sub-working Group.

A number of coastal countries, including some EU member-states, have cabotage laws that restrict or forbid foreign-flagged vessels from participating in domestic shipping.\textsuperscript{100} In China, this means that one foreign-flagged vessel shipping goods out of Tianjin and another shipping goods out of Shanghai cannot then consolidate and reorganise their cargo between the two ships in a Chinese port to more efficiently


move goods to their respective final destinations. However, Chinese-flagged vessels operated by a wholly Chinese-owned company can.

On the face of it, this may look like reciprocal treatment, as a few member states have similar restrictions. The issue is that China has a massive coastline (the world’s 11\textsuperscript{th} longest\textsuperscript{101}) with many busy ports (nine of the world’s top twenty busiest ports by container throughput).\textsuperscript{102} The EU only holds three of the world’s busiest ports in Rotterdam, Antwerp and Hamburg, all of which are in different member states, none of which have a long coastline. This means that a Chinese flagged vessel can load up in Hamburg, consolidate with another Chinese-flagged ship in Rotterdam, then do it yet again in Antwerp so that goods from these three markets can then be shipped more efficiently to other markets, all within less distance than it takes to sail from Tianjin to Qingdao.

This puts European shipping companies at a disadvantage when competing against the Chinese shipping industry. One possible remedy is through an EU-China agreement that allows EU-flagged vessels to engage in international relay in Chinese ports to rearrange containers (not to be confused with domestic shipping). If such an agreement cannot be reached, a layer of common cabotage laws could then be introduced in the EU, preventing non-EU-flagged vessels from performing international relay. Such a common EU approach could help to leverage a resolution to this situation.

These proposed measures are not offensive tools to be used against Chinese companies, or as methods to boost protectionism in the EU market. They are instead fail-safes. In the event that China does not follow through with SOE reform and competitive neutrality in the coming years, such measures will be necessary to protect the EU market; not from competition but from distortions caused by entities that do not conform to the multilateral trade and investment system. If China’s reforms are forthcoming, then these mechanisms become all but irrelevant to Chinese businesses looking to invest in the EU.

Europe’s Sputnik moment: the need to boost internal competitiveness

Between persistent market access barriers, perpetual unequal treatment, extensive support for SOEs and the state-directed nature of its top-down industrial policies, China has fallen short of many of its WTO commitments. It has also repeatedly resisted the spirit of WTO membership, which is to continue to push beyond initial accession agreements and join other members as a fully open and fair market. China’s national champions now exert an economy of scale based on their uncontested dominance of their home-market of a fifth of the world’s consumers. This, coupled with state support, allows them to go abroad and undercut market prices, dominate public procurement bids and push out competition.

As such, the EU must explore innovative ways to counter the imbalance in the global system caused by the distortions emanating from the Chinese market.

Europe’s own debate

Just as there is a debate underway in China to re-examine the role of the state-owned economy, a discussion is also taking place within the EU about potential changes to the Common Market. Industry associations like the Federation of German Industries (BDI) and the General Confederation of Italian

\textsuperscript{101} Countries with the Longest Coastline, World Atlas, viewed 20\textsuperscript{th} August 2019, <https://www.worldatlas.com/articles/countries-with-the-most-coastline.html>

\textsuperscript{102} One Hundred Ports 2018, Lloyds List Maritime Intelligence, 2018, subscription service.
Industry (Confindustria) have been joined by political leaders like German Federal Minister for Economic Affairs and Energy Peter Altmaier in calls for reforms in the EU. 103,104&105

One such reform being called for is the creation of an EU industrial policy suited to its market economy. While China’s industrial policy often focuses on state-directed innovation and providing undue support to hand-picked national champions, the EU approach should follow market principles and empower SMEs as major drivers of innovation and growth. Tax incentives for research and development (R&D) can help encourage innovation in the private sector, but stronger support for basic research in non-profit and educational institutions can ensure advances in new areas.

EU competition law would also benefit from some re-evaluation. Within the European Common Market, tight controls to limit the power and market share of individual companies has helped drive competition. However, as other major economies have either laid aside anti-trust rules (as in the USA) or have shaped national champions through market intervention and protection (as in China), the EU may have little choice but to examine how to allow the market to create its own European champions so that external markets become fields of competition rather than places that have already been claimed by industrial giants from other economies.

Finally, boosting the amount of resources at the disposal of the EU for building modern infrastructure in rural areas and in less wealthy member states could help drive fresh growth, while also ensuring that the talent in those places have the foundation they need to build world-class companies and contribute even more to European innovation. Doing so can also help to build greater unity across member states, which will further strengthen the Common Market.

**Connectivity is another key**

It is also advisable for the EU to continue to look beyond its own borders to mitigate the distortions emanating from China. While much of the hype surrounding China’s Belt and Road Initiative (BRI)—its signature foreign policy for the last six years—is overblown, the impact on global competition is considerable.106 The BRI follows its own approach to things like procurement for its projects, resulting in a system where Chinese firms win the lion’s share of bids and keep out foreign competition.107

Further consolidation and promotion of the EU Connectivity Strategy can help in this respect, by boosting cooperation with trade and investment partners while also building their capacity for following fair and rules-based systems.108

The earlier the EU can start down this road, the better.
The campaign to uphold multilateralism and a rules-based order

Since the global multilateral and rules-based economic order came under threat from the recent surge in nationalism and protectionism—including from countries that historically championed institutions like the WTO—the EU has stepped up its fight to maintain the system. It has also made clear its intention to cooperate with like-minded nations to reform the WTO, for example, by forming a working group with China to explore what needs to be done.

It is important for WTO reforms to be holistic in nature. Rather than using reforms to tweak a few areas of concern, they should be viewed as an opportunity to advance the cause of economic liberalisation. This will entail addressing new developments like the rise of e-commerce and digital goods, but it also means that the WTO should broaden its scope to more thoroughly cover investment between members.

Agreements abound

Since the EU and China began negotiations on the CAI in 2013, the EU has successfully concluded a wide range of agreements with other major economies. For example, the EU-Japan Economic Partnership Agreement—the talks for which began around the same time as those for the CAI—was brought into force in February 2019. Similar agreements, along with FTAs and bilateral investment treaties (BITs), have been implemented in South Korea (2016), the South African Development Community (Botswana, Lesotho, Mozambique, Namibia, South Africa and Eswatini (formerly Swaziland)) (2016), Canada (2017), Singapore (2018) and Vietnam (2019).

Other negotiations have also seen the EU reach agreements in principle, with just the details in need of ironing out, such as those with Mexico (2018) and Mercosur (Argentina, Brazil, Paraguay and Uruguay) (2019). Looking forward, the EU has already begun negotiations with the Philippines (2015), Myanmar (2016), Indonesia (2016), New Zealand (2019) and Australia (2019).

It is very encouraging that the EU and China signed a Joint Statement during the 21st EU-China Summit on 9th April 2019, which included a commitment to complete negotiations on the CAI by 2020. After more than seven years of negotiation, the concluded agreement will act as a clear indicator as to the strength and future direction of the EU-China relationship, and the sincerity of China’s reform and opening agenda. It should be bold and result in meaningful improvements in market access and operating conditions for European firms in China.

Recommendations

Recommendations for the Chinese Government

• Align China’s reform agenda with the OECD’s, the World Bank’s and the IMF’s SOE reform and competitive neutrality recommendations, establish a timeframe and a roadmap to pursue these in a

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realistic and steady manner, and share it publicly so that progress can be clearly measured.

- Follow up on the China 2030 report and the Decision passed on the Third Plenum of the 18th Central Committee of the CCP to unleash market forces in the economy and ensure that China can escape the middle-income trap.

- Reinvigorate China’s opening up process to embrace a holistic understanding of market access that goes beyond direct barriers like the negative lists and also considers secondary barriers like licensing.


Recommendations for the EU and Member States

- Continue to advance cooperation with China, emphasising areas where advances are most feasible, and pursue a results-orientated approach.

- Strengthen protective mechanisms like investment screening and the IPI to mitigate distortions caused by China’s protected SOEs and national champions.

- Further strengthen the European Common Market, identifying areas that are prone to abuse by external actors, such as international shipping.

- Craft a market-based EU industrial policy that encourages innovation and development while supporting SMEs, and take greater efforts to modernise infrastructure for countries within the Common Market where required.

Recommendations for the EU and China

- Meet the 2020 deadline for a meaningful CAI that contains bold and reciprocal commitments for market access and fair operating conditions.

- Pursue additional bilateral and multilateral cooperation on issues such as WTO reform and for addressing problems like steel overcapacity.

- Approach WTO reforms in a holistic way that advances the cause of economic liberalisation.
Section Two

Horizontal Issues
Horizontal Issues

The position papers in this section address the main horizontal issues that affect European businesses in China, covered by the following working groups:

- Compliance and Business Ethics
- Environment
- Finance and Taxation
- Human Resources
- Intellectual Property Rights
- Inter-chamber Small and Medium-sized Enterprise
- Investment
- Legal and Competition
- Research and Development
- Standards and Conformity Assessment
  - Quality and Safety Services

Ambiguous rules and regulations, administrative issues and discretionary enforcement remain the top three obstacles European businesses face when operating in China, according to the *European Business in China Business Confidence Survey (BCS) 2019*. These are also some of the main issues the Chamber’s working groups address in this horizontal issues section.

In March 2019, the Foreign Investment Law (FIL) was published after many years of drafting, a central piece of legislation that will affect all foreign businesses investing in China. When the FIL comes into force on 1st January 2020, the three main laws that currently govern foreign investment—the Chinese-Foreign Equity Joint Ventures Law, the Wholly Foreign-Owned Enterprises Law and the Chinese-Foreign Contractual Joint Ventures Law—will be abolished, and with them the ‘case-by-case’ approval system for foreign investment. The FIL formally introduces a new ‘national treatment plus negative list’ administration system, which will replace the approval system under the *Catalogue for the Guidance of Foreign Investment Industries (Foreign Investment Catalogue)*. Foreign investment in industry sectors not included in the negative list for foreign investment will enjoy national treatment, and only foreign investment in restricted industry sectors will remain subject to specific government approvals. The latest version of the list was issued by the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) in June 2019. It was followed by the release of the *Encouraged Foreign Investment Industrial Guidance Catalogue (Encouraged Catalogue)*, which replaces the last remaining part of the *Foreign Investment Catalogue* and completes the shift to the new investment administration system.

When the FIL was still in draft stage, the European Chamber had stated its recommendation for the law to abolish the legal distinction between foreign and local companies, and only allow exceptions for legitimate reasons such as specific national security concerns. Now that the FIL has been passed with this legal distinction still unfortunately intact, the European Chamber’s working groups will closely monitor its implementation to ensure that the equal treatment announced in the law will be granted at all levels of

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administration. The FIL is a framework law that addresses many areas of the Chinese legal system related to investment, but it lacks specificity. Only coherent implementation rules will reduce ambiguity and allow for its fair application. The European Chamber’s working groups also ask for timely consultation during the drafting of implementation rules, particularly given the complexity of the task. Specific recommendations regarding the implementation of the FIL are discussed in detail in the Investment Working Group and Legal and Competition Working Group position papers.

Another important development with regard to foreign investment in general was the joint statement signed during the 21st European Union (EU)-China Summit on 9th April 2019, which includes a commitment to conclude by 2020 the negotiations for the EU-China Comprehensive Agreement on Investment (CAI), which started in 2013.

During the summit, the EU and China also stressed the importance of showing resolve on the issue of clean energy transition, and of assuming greater leadership on global environmental issues. Both sides committed to actively implementing the Memorandum of Understanding on the Circular Economy and promote practical cooperation between industries. However, for companies on the ground, the implementation of environmental initiatives in China can often result in local governments interpreting regulations in such a way that leads to inconsistent and unpredictable enforcement. This can also impact compliant companies, be it through the burden of additional administrative reporting or requirements to restrict production. Increased dialogue and cooperation between companies and relevant authorities would help with the development of realistic action plans that all share the common goal of improving environmental protection.

Protecting intellectual property (IP) remains a key concern for European businesses in China. Right holders therefore welcomed the newly released Trademark Law. Coming into effect on 1st November 2019, the law introduces wording that will allow for a crack-down on bad-faith trademark applications. This addresses a long-standing recommendation of the Intellectual Property Rights (IPR) Working Group and, once implemented, should improve the protection of European brands in China. In the area of patents, the Chinese Patent Law is expected to pass its fourth revision in 2019. The draft extends the protection term for design patents to 15 years and introduces the extension of the protection term for innovative drugs, as well as various measures for the promotion of patent exploitation. Despite these positive developments, according to the BCS 2019, the general perception among European businesses is that improvements in both IPR protection legislation and enforcement have stalled. At the same time, cases of forced technology transfers remain commonplace, as evidenced by the 20 per cent of respondents to the BCS 2019 who reported feeling compelled to do so to maintain market access. A concerning 26 per cent of these European Chamber members indicated that the transfer was taking place at the beginning of 2019 when the survey was conducted. These issues are discussed in detail in the Intellectual Property Rights Working Group and Research and Development Working Group position papers.

The Implementation Regulations of the Individual Income Tax Law of the People’s Republic of China took effect on 1st January 2019. Both the Human Resources and Finance and Taxation working groups had provided comments at various stages of the drafting process of both the Individual Income Tax (IIT)
Law and its implementation regulations. The new IIT Law takes into consideration an individual's circumstances to a large extent by including six additional itemised deductions to taxable income, which echo recommendations made in the Human Resources Working Group Position Paper 2018/2019. At the same time, the implementing rules stipulate that certain reasonable non-cash benefits for foreign employees—which so far are exempt from the individual income tax if provided by the employer and supported by fapiaos—will become fully taxable from 1st January 2022. This development is of great concern to the European business community as it will substantially increase the cost of cross-border assignments for companies and discourage international talent from looking for employment here, ultimately making China a less attractive destination to much-needed international skilled workers.

The Standards and Conformity Assessment Working Group has been following the implementation of the Standardisation Law over the past 18 months, and provides recommendations with regard to streamlining and consolidating standards with sufficient transition periods for the industry to adapt.

Although the Quality and Services Sub-working Group saw some progress in the revision process of Regulations on Certification and Accreditation (2016 Amendment) (Regulations) in May 2019, when the Certification and Accreditation Administration of China issued a call for comments on the amendments, the revision of the Regulations was only listed as a secondary programme in the 2019 Legislative Work Plan of the State Administration for Market Regulation (SAMR) (Work Plan), with no completion dates provided. The working group is concerned about the time the revision may take to complete, as foreign-invested certification agencies continue to be faced with market access restrictions stipulated in the Regulations. Article 11 of the Regulations requires that, in order to be qualified as a certification body, in addition to conditions prescribed for domestic investors, a foreign investor must have at least three years of experience in certification activities, and be accredited by an accreditation body in its country or region of origin. These special conditions for foreign-invested enterprises contradict the concept of the ‘pre-market access national treatment plus negative list administrative system’ introduced by the new FIL.

While small and medium-sized European companies face the same regulatory challenges as large multinational companies in China, their concerns are aggravated by financial constraints. They are often faced with less favourable treatment when trying to access finance or have their rights enforced. The Inter-Chamber Small and Medium-sized Enterprise (SME) Working Group continues to address these and other challenges that European SMEs experience while operating in the Chinese market, including, but not limited to, access to finance, lack of administrative coordination and IPR concerns.
Key Recommendations

1. Ensure a Uniform Approach to Anti-bribery Legislation and Enforcement that Parallels International Standards
   - Refer to international standards and other jurisdictions, such as the United Kingdom’s Bribery Act and United States’ Foreign Corrupt Practices Act (FCPA), for best practices.
   - Increase cooperation and joint enforcement actions with foreign and international investigatory agencies.

2. Increase the Clarity of Anti-bribery Legislation, Including the Establishment of Clear Criteria to Determine Whether a Certain Act Constitutes an Act of Commercial Bribery or is a Legitimate Business Practice
   - Clarify who should be considered a recipient of a bribe, as listed in the Anti-unfair Competition Law, by utilising case studies and examples.
   - Provide investigation manuals to law enforcement bodies at different levels to ensure the consistent and uniform enforcement of the law.
   - Grant companies the right to legal defence in the face of corruption charges.

3. Raise Compliance Standards in Collaboration with Companies
   - Consider internationally recognised best practices/compliance systems as a valid defence and allow companies to claim leniency or be exonerated from vicarious liability as a reward for establishing a strong and robust compliance system.
   - Provide guidance to companies on what is meant by ‘adequate procedures’ and ‘good compliance’ through case studies and examples.
   - Reinforce awareness of anti-bribery regulations within the business community and encourage all companies to adopt modern and sophisticated compliance systems and policies.
   - Strengthen dialogue between business communities and governmental enforcement agencies and demonstrate companies’ efforts and practices to combat corruption and bribery.
   - Modify government procurement legislation to ensure credit is given to bidders implementing effective compliance systems.

Introduction to the Working Group

The main responsibility of a corporate citizen is to be profitable. Profit is both a company’s reward for a product or service and recognition from the market that society deems the output valuable. Profit should be achieved without burdening society or the state, otherwise it will divert key resources away from areas that need it more. Corporate citizens also need to ensure that their operations do not negatively impact the environment and society at large, by continuously improving themselves. If a corporation causes any negative externalities, then government should ensure the social costs are fully reflected in the corporation’s production costs so that no single corporate citizen can gain an advantage at the expense of others. This will deter corporate citizens, their employees and known...
associates from violating laws, rules, regulations and norms.

A company’s compliance function consists of any and all efforts it makes to exert control and address any negative impacts that may arise over their internal operations. Effective compliance management and ethical practices by corporations will not only reduce their risk of non-compliance but will also help build trust in businesses that promote market integrity. They can also substitute for state-led law enforcement and uphold the rule of law.

Created in 2015, the Compliance and Business Ethics Working Group provides a trusted platform for European Chamber members to discuss management practices, including any successes or failures they have experienced in compliance and business ethics. Working group members meet in an effort to advocate for greater clarity on compliance-related legislation and to better understand how businesses can comply with existing regulatory structures. By sharing their experiences, working group members can learn and develop while enhancing compliance practices across China. The working group is active in Shanghai and Beijing, and membership is open only to industry representatives who are in-house counsels, compliance officers or internal auditors.

Recent Developments

Since President Xi Jinping took office in 2012, fighting corruption has been one of the government’s primary political objectives, as graft is considered a problem that may put China’s long-term sustainable economic development at risk.2,3 Investigations into officials and business affiliates continue to increase at an unprecedented rate,4 particularly with respect to corruption inside the Communist Party. In 2018, the Supreme People’s Court accepted 34,794 cases and concluded 31,883, amounting to a 22.1 per cent and 23.5 per cent year-on-year increase respectively.5 Anti-corruption efforts also go hand in glove with major efforts made by the central government to gain greater control over local authorities, particularly relating to finances. In March 2018, a National Supervisory Commission was officially inaugurated to strengthen oversight and supervise all public servants.6 The impact of such anti-corruption measures can be seen in foreign enterprises reporting lower levels of concern over the issue. While corruption was one of the top three regulatory obstacles shaking foreign businesses’ confidence back in 2013, corruption is no longer even in the top ten concerns in 2019. It has been overtaken by ambiguous rules and regulations, an unpredictable legislative environment and administrative issues.7

Since the anti-corruption campaign took off in 2012, over a million Chinese government officials have been disciplined.8 The campaign even went international when Operation Skynet was set up in 2015 to return white-collar officials that had fled the country to avoid persecution. The government has tried to draft extradition treaties with the United States (US), Australia, and others for this purpose. Last year, over 1,000 suspects who fled abroad were returned to China and more than US dollars (USD) 519 million in ill-gotten gains recovered.9

Anti-corruption efforts have not been limited to government officials. The importance of putting in place robust compliance programmes has increased for multinational, local, private and state-owned businesses in China. This has motivated companies to look more closely at their own internal compliance procedures and facilitated the acceptance of compliance protocols by third parties, especially at state-owned enterprises (SOEs). The Compliance and Business Ethics Working Group welcomes these developments as a positive step in China’s reform process. However, uncertainty and inconsistency remain factors in law enforcement

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3 Anti-graft Watchdog Continues Corruption Clampdown, China Daily, 15th October 2017, viewed 24th April 2019, <http://www.chinadaily.com.cn/a/201710/19/W020171019a_1aD38846ae.html>


and government efforts at reform. In the case of compliance regulations, such ambiguity increases the risk of unintentional infractions and can incentivise non-compliance in businesses.

Amendments to the Anti-unfair Competition Law
After the first amendments in 2017, the second amendments to the Anti-unfair Competition Law took effect on 23rd April 2019. The new Anti-unfair Competition Law emphasises trade secret protection and enhances liabilities for unfair competition acts. The working group welcomes the revisions made to the law, including the monitoring of internet/online business behaviour, increased clarity on what constitutes commercial bribery and the introduction of severer forms of punishment.

Compliance Management Guidelines and Standards
The former General Administration of Quality Supervision, Inspection and Quarantine and the Standardisation Administration of China (SAC) published the GB/T 35770-2017 Compliance Management Systems – Guideline, which came into effect on 1st July 2018. This references international compliance standards, such as those issued by the International Organization for Standardization (ISO) and the International Electrotechnical Commission.

The Shenzhen City Government has been piloting its anti-bribery management system, which is based on the ISO 37000 since 2017. It requires the implementation of a series of measures, such as an anti-bribery policy, the appointment of someone to oversee policy compliance, the vetting and training of employees, the undertaking of risk assessments on projects and business associates, the implementation of financial and commercial controls, and the institution of reporting and investigation procedures. The creation of voluntary standards at both national and local levels shows the Chinese Government is paying more attention to corporate compliance issues.

On 2nd November 2018, the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council issued Guidelines on Compliance Management for Central State-owned Enterprises (for trial implementation). The guidelines target state-owned enterprises, and cover areas such as market transactions, environment and safety standards, product quality, employment, financial taxes, intellectual property and business partners, among others. It provides detailed advice on how to carry out compliance management.

On 26th December 2018, the National Development and Reform Commission (NDRC) together with several other authorities including the Ministry of Commerce (MOFCOM), Ministry of Foreign Affairs (MFA), People’s Bank of China (PBoC), State Administration of Foreign Exchange (SAFE), All-China Federation of Industry and Commerce (ACFIC), and SASAC, released the Guidelines for Corporate Overseas Compliance Management. This document requires Chinese enterprises and their overseas subsidiaries operating under the ‘Going Global’ strategy to establish compliance management frameworks and improve compliance operations. The guidelines aim to cultivate a business culture that values compliance and risk management.

Following the Interim Measures for the Recordation (or Confirmation) and Reporting of Outbound Investment that came into effect on 18th January 2018, on 8th April 2019, Ministry of Commerce (MOFCOM) released a call for comments on the detailed implementation rule for this law. This rule requires investors to report their compliance implementation and investment barriers of overseas enterprises every six months. This requirement signifies a more rigorously monitored implementation of compliance management of enterprises.

State Market Regulatory Administration
A consolidated state market regulator, the State Administration for Market Regulation (SAMR), was established in accordance with the institutional restructuring plan submitted by the State Council and approved by the National People’s Congress (NPC) in March 2018. Responsibilities of the administration

11 After the government restructuring in March 2018, the Administration of Quality Supervision, Inspection and Quarantine was dissolved, and its functions were merged with the newly created State Administration for Market Regulation (SAMR).
14 ‘Going Global’ refers to China’s current strategy to encourage its enterprises to invest overseas.
include comprehensive market supervision and management, market entity registration and market order maintenance. The antitrust enforcement units formerly separately incorporated within the NDRC, the State Administration for Industry and Commerce (SAIC) and the MOFCOM have been consolidated into the SAMR. Since its formation, the SAMR has brought more than 20 enforcement actions, signalling its commitment to curtail bribery, fraud and unfair competition across the country. This restructuring of the anti-bribery and anti-trust enforcement apparatus has been requested for years, and the working group hopes that with this unified and streamlined regulator, the efficiency and consistency of business compliance enforcement will increase.

Key Recommendations

1. Ensure a Uniform Approach to Anti-bribery Legislation and Enforcement that Parallels International Standards

Concern
Anti-bribery legislation in China often diverges from international standards.

Assessment
While the United Kingdom’s (UK) Bribery Act and the US’ FCPA are the most widely enforced anti-corruption laws, more and more countries are adopting their own sophisticated anti-bribery and -corruption legislation with complex compliance requirements. Facing increasingly strict regulatory requirements both at home and abroad, companies around the world are focusing more on building up their corporate compliance management capabilities.

In this context, the divergence of Chinese anti-bribery legislation from international standards adds additional strain to multinational companies’ daily activities, as globally-implemented compliance programmes need to be adapted to local circumstances. The Compliance and Business Ethics Working Group, therefore, encourages Chinese authorities to introduce and implement regulations that align with international standards. Replicating best practices laid out in foreign legislation will also contribute to the efficiency and development of international trade. A regulatory environment that is effective, predictable and transparent will promote foreign investment in China and increase trust in Chinese companies among non-Chinese parties. It will also help increase Chinese investment abroad, as Chinese companies will be more prepared to meet foreign stakeholders’ expectations.

Dialogue between Chinese and foreign anti-bribery authorities, including with actors of significant influence in different industries, can create a healthy dynamic that will contribute towards improving levels of compliance. Meeting compliance standards can become a competitive advantage for both Chinese and foreign companies alike.

Recommendations
- Refer to international standards and other jurisdictions, such as the UK’s Bribery Act and the US’ FCPA, for best practices.
- Increase cooperation and joint enforcement actions with foreign and international investigatory agencies.

2. Increase the Clarity of Anti-bribery Legislation, Including the Establishment of Clear Criteria to Determine Whether a Certain Act Constitutes an Act of Commercial Bribery or is a Legitimate Business Practice

Concern
Neither in the old Anti-unfair Competition Law issued in 1993 nor in its subsequent amendments in 2017 and 2019, did China clearly distinguish between commercial bribery and the carrying out of legitimate business. This lack of clarification has resulted in related laws and sanctions to be implemented in a non-transparent manner.

Assessment
The Compliance and Business Ethics Working Group is pleased that comprehensively advancing the rule of law in China was a central topic of the Fourth Plenum of the 18th Communist Party of China’s Central Committee and that China’s campaign against corruption has continued to advance since then. The working group acknowledges the significant efforts made by various government authorities over the years: (i) ‘commercial bribery’ was defined in the...
Section Two: Horizontal Issues

Interim Provisions on Banning Commercial Bribery; (ii) providing policy guidelines to follow in the Opinions Concerning Correctly Mastering Policy Lines in the Special Tasks for Handling Commercial Bribery Cases; (iii) what constitutes as corruption was clarified in the Interpretation of the Supreme People’s Court and the Supreme People’s Procuratorate on Several Issues Concerning the Specific Application of Law in the Handling of Criminal Cases of Offering Bribes; 16 and (iv) the scope of commercial bribery was limited in the 2017 revision to the Anti-unfair Competition Law.

The Anti-unfair Competition Law (2019 amendment) prohibits a business operator from using cash, property or other means to seek a competitive advantage by bribing any of the following entities or individuals: (i) employees of a transaction counterparty; (ii) entities or individuals entrusted by a transaction counterparty to handle any relevant affairs; or (iii) entities or individuals that use their authority or influential power to influence a transaction. The law retained the provisions permitting incentives to be provided in the form of discounts to the counterparty or commissions to the middlemen, provided that such discounts or commissions are faithfully recorded in both parties respective accounts.

The Compliance and Business Ethics Working Group acknowledges the legislature’s efforts in providing clearer guidance on the scope of commercial bribery. However, from the working group’s perspective, much still needs to be done to clarify this aspect. For example, uncertainties and ambiguities still surround certain categories of bribery under the Anti-unfair Competition Law. It remains possible that a counterparty to a transaction may be considered a bribe recipient in certain circumstances, even if the counterparty does not fall into one of the above-mentioned three categories.

Similar issues are also present in cases involving bribe recipients that are considered to have used their ‘authority’ or ‘influence’ in a transaction. There are no definitions provided in the law as to what the terms ‘authority’ or ‘influence’ entail. Variations or inconsistencies in local practices further complicate the issues, as companies operating nationwide often find they cannot accurately rely on any particular regulation or precedent. One example would be providing hospitality to employees of business partners (e.g. dealers, agents, brokers, or channel partners). While, in general, a company can provide hospitality to business partners’ employees, there is a lack of guidance in determining how to differentiate acceptable hospitality from commercial bribery. This uncertainty impairs business operators’ ability to formulate and enforce company policy against commercial bribery.

With sound and consistent law enforcement, there comes greater willingness and ability to cooperate. It still remains unclear what the rights of companies and employees are if they were to be investigated by Chinese authorities. Due process should be followed, and legal counsel should be available. Companies need to be provided with more detail on what their rights may be while under investigation for bribery in China. The working group believes it is in the interests of both the authorities and businesses under their oversight for those under investigation to receive timely access to legal representation that allows for a sufficient amount of time to respond or refute any allegations.

Recommendations

• Clarify who should be considered a recipient of a bribe, as listed in the Anti-unfair Competition Law, by utilising case studies and examples.
• Provide investigation manuals to law enforcement bodies at all levels to ensure the consistent and uniform enforcement of the law.
• Grant companies the right to legal defence in the face of corruption charges.

3. Raise Compliance Standards in Collaboration with Companies

Concern
Companies setting high compliance standards are not rewarded for their efforts.

Assessment
Currently, good corporate compliance measures or policies adopted by a company do not constitute a valid defence when a bribery issue arises. The company involved does not receive lenient treatment by the authorities and/or lower fines.

Article 7 of the Anti-unfair Competition Law states that

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an employee’s bribery activity shall be considered company activity—a form of liability known as vicarious liability—except when the company has evidence to prove the activity does not relate to the business operator’s objective of obtaining a specific business transaction or some other form of competitive advantage. A senior official from the Anti-Monopoly and Anti-unfair Competition Bureau said a company can put up a defence against vicarious liability if it can demonstrate that it has adopted proper compliance policies and measures, has implemented effective measures to supervise and control its employees’ activities and did not indulge either openly or in a disguised form in the bribery activity.  

The explanation provided by the official supports a concept widely recognised by competent foreign law enforcement bodies that the adoption of a robust compliance system is a valid defence. However, Article 7 has not incorporated this concept. As it currently stands, a company with a sound and robust internal compliance system has no legal right to assert this fact in their defence when facing charges of bribery in China.

At present, the UK Bribery Act is recognised as the gold standard in anti-bribery legislation. Under both the UK and Chinese legislation, companies can be held liable for acts perpetrated by employees. However, it is generally recognised that no regime is capable of preventing all possible instances of bribery. Therefore, UK legislation recognises the defence of adequate procedures. This means that if companies can show they took certain actions to prevent bribery by employees, they may be ‘rewarded’ with a partial or full defence. Other factors also remain relevant, such as willingness to cooperate with the authorities.

The defence of adequate procedures will depend on the circumstances of the offence, including the scale and complexity of the organisation and any risks the potential act of bribery exposed the company to. Anti-bribery procedures are expected to be proportionate to the risk.

This approach promotes greater transparency and compliance as companies are encouraged to improve their internal compliance systems. This statutory defence may also provide guidance and incentives for other companies to assess what constitutes best practices and, based on those recommendations, implement strong compliance systems. Consequently, it leads to continuous improvement by authorities, companies, their shareholders and society as a whole, contributing to a reduction in bribery risk.

The ‘adequate procedures’ concept covers the following six principles:

1) Proportionate procedures
Companies need to put in place policies and procedures which are clear, practical, accessible, effectively implemented and enforced. These measures will help to maintain an anti-bribery stance and create a corporate culture that supports it. Such procedures can address a wide range of subjects, e.g. due diligence, gifts and hospitality, different third-party relationships, the disclosure of information, whistle-blowing procedures, communication, training, and monitoring.

2) Top-level commitment/Tone from the top
Top-level management should foster a culture of integrity in which bribery is never acceptable. Management should be involved in key decisions in order for anti-bribery policies to be effective. They should also participate in explaining to staff why it is important to have clear rules on this issue and elaborating on the benefits of complying with company rules, along with how employees would be punished if they chose not to follow company policy. Furthermore, top-level management should be committed to mobilising the necessary resources on the right level and with meaningful impact to make the stated policies effective.

3) Risk assessment
Depending on the nature of its business and its size, each organisation will need to introduce a form of risk assessment, which covers bribery, in order to limit the effects of bribes and undertake precautionary measures to prevent a risk of recurrence. Such assessments should include both external risks (e.g. country, market, transaction, business opportunity and business partnerships) and internal risks (e.g. deficiencies in training, incentives, governance or financial controls).

Risk assessments will need to be carried out on a regular basis in order to keep up with the quickly changing economic environment. Accurate and

appropriate documentation on risk assessment is an important element of assessing risk and contributes to organisational transparency.

4) Due diligence
Due diligence plays an important role in mitigating the risk of bribery. This effort could encompass the selection process of third-party agents and distributors, but it would need to do so with an understanding of the risks associated with having a joint-venture partner or business. Recruitment processes may also include a form of due diligence.

5) Communication
Training increases awareness and understanding among both employees and third parties. It also provides the knowledge and skills required to apply the company’s policies and procedures in an effective manner and to deal with any compliance matters that arise. Training should meet the varied needs of a multifaceted organisation.

While internal communications should emphasise the tone handed down from the top of the organisation, external communications should reassure third parties of what the company stands for. Typically, an annual report will include a chapter on compliance. Internal communications and processes should include a whistle-blower procedure that is accessible to all employees.

6) Monitoring and review
Companies should monitor and evaluate the effectiveness of their anti-bribery policies and procedures, amending them when necessary in order to meet both internal and external demands. This monitoring can be done, for example, through staff questionnaires, compliance audits, and external verification. Peer practices can also be referred to as examples.

The Compliance and Business Ethics Working Group is pleased to see that the Chinese authorities are making efforts to promote and encourage companies to adopt internal compliance systems. The working group notes that the Shenzhen Administration for Market Supervision issued the local standard of Anti-bribery Management Systems (Shenzhen Standard) on 12th June 2017. The Shenzhen Standard references the Anti-bribery Management System (ISO 37001) and other internationally recognised best practices that include the six principles of ‘adequate procedures’. As previously mentioned, the working group also welcomes multiple compliance guidelines that have been issued by several central government agencies over the past two years.

If the Shenzhen Standard or other internationally recognised compliance policies/measures can be legally incorporated as a statutory defence for breaching Article 7 of the Anti-unfair Competition Law, this would incentivise and motivate companies to establish a robust compliance system.

Recommendations
• Consider internationally recognised best practices/compliance systems as a valid defence and allow companies to claim leniency or be exonerated from vicarious liability as a reward for establishing a strong and robust compliance system.
• Provide guidance to companies on what is meant by ‘adequate procedures’ and ‘good compliance’ through case studies and examples.
• Reinforce awareness of anti-bribery regulations within the business community and encourage all companies to adopt modern and sophisticated compliance systems and policies.
• Strengthen dialogue between business communities and governmental enforcement agencies and demonstrate companies’ efforts and practices to combat corruption and bribery.
• Modify government procurement legislation to ensure credit is given to bidders that implement effective compliance systems.

## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ACFIC</td>
<td>All-China Federation of Industry and Commerce</td>
</tr>
<tr>
<td>FCPA</td>
<td>Foreign Corrupt Practices Act</td>
</tr>
<tr>
<td>ISO</td>
<td>International Organization for Standardization</td>
</tr>
<tr>
<td>MFA</td>
<td>Ministry of Foreign Affairs</td>
</tr>
<tr>
<td>MOFCOM</td>
<td>Ministry of Commerce</td>
</tr>
<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>NPC</td>
<td>National People’s Congress</td>
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<tr>
<td>PBOC</td>
<td>People’s Bank of China</td>
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<tr>
<td>SAC</td>
<td>Standardisation Administration of China</td>
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<tr>
<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
</tr>
<tr>
<td>SAIC</td>
<td>State Administration for Industry and Commerce</td>
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<tr>
<td>SAMR</td>
<td>State Administration for Market Regulation</td>
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<tr>
<td>SASAC</td>
<td>State-owned Assets Supervision and Administration Commission</td>
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<tr>
<td>SOE</td>
<td>State-owned Enterprise</td>
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<tr>
<td>UK</td>
<td>United Kingdom</td>
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<tr>
<td>US</td>
<td>United States</td>
</tr>
<tr>
<td>USD</td>
<td>United States Dollar</td>
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</table>
Environment Working Group

Key Recommendations

1. Increase the Transparency and Predictability of Environmental Protection Enforcement, and Improve Access to Digitised Information of Relevant Environmental Regulations and Enforcement Initiatives at all Levels of Government
   • Enforce the Environmental Protection Law and related regulations in a transparent fashion.
   • Communicate environmental enforcement plans well before the winter season, and discuss with relevant industries to mitigate any potential negative impact they might have.
   • Provide full online access to environmental information including policies and standards that apply locally and nationally.
   • Agree and accept transition plans for industries/companies that are using best practices, but can only partially meet the latest environmental standards and requirements.
   • Provide clear guidance on how to avoid production disruptions due to enforcement of the Environmental Protection Law.
   • Support investment efforts of the industry to become compliant and/or go beyond existing standards by implementing the latest technology for exhaust gas cleaning and emission reduction.
   • Install direct communication channels for companies to notify central government authorities of any issues/irregularities related to ‘one-cut’ approaches or other unreasonable environmental enforcement.
   • Set up a department that guides individual companies required to close or relocate to new regions in line with the country’s industrial and urban transformation.
   • Promote further investment in clean technologies by providing tax benefits or low mortgage loans.
   • Provide structured access to digitally available environmental-related information, including policies and standards, from the national to the municipal level.

2. Promulgate Clear, Flexible and Adaptable Policies to Strengthen Sludge Management
   • Increase wastewater treatment fees so that the cost of sludge treatment can be covered.
   • Consider sludge treatment solutions during the early planning and design stages of wastewater treatment plants.
   • Localise sludge treatment solutions to suit varying local conditions.

3. Engage with the European Union (EU) to Align on Policies that Support a Transition Towards a Circular Economy and Jointly Implement Projects on ‘No Waste City’ Pilots
   • Enhance industrial players’ involvement in, and promote frequent and in-depth exchange and dialogue on, the joint Memorandum of Understanding on Circular Economy Cooperation.
   • Define an overall strategy for circular economy development, with a mid- and long-term legislation
framework, including targets and roadmaps.
• Implement a number of circular economy pilot projects, particularly with joint involvement of both Chinese and EU companies, to create a circular economy eco-system.
• Address the long-existing informal scrap recycling system to ensure that post-consumption recyclable material is of the highest possible quality and reduce secondary pollution in the current down-cycling process.
• Build new reliable infrastructure for the treatment of wet waste (anaerobic digestion).
• Develop a new policy that encourages the use small-scale digesters for commercial activities.
• Encourage the re-use of compost at the local level.
• Create better market conditions for recycled materials in China to attract more social investment in the upgrading of the sector.
• Develop national or industrial standards on recycled materials and recycling processes.
• Increase the involvement of designers and manufacturers in the circular economy value chain, so that the design of products and packaging can be optimised in line with the concept of "reduce, reuse and recycle".
• Encourage technology and innovation to better recycle not only high-value and easy-to-recycle materials such as cardboard and polyethylene terephthalate (PET), but also other materials such as polypropylene, polyethylene, polystyrene, glass, non-ferrous metals and critical mineral resources.
• Involve more foreign-invested enterprises (FIEs) in China’s recent ‘no waste city’ initiative, as the transition to a circular economy offers Chinese cities significant opportunities to create not only economic growth and innovation, but also more liveable conditions.
• Enhance China’s hazardous waste traceability system to prevent illegal treatment and allow the recycling industry to thrive, while also including products generated from hazardous waste.

4. Improve the Regulatory Framework for the Remediation of Contaminated Land, Encourage Government at all Levels to Develop Efficient and Reliable Action Plans for Soil Pollution Remediation, and Introduce Advanced Soil Pollution Processing Technology from the EU

• Adopt scientific and practical approaches for standards development in order to limit priority soil contaminants to a small group of substances, and set up reasonable environmental quality criteria for water and soil.
• Introduce specific guidelines on soil monitoring based on the potential harm of the pollution generated.
• Set comprehensive technical guidelines at the national level as soon as possible for land contamination monitoring, assessment and remediation.
• Revise and integrate existing rules and regulations related to soil contamination to comply with the principles of the newly-revised Environmental Protection Law and the Law on Soil Pollution Prevention and Control.
• Accelerate the commercialisation of the land remediation system by encouraging the formation of specialist environmental liability transfer companies with strong balance sheets, which can purchase and remediate contaminated land under government supervision and sell the land use rights later at a profit.
• Encourage the development of a pollution insurance market by government agencies at all levels.
• Introduce advanced technology from the EU to process polluted soil and contaminated land.
• Provide financial support for the development of provincial process capability, which provides an accessible solution for manufacturers.
• Increase penalties for secondary pollution during hydrocarbon-contaminated soil processing, and encourage the use of advanced process technology to ensure there are no additional emissions resulting from the decontamination process.

5. Promote Highly Efficient Energy Use, Especially for Fossil Fuels or Fuels Derived from Fossil Sources
• Generate awareness of energy efficiency especially for highly consuming industries, but for private households as well.
• Increase energy efficiency by utilising an appropriate pricing and subsidisation policy.
• Further improve standards for energy-efficient building construction.

Introduction to the Working Group

There is only one earth and it has finite resources. The negative environmental impacts that have resulted from human activities over the past hundred years have seriously threatened the global ecosystem. Thus, environmental protection should be the highest social responsibility for any organisation.

Ecological and environmental protection, particularly the prevention and control of pollution, is now a top priority in China, not only for the government, but for industries and the general public as well.

For European companies, complying with environmental protection laws and regulations is an commitment they are unwilling to compromise on. European companies in China are driven by a desire to contribute to the country’s economic development. They bring advanced manufacturing technologies with them and help to cultivate a highly competent workforce. All of these things are done with a sense of social responsibility and environmental awareness.

Established in 2006, the Environment Working Group currently consists of more than 150 member companies involved in engineering, manufacturing, construction, consultancy and certification services. Members come from a variety of industry sectors, such as waste, water, smart grids, chemicals, pharmaceuticals, petroleum, biochemistry and logistics. Environmental technology service providers, environmental consultants and lawyers are also active members of the working group.

The working group serves as a channel for government stakeholder engagement, particularly with the National Development and Reform Commission (NDRC), the Ministry of Ecology and Environment (MEE), the Ministry of Industry and Information Technology (MIIT) and the Ministry of Housing and Urban-Rural Development (MOHURD), along with local bureaus. The working group also provides regular feedback on environmental regulations, standards and technologies in China. Additionally, the working group provides a platform for companies to share best practices, experiences, solutions and recommendations on how to best protect the environment.

Recent Developments

On 19th May 2018, high-level messages were delivered by President Xi Jinping on ecological and environmental protection during a tone-setting meeting on national environmental protection in Beijing. President Xi stated that China would work towards developing an “ecological civilisation” and would channel more energy into resolving environmental issues. This commitment was reaffirmed at the annual sessions of the National People’s Congress (NPC) and Chinese People’s Political Consultative Conference held from 5th to 15th March 2019.

China has already started to carry out environmental

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1 Previously known as the Ministry of Environmental Protection (MEP). It became the MEE at the end of March 2018 following wider government restructuring.
inspections, implement new guidelines to control air, water and soil pollution, and publish its own plans for realising commitments made under the United Nations’ (UN) 2030 Agenda for Sustainable Development. In line with this new push for protecting the environment, President Xi Jinping emphasised at the tone-setting meeting on 19th May 2018 the following six principles to help China become an ecological civilisation:

- Humanity and nature must be in harmony.
- Bodies of water and mountains in China are valuable and should be protected.
- A sound ecological environment is necessary for people’s well-being.
- Mountains, rivers, forests, farmlands, lakes and grasslands are all connected.
- Protecting the environment requires streamlined institutions and a strict rule of law.
- It is important to work together on cultivating an ecological civilisation globally, to engage in global environmental governance and to work together with other countries to tackle climate change.3

To further highlight the significance of China’s environmental priorities, on 24th June 2018, the Communist Party of China (CPC) and the State Council jointly issued the Opinions on Strengthening Comprehensive Protection of the Ecology and Environment and Combating Pollution.4 A few days later, on 10th July 2018, the 13th Standing Committee of the NPC passed the Decision on Strengthening Comprehensive Protection of the Ecology and Environment and Resolutely Combating Pollution.5

European businesses in China are affected by these policies. Thus, the Environment Working Group calls for clear, transparent, consistent and predictable enforcement by the relevant government authorities at all levels on these issues. It is noteworthy that all of the aforementioned policies target pollutant discharge management, while energy efficiency or carbon dioxide (CO₂) footprints are not properly addressed.

This represents a missed opportunity for China to demonstrate its commitment to the Paris Agreement6 to mitigate greenhouse gas (GHG) emissions.

Within the past few years, China has efficiently overhauled and established a new legislative framework for environmental protection. The NPC has put in place the Environmental Protection Law (updated in 2014),7 the Law on Soil Pollution Prevention and Control (passed in 2018),8 the Law on Water Pollution Prevention and Control (updated in 2017),9 the Law on the Prevention and Control of Atmospheric Pollution (updated in 2018)10 and the Law on Solid Waste Pollution Prevention and Control (updated in 2016).11 & 12 In terms of standards, the MEE and other relevant ministries have introduced the Risk Control Standard for Soil Contamination of Agricultural Land (GB15618-2018),13 the Risk Control Standard for Soil Contamination of Development Land (GB36600-2018),14 and the Control Standards of Pollutants in Sludge for Agriculture Use (GB4284-2018).15

To implement a pollutants discharge permit system, the Administrative Measures on Pollutants Discharge Permit (Trial Implementation) and the Technical Specifications for Application and Issuance of the General Pollutants Discharge Permit Programme were released in 2018.

To realise all the targets set out in the various environmental protection policies, the public, industry associations and enterprises must all be allowed to participate. The Environment Working Group is pleased to see recent

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policy support for private investment in the environmental sector through the increase of public-private partnership (PPP) projects as stipulated in the Guiding Opinions on Encouraging the Participation of the Private Sector in PPP Projects.\textsuperscript{16} The working group believes that if these guidelines are implemented well at the local level, they will benefit China’s tendering processes by helping to eliminate any bias that may exist towards international enterprises that operate in the country. In addition, European businesses in the environmental sector believe they will benefit from the improved price mechanism as announced in the Opinions of the NDRC Concerning Innovation and the Improvement of the Price Mechanism to Facilitate Green Development.\textsuperscript{17}

During the 2019 EU-China Summit, both sides stressed the importance of showing resolve on the transition to clean energy and of assuming greater leadership on the global environmental agenda. Both sides said they will actively implement the Memorandum of Understanding (MOU) on Circular Economy\textsuperscript{18} cooperation and promote practical cooperation between industries.\textsuperscript{19} The European Commission and the NDRC also signed a MOU on the Circular Economy at the 2018 EU-China Summit on 16\textsuperscript{th} July 2018. The Environment Working Group is ready to contribute to all fields of cooperation under the MOU, not only from a technological and business perspective, but also in the design and standardisation of policy for relevant industries.

**Key Recommendations**

1. **Increase the Transparency and Predictability of Environmental Protection Enforcement, and Improve Access to Digitised Information of Relevant Environmental Regulations and Enforcement Initiatives at all Levels of Government**

   **Concern**

   In order to meet their goals, local governments often implement environmental protection initiatives in such a way that results in inconsistent and unpredictable enforcement, which can negatively impact compliant companies.

   **Assessment**

   Local government agencies are being encouraged to implement rigorous environmental protection initiatives on top of existing strict rules, regulations and standards, to meet their targets. This has resulted in stricter environmental standards for wastewater discharge and air emissions, among others. It also has resulted in environmental enforcement sometimes unexpectedly impacting companies that comply with relevant regulations because of the so-called ‘one-cut’ approach.

   To address the frequent occurrence of severely polluted air in some parts of the country, the Chinese Government has taken special measures to control emissions and curb air pollution, in an attempt to protect the health of its population. One well-known example took place in the Beijing-Tianjin-Hebei area where such a measure was applied from 1\textsuperscript{st} October 2018 until 31\textsuperscript{st} March 2019.\textsuperscript{20} The final action plan, with detailed measures, was only made available to affected industries and the public on 27\textsuperscript{th} September 2018, leaving companies almost no time to prepare. This made it hard for many companies to take technical measures to help reduce emissions; at the same time, setting production limits put these companies under enormous pressure, with some unable to deliver client orders to which they had already committed.

   From analysing the numbers on environmental inspections, the working group saw shifts in the enforcement tools being implemented, indicating that environmental enforcement is maturing. This is reflected in the nature of 2018’s inspections—labelled ‘looking back’ inspections, which focused on thoroughly addressing environmental issues and targeting companies that were inspected previously. Compared that to the previous year, 2018 saw less production restrictions (6,196 compared to 7,842) but more operational halts (19,903 compared to 16,429). There was also a lower number of administrative penalties (166,210 compared to 233,000), but they amounted to a higher total monetary value (Chinese yuan (CNY))

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\textsuperscript{16} Guiding Opinions on Encouraging the Participation of Private Section in PPP Projects, NDRC, 26\textsuperscript{th} November 2017, viewed 16\textsuperscript{th} June 2019, <http://www.ndrc.gov.cn/ztb/zdtbs201711220171130_871870.html>

\textsuperscript{17} Opinions of NDRC Concerning Innovation and Improvement on the Price Mechanism to Facilitate Green Development, NDRC, 21\textsuperscript{st} June 2018, viewed 12\textsuperscript{th} May 2019, <http://www.ndrc.gov.cn/zrbgfwj/201806/20180629_891044.html>


\textsuperscript{19} China-EU Joint Statement, NDRC, 9\textsuperscript{th} April 2019, viewed 3\textsuperscript{rd} June 2019, <http://hzs.ndrc.gov.cn/newggzt/201807/20180730_893930.html>

\textsuperscript{20} 2018-2019 Comprehensive Control & Management Plan on Beijing-Tianjin and Hebei and Surrounding Areas, MEE, 9\textsuperscript{th} August 2018, viewed 6\textsuperscript{th} May 2019, <http://www.mee.gov.cn/gkml/hbb/bwj/201708/20170824_420330.htm>
13.6 billion compared to CNY 11.58 billion).21

At the same time, many European member companies still complain that they encounter unexpected requirements to reduce environmental impacts—sometimes beyond what is realistically possible—by restricting production, in order to contribute towards improving the environment. For companies that are already operating in authorised locations such as designated industrial parks, and that comply with applicable regulations of the highest standards, this represents exactly the kind of business uncertainty they try to avoid when choosing where to invest and manufacture.

The working group realises that the Chinese Government faces the difficult task of balancing the needs of a healthy and happy community with a sustainable economy, and wishes to contribute in any reasonable way possible. Achieving balance could, for example, be done by involving affected industries in the development of industry-level action plans, in order to drive improvements that address relevant environmental challenges. In this way, all sides could evaluate and agree on the best, currently available and economical technologies and standards to reduce environmental impacts, as well as reasonable lead times for implementation. The working group believes such cooperation will allow for constructive dialogue and agreement that will drive positive environmental improvements in the shortest possible time. If improvements are needed more quickly, discussions can focus on how to finance industrial upgrades that would be of benefit to both society and industry.

The working group also believes China would benefit by using online platforms to improve the transparency of environmental information. This would help companies to better assess how stricter environmental standards could affect them. They could also assess local enforcement initiatives to protect their operations against any potential ‘one-cut’ approach enforcement. This type of environmental information is currently not accessible in a structured way for companies wishing to use it for business planning purposes.

Therefore, the working group proposes speeding up the process of enforcing the Environmental Protection Law in a more accessible way, by providing structured information online on environmental regulations, standards, environmental quality data, environmental inspections and enforcement planning, as well as about industrial and urban planning (e.g. announced relocations and closures with target timelines). Such resources would improve transparency and guidance for relevant industries. The same digital platforms could be made available to facilitate communication between companies and relevant authorities, in order to address any perceived unreasonable enforcement initiatives, including ‘one-cut’ approaches.

Recommendations

- Enforce the Environmental Protection Law and related regulations in a transparent fashion.
- Communicate environmental enforcement plans well before the winter season, and discuss how best to mitigate any potential negative impact with the relevant industries.
- Provide full online access to environmental information, including policies and standards, that are applied locally and nationally.
- Agree and accept transition plans for industries/companies that use best practices, but can only partially meet the latest environmental standards and requirements.
- Provide clear guidance on how to avoid production disruptions caused by enforcement of the Environmental Protection Law.
- Support companies’ efforts to become compliant and/or go beyond existing standards by investing in the latest technology for exhaust gas cleaning and emission reduction.
- Install direct communication channels for companies to notify central government authorities of any issues/irregularities related to ‘one-cut’ approaches or other unreasonable environmental enforcement.
- Set up a department to guide individual companies required to close or relocate to new regions in line with the country’s industrial and urban transformation.
- Promote further investment in clean technologies by providing tax benefits or low mortgage loans.
- Provide structured access to digitally available environmental-related information, including policies and standards, from the national to the municipal level.

2. Promulgate Clear, Flexible and Adaptable Policies to Strengthen Sludge Management

Concern
Despite some progress in China’s water management market over the past decade, sludge disposal remains a major issue due to management loopholes.

Assessment
Municipal wastewater treatment is one of the most mature sectors of China’s water industry. According to the Notification of the Full Implementation of PPPs of Government Wastewater and Waste Treatment Projects, launched by the Ministry of Finance and the MEE in July 2017, all new wastewater and waste treatment plants should be operated under the PPP model.

Sludge, a by-product of wastewater treatment, can cause secondary pollution if not properly treated. In urban areas (including cities and counties, but excluding administrative towns) in 2017, 55.6 billion out of 59.3 billion cubic metres (m³) of effluents were treated. This was a treatment rate of 93.8 per cent, an increase of 1.3 per cent from 2016. Of this, 47.1 billion m³ out of 49.8 billion m³ of effluents were treated in cities, with the treatment rate hitting 94.7 per cent; while in counties 8.6 billion m³ out of 9.6 billion m³ of effluents were treated, a treatment rate of 89.3 per cent. Based on these figures, 32.57 million metric tonnes of wet sludge were produced in 2017. However, several experts have expressed doubts over this number, believing that the actual number is lower – one Chinese environmental industrial institute estimates that the treatment number in 2017 was in fact 52 per cent of the total sludge produced.

Low fees being earned in the treatment of wastewater is one of the major reasons for the current low sludge treatment rate. In China, there is no standard fee for sludge treatment; instead, it is combined in a total package fee for wastewater treatment, which is paid regularly by the government to wastewater facility operators. According to the Regulations on Urban Drainage and Wastewater Treatment, published by the State Council in 2013, wastewater treatment fees should be exclusively spent on facility construction, operation and sludge treatment. The Opinions on Innovating and Promoting a Price System of Green Development, released by the National Development and Reform Commission in June 2018, states that a flexible price system should be developed for urban wastewater treatment, and that the price should be enough to cover treatment costs of both wastewater and sludge. Yet in reality, the wastewater treatment fee is barely enough to cover the cost of just the wastewater service, let alone the expense of sludge treatment. In some cases, the government has postponed the payment of this fee.

Sludge treatment solutions can vary from place to place. A single unified solution that neglects local conditions may lead to non-optimal sludge disposal. For example, in some heavily populated cities in China, it may be more economical to treat sludge in a central facility. In other less-populated areas, decentralised solutions are likely to be more beneficial. Whatever the final solution, it is important for local conditions to be considered in regard to sludge treatment in the early stages of facility planning.

Recommendations
• Increase wastewater treatment fees so that the cost of sludge treatment can be covered.
• Consider sludge treatment solutions during the early planning and design stages of wastewater treatment plants.
• Localise sludge treatment solutions to suit different local conditions.

3. Engage with the European Union (EU) to Align on Policies that Support a Transition Towards a Circular Economy and Jointly Implement Projects on ‘No Waste City’ Pilots

Concern
Although China has long been a frontrunner in resource recycling practices and has shown ambition to develop a circular economy, institutional arrangements are weak

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23 Ibid, p.28.
24 Ibid, p.29.
and there is no holistic strategy or management system, meaning that implementation of waste classification polices in certain cities may be hindered.

**Assessment**

Having a circular economy refers to an industrial economy that is, by design or intention, restorative, and one in which resources are managed in a regenerative way. Transition towards a circular economy will foster sustainable economic growth, improve ecological development and generate green jobs.

The successful implementation of a circular economy needs a holistic design and overarching policy approach. It also needs a concrete and ambitious programme of action, with measures covering the whole cycle: from design, production and consumption to waste management and the market for secondary raw materials, including an overall legislative proposal on waste.

On 2nd December 2015, the European Commission adopted an ambitious circular economy package, creating a comprehensive framework that will truly enable the transition from linear economies. The EU has since delivered on almost all 54 actions under the plan, leading the way as a trail blazer for the rest of the world. On 17th July 2018, China and the EU signed a MOU on Circular Economy Cooperation, demonstrating that the world’s two largest economies stand to gain from aligning policies that can help establish global standards for the treatment and use of waste materials. Under the MOU, the two sides agreed to establish a high priority dialogue on the circular economy to be led by high-level officials. It will feature activities such as cooperation on information exchange and research, capacity-building, training programmes, workshops and personal exchanges, with broad participation by relevant stakeholders.

It is important to acknowledge that the EU's achievements in this area during the past three years would not have been possible without a comprehensive circular economy action plan. Whereas China now has many initiatives in areas such as industrial symbiosis, urban mining, resource recycling and utilisation and municipal waste separation, these efforts are led by different ministries without overall coordination. The working group therefore recommends that China’s central government initiate an overall strategy for circular economy development, with a clearly defined mid- and long-term legislation framework, including targets and roadmaps. This will build the foundation for more effective EU-China dialogue and cooperation. In addition, the working group suggests China consider implementing a few circular economy pilot projects under the PPP model, particularly with the joint involvement of both Chinese and EU companies, thereby also creating a circular economy eco-system.

Plastic waste is one of the key issues circular economies aim to address, and the European Strategy for Plastics in a Circular Economy is the first policy framework adopting a material-specific life cycle approach. China similarly sees plastic waste as one of the most pressing environmental, climate and economic challenges; however it currently lacks a clear strategy for addressing the whole value chain. China has a functioning plastic recycling industry, consisting of a long-existing informal scrap collecting and processing system. However, the industry is not well regulated and, in many cases, leads to secondary pollution and avoidable down-cycling. From a circular economy point of view, processes like collection and segregation of plastics are the most important phases, since the quality of the input determines the quality of the output. For single-use plastic packaging, a deposit and return system—especially on beverage packaging—is a proven mechanism for delivering a high collection rate and high-quality material recovery. It provides accurate data to all stakeholders on the value chain, therefore creating a stable demand-supply relationship as well as transparency that can help the government improve policy. Moreover, the mechanism brings new job opportunities, meaning that unofficial or part-time collectors can be offered better working conditions.

The circular economy is not only about recycling; its success also depends on the use of recycled raw materials and products. To eventually achieve a closed loop, it needs a proven business case for the trade of recycled content to production markets, which have high demands on the quality of materials. This could mean that some types of plastic products will be banned,

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because if a replacement material is available it would be difficult to justify an economic case for recycling. But more importantly, the market for recycled plastics will need to be better regulated and enlarged, and an increasing number of products will have to be made of recycled materials. China must form relevant policies and national or industrial standards on areas such as recycled materials and recycling processes.

Better design is also key to facilitating the concept of ‘reduce, reuse and recycle’ (3Rs), therefore incentives should be provided to support the development of more eco-friendly designs. Requirements on producers to make products that have longer durability, and are easier to repair, reuse or recycle should be set and enforced. The Extended Producer Responsibility (EPR) policy approach should be adopted, in which producers pay different financial contributions to the scheme based on the end-of-life-costs of their products. This would help create economic incentives for the design of products that can be more easily recycled or reused.

Currently, the circular economy models for some ‘high value’ and ‘easy-to-recycle’ materials such as cardboard, metal and polyethylene terephthalate (PET) plastic are better established, because the collection and recycling value chain is more mature. But there are many other waste materials—such as polyolefins, glass and ceramics—which are not only high in volume, but also in material value. Technology and business model innovation should be encouraged to turn this waste into resources.

In January 2019, China’s State Council issued a work plan for ‘no-waste cities’ pilots. Through this project, China aims to promote green lifestyles, minimise the amount of waste produced, strengthen recycling programmes and ensure that any waste released into the environment is harmless. This has a strong correlation with the circular economy, in that both promote a resource-saving and environmentally friendly consumption model. In the EU, many countries have several years’ practice of building zero-waste cities, meaning there is vast amounts of experience to be shared. Therefore, the working group recommends that the EU-China MOU on Circular Economy Cooperation be expanded to include cooperation on ‘no-waste cities’ pilots, and that EU cities and enterprises be encouraged to jointly work with their Chinese counterparts on these projects.

The government should also enhance China’s hazardous waste traceability system to prevent illegal treatment, which in turn will allow the recycling industry to thrive, while also including products generated from hazardous waste. A specific permit system for industrial companies using recycled hazardous waste could be implemented, to ensure any such company can only accept a defined range of recycled waste, and that it has adequate facilities to do so safely and with controlled environmental impacts.

**Recommendations**

- Enhance industrial players’ involvement in, and promote frequent and in-depth exchange and dialogue on, the joint MOU on Circular Economy Cooperation.
- Define an overall strategy for circular economy development, with a mid-and long-term legislation framework, including targets and roadmaps.
- Implement a number of circular economy pilot projects, particularly with joint involvement of both Chinese and EU companies, to create a circular economy ecosystem.
- Address the long-existing informal scrap recycling system, to ensure post-consumption recyclable material is the highest possible quality and to reduce secondary pollution in the current down-cycling process.
- Build new reliable infrastructure for the treatment of wet waste (anaerobic digestion).
- Develop a new policy that encourages the use of small-scale digesters for commercial activities.
- Encourage the re-use of compost at the local level.
- Create better market conditions for recycled materials in China to attract more social investment in upgrading the sector.
- Develop national or industrial standards on recycled materials and recycling processes.
- Increase the involvement of designers and manufacturers in the circular economy value chain, so that the design of products and packaging can be optimised in line with the concept of ‘reduce, reuse and recycle’.
- Encourage technology and innovation to better recycle not only high-value and easy-to-recycle materials such

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as cardboard and PET, but also other materials such as polypropylene, polyethylene, polystyrene, glass, non-ferrous metals and critical mineral resources.

- Involve more FIEs in China’s ‘no-waste city’ initiative, as the transition to a circular economy offers Chinese cities significant opportunities to create not only economic growth and innovation, but also better living conditions.
- Enhance China’s hazardous waste traceability system to prevent illegal treatment and allow the recycling industry to thrive, while also including products generated from hazardous waste.

4. Improve the Regulatory Framework for the Remediation of Contaminated Land, Encourage Government at all Levels to Develop Efficient and Reliable Action Plans for Soil Pollution Remediation, and Introduce Advanced Soil Pollution Processing Technology from the EU

Concern
Unclear remediation guidelines, coupled with strict remediation targets, can ultimately hinder regulatory modernisation, advances in industry technology and opportunities for solution providers.

Assessment
Within the past few years, China has efficiently overhauled and established a new legislative framework for environmental protection. Two lists have since been developed to prioritise the management of certain dangerous substances: the List of Toxic and Harmful Air Contaminants was released in January 2019,\(^{31}\) and the List of Toxic and Harmful Water Contaminants (first batch).\(^{32}\) Both lists define a small group of substances that are recognised globally as toxic, including cadmium, lead, mercury, hexavalent chromium and arsenic. Also in the legislative pipeline, Article 20 of the new Soil Pollution Prevention and Control Law mandates the development of a list of toxic and harmful soil contaminants for priority control; however it is important that this list should be both concise and highly specific, with science-based approaches being adopted to better determine which substances actually belong on the list.

The Soil Pollution Prevention and Control Law’s adoption of the term ‘heavy metal’ is problematic, as it is not scientifically defined and can be misleading to the public. There are many metals that pose no threat to the environment, and are indispensable in many facets of life. Any concerns should establish a clear link with dose, exposure and the bioavailability of a given substance. It would therefore be advisable to instead use the term ‘pollutants containing certain metal or metalloid elements’, which is the term used by the People’s Supreme Court and People’s Supreme Procuratorate’s Interpretation on Several Issues Concerning Applying Laws in Handling Criminal Cases in Environmental Pollution.

It is notable that the MEE has involved environmental research organisations like the Chinese Academy of Agricultural Science, the Chinese Research Academy of Environmental Science and the Nanjing Institute of Environmental Science to develop soil environmental quality standards (EQS) and work on updating the existing Water Environmental Quality Standard (GB3838-2002). This process will ensure background concentration, dose, exposure and bioavailability are all taken into account with respect to legislation and enforcement.

Recommendations
- Adopt scientific and practical approaches for standards development in order to limit priority soil contaminants to those of genuine potential harm, and set up reasonable environmental quality criteria for water and soil.
- Introduce specific guidelines on soil monitoring based on the potential harm of the pollution generated.
- Set comprehensive technical guidelines at the national level as soon as possible for land contamination monitoring, assessment and remediation.
- Revise and integrate existing rules and regulations related to soil contamination to comply with the principles of the newly-revised Environmental Protection Law and the Law on Soil Pollution Prevention and Control.
- Accelerate the commercialisation of the land remediation system by encouraging the formation of specialist environmental liability transfer companies with strong balance sheets, which can purchase and remediate contaminated land under government supervision and

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\(^{32}\) List of Toxic and Harmful Water Contaminants (First Batch), State Council, 18th December 2018, viewed 20th March 2019, <http://www.gov.cn/xinwen/2018-12/15/content_5349089.htm>
sell the land use rights later at a profit.

- Encourage the development of a pollution insurance market by government agencies at all levels.
- Introduce advanced technology from the EU to process polluted soil and contaminated land.
- Provide financial support for the development of provincial process capability, which provides an accessible solution for manufacturers.
- Increase penalties for secondary pollution during hydrocarbon-contaminated soil processing, and encourage the use of advanced process technology to ensure there are no additional emissions resulting from the decontamination process.

5. Promote Highly Efficient Energy Use, Especially for Fossil Fuels or Fuels Derived from Fossil Sources

Concern

Despite the many benefits of using energy-efficient solutions, building awareness tops neither industrial nor private agendas, and no effective incentives are in place to promote the use of these solutions.

Assessment

More efficient use of energy pays off in many ways: the reduction of exhaust gases helps to improve air quality; the reduction of waste heat radiation – a contributor to global warming; and natural resources are better conserved. However, there is currently a lack of effective incentives to promote these solutions on either an industrial or private scale.

Although China has started its battle against air pollution, there is no visible effort to tackle pollution resulting from energy generation that utilises fossil fuels. China accounts for more than 50 per cent of worldwide coal consumption. Oil is China’s second most important energy source, with 608.4 million tonnes of oil equivalent (mtoe) produced in 2017. The country accounted for 13.2 per cent of the world’s oil consumption in 2017. These two fossils fuels cover almost 80 per cent of China’s energy consumption. Increasing energy efficiency would directly translate to a reduction in coal and oil consumption and therefore immediately reduce air pollution and the emission of greenhouse gases like CO₂.

On the supply side, the Chinese Government focuses on guaranteeing sufficient heating supply and the safe operation of urban heating systems in northern areas of China during winter, without taking energy efficient requirements into account. Loss-making heating companies can even obtain heavy subsidies, meaning there are no incentives for them to employ energy-efficient solutions.

Recommendations

- Generate awareness of the need for energy efficiency, especially for highly consuming industries, but for private households as well.
- Increase energy efficiency by utilising an appropriate pricing and subsidisation policy.
- Further improve standards for energy-efficient building construction.

Abbreviations

3Rs | Reduce, Reuse, Recycle
---|---
CNY | Chinese Yuan
CO₂ | Carbon Dioxide
CPC | Communist Party of China
EPR | Extended Producer Responsibility
EQS | Environmental Quality Standards
EU | European Union
m³ | cubic meters
MEE | Ministry of Ecology and Environment
MEP | Ministry of Environmental Protection
MIIT | Ministry of Industry and Information Technology
MOHURD | Ministry of Housing and Urban-Rural Development
MOU | Memorandum of Understanding
mtoe | million tonnes of oil equivalent
NDRC | National Development and Reform Commission
NPC | National People’s Congress
PET | Polyethylene Terephthalate
PPP | Public-Private Partnership
SOE | State-Owned Enterprise
UN | United Nations

Key Recommendations

1. Take Alternative Measures to Further Attract Foreign Investment into China
   - Allow companies in China to file corporate income tax returns on a consolidated, central basis.
   - Simplify the post-administration of the preferential withholding tax (WHT) deferral system for reinvestment by replacing it with a WHT exemption plus a minimum holding period requirement (for shares obtained through reinvestment).
   - Maintain non-taxable treatment under individual income tax (IIT) conditions for reimbursement of additional costs for overseas assignees (i.e., children’s education, flights home and housing).
   - Keep the preferential IIT treatment for one-off annual bonuses and equity compensations.
   - Improve European firms’ access to investment opportunities in the Greater Bay Area by implementing rules that make the IIT incentive broadly applicable to high-end talent employed by foreign entities; and minimise restrictions such as the number of applicable employees per company, job title/position, educational level and industry experience.
   - Simplify the tax treatment and payment restrictions for salary cost reimbursement for assignees by the Chinese host enterprise to the overseas home enterprise.
   - Ensure fair application of laws to both Chinese and foreign businesses, in particular social security contributions for foreign employees.

2. Clarify Regulations on Customs Valuation Rules and Transfer Pricing, and Eliminate Inconsistencies in Cross-Border Movement
   - Issue reference cases on dutiable and non-dutiable item adjustments to clarify customs valuation rules.
   - Reflect World Trade Organization (WTO) criteria on royalty payments, and consider economic and commercial arrangements for customs valuation of dutiable items.
   - Eliminate the ‘double tax’ effect of customs valuation adjustments for non-trade payment related items.
   - Harmonise the transfer pricing (TP) evaluation approach adopted by the customs and the tax authorities.
   - Issue clear State Administration of Foreign Exchange (SAFE) rules and enable TP adjustments between local and overseas firms, including pay-in and pay-out.

3. Further the Implementation of Value-Added Tax (VAT) Reform
   - Align Chinese VAT place of supply rules with the destination principle; and provide clearer guidance and issue reference cases on the concept of ‘fully consumed outside China’.
   - Expand the scope of zero-rating and ease administrative requirements for application.
   - Upgrade the export refund system and adapt it to current regulatory requirements.
   - Provide zero-rating for extra-territorial financial services.
   - Provide a unified tax standard to avoid irrecoverable VAT on overseas warranty claims.
   - Carry back/forward trading losses of financial products indefinitely, rather than simply forward
within the same calendar year.

- Expedite the reform and implementation of the electronic special VAT invoice system through pilot programmes in specific cities/industries.
- Allow taxpayers to claim the input VAT incurred on loan interest, as loan interest is a business-related expense, too.
- Allow qualified service agencies to issue special VAT invoices on specific passenger transportation to mitigate taxpayer administrative efforts on passenger itinerary management.

4. Take Prudent Steps in Consumption Tax Reform

- Align the taxation point with the consumption of refined oil products (ROPs) by end-users and move the taxation point to the end of supply chain (i.e., retail point of sale).
- Involve experts in discussions on standards and measurements (e.g., consumption tax rate, tax production stage or retail stage) in line with the development status of specific industries.
- Implement a unified direct exemption treatment for all ROP (including naphtha) purchases as feedstock to produce chemical products without restrictions, regardless of source (domestic or import).
- Update the taxation method based on international best practices on taxpayers, tax basis, tax collection channels and credit mechanisms.

5. Release the Potential of Research and Development (R&D) and Innovation

- Grant preferential tax policies to European companies that transfer the use right of core intellectual property rights (IPR) to local firms.
- Encourage entrusted R&D activities by granting corporate income tax (CIT) incentives.
- Expand the scope of R&D expense super deduction to include contract R&D service providers to overseas entrusting parties.

6. Modernise Tax Rules for Corporate Reorganisations

- Allow preferential tax treatment for direct and indirect share transfers for situations in which the shareholder chain of a Chinese subsidiary is shortened rather than prolonged, to facilitate legal reorganisation within European companies.
- Clarify and expand the scope of commercially driven reorganisations by providing further clarification on what is covered by preferential tax treatment; expand the tax neutral reorganisation rules to Chinese transfers triggered by commercially driven reorganisations overseas (e.g., overseas mergers resulting in share transfers within China).
- Guide tax authorities and companies on how to assess "reasonable commercial purpose" for reorganisations under special tax treatment; and provide clearer guidance on the substantive business requirements with regard to an overseas company’s beneficial ownership status so as to increase planning security for enterprises undergoing reorganisation.
- Provide guidance on how capital gains under an indirect share transfer lead to a stepped-up tax value of the shares in the hands of the transferee in order to avoid multiple taxations for indirect share transfers.
- Increase planning security for indirect share transfers by providing guidance on how to derive the capital gain relevant for China from the overall transaction price.
- Reconsider the “100 per cent ownership requirement” when taking a look-through approach to determine the beneficial owner (as per Announcement [2018] No. 9), and replace it with a regulation that considers joint ventures and minority shareholders.
Introduction to the Working Group

Taxes, customs and levies are the essential tools of governments looking to finance national needs, administrative functions and public expenditures. Societies without functional financial systems cannot adequately cater to their citizens’ needs and thus struggle to fund public services. As well as citizens’ willingness to pay taxes, public entities that are efficient, transparent, and non-corrupt are critical to enabling steady fiscal revenue streams.

Businesses in China, including foreign firms, contribute to public development by paying taxes. Their investment decisions are less influenced by favourable tax policies and more by open, competitive landscapes, as well as by efficient regulations.

The Finance and Taxation Working Group consists of member companies that range from multinational corporations (MNCs) to law firms with operations in China. The goal of the working group is to engage in an effective dialogue with regulators so as to develop an integrated set of taxation, finance and accounting rules in line with international best practices. The working group’s recommendations are not sector specific but rather represent the interests of all European Chamber member companies.

Recent Developments

The working group appreciates efforts made by the Chinese authorities in promulgating new regulations and reinforcing the existing tax administration. These efforts were also reflected in the World Bank’s Doing Business 2019 report, which places China among 2019’s top ten improved global economies. However, China still ranks 114th in the world for ease of paying taxes. In this regard, the 2018 Individual Income Tax (IIT) reform introduced important changes to finance and taxation regulations; the working group welcomes reforms that align with international standards, yet remains concerned over the removal of itemised personal deductions, which may impact the ability of European firms to attract and retain high-level talent in China, as well as changes that may increase administrative burdens.

In March 2019, the State Council announced widespread reductions to value-added tax (VAT) rates. These included reductions from 16 per cent to 13 per cent in mining and manufacturing; from 10 per cent to nine per cent in sectors such as transport, agroforestry, real estate, utilities and communications; and from six per cent to zero in the financial services sector. While the working group welcomes such measures, much remains to be done to align China with the Organisation for Economic Development’s (OECD’s) VAT guidelines, and to benefit both local and international companies operating in the country.

Key Recommendations

1. Take Alternative Measures to Further Attract Foreign Investment into China

Concern

Further efforts are required to boost the attractiveness of China’s tax system and to facilitate long-term retention of foreign talent by European companies.

Assessment

Many European investors operate multiple legal entities across China. This enables them to serve different markets, but also increases complexities in administrative work, as foreign investors are required to produce separate tax filings and comply with transfer pricing monitoring by tax authorities. The ability to file corporate income tax (CIT) returns on a consolidated, central basis, subject to certain preconditions (e.g., 100 per cent direct or indirect shareholding by the ultimate holding company) would significantly benefit these firms.

To encourage foreign investment in China, Caishui [2017] No. 88, later replaced by Caishui [2018] No. 102 introduced a preferential deferral system for dividend withholding tax (WHT) for cases in which the dividend is directly invested into investment projects in China.

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To encourage foreign investment in China, Caishui [2017] No. 88, later replaced by Caishui [2018] No. 102 introduced a preferential deferral system for dividend withholding tax (WHT) for cases in which the dividend is directly invested into investment projects in China.
Because the period between investment and disposal can span several decades, European investors find it administratively complex to keep track of the deferred WHT, and run the risk of late payment. Replacing the post-administration of the preferential WHT deferral system with a combination of: 1) a WHT exemption; and 2) a requirement for a minimum holding period for the shares obtained through the re-investment, similar to Caishui [2009] No. 59 regulations, would simplify the process.

Another key factor in attracting foreign investment is talent retention. Many European investors assign highly qualified foreign employees to China to upgrade their business operations, and are hence willing to grant assignees notable cost reimbursements. Subject to limitations, foreign employees now enjoy non-taxable treatment for certain cost reimbursements, such as children’s education and housing rental. As per Caishui [2018] No. 164, such cost reimbursements are to become taxable from 2022; this will bring foreign hires extra costs that are likely to deter them from moving, and contributing, to China. Likewise, the preferential tax treatments for annual bonuses and equity compensations, which have long been used to mitigate tax progression for high income earners, are to be abolished by 2022. These changes stand to reduce China’s tax competitiveness and will impact both foreign and Chinese talent.

To date, relatively high IIT rates have made it difficult for China to attract high-value foreign investment, as firms often choose lower tax jurisdictions like Hong Kong or Singapore for their regional headquarter operations. The working group welcomes the government’s consideration of the issue through the promulgation of a new preferential policy that reduces IIT rates for foreign, high-end talent in the Greater Bay Area (GBA) to the corresponding tax rate of Hong Kong; to further attract investment in the region that the policy currently covers, authorities should facilitate implementation and apply the tax incentives on a broader basis.

Huifa [2013] No. 30 and Bulletin [2013] No. 40 allow Chinese enterprises to remit reimbursements to their overseas affiliates that relate to expatriates’ salaries, welfare and insurance costs, and travel and training expenses. In international tax practice, cost reimbursements between affiliated companies are considered a genuine measure to allocate cost to the appropriate legal entity. Since these cost reimbursements are non-service in nature, no service-type taxation should apply. In China, however, cost reimbursements are often subject to service-type tax treatment such as CIT, VAT or local surtax. Further technical guidance should therefore be provided to tax authorities on the reduction of administrative burdens and the treatment of cost reimbursements, in accordance with international tax practice.

A transparent and efficient tax environment in China would serve as an enabler for European investment, which remains a pillar of national advancement. European investors also require fair and level application of rules across all areas of business, especially in the taxation realm. More equal enforcement of existing regulations and consistent application of laws would be to the benefit of foreign and Chinese businesses alike.

Key Recommendations

- Allow companies in China to file corporate income tax returns on a consolidated, central basis.
- Simplify the post-administration of the preferential WHT deferral system for re-investment by replacing it with a WHT exemption plus a minimum holding period requirement (for shares obtained through re-investment).
- Maintain non-taxable treatment under IIT conditions for reimbursement of additional costs for overseas assignees (i.e., children’s education, flights home and housing).
- Keep existing preferential IIT treatment for one-off annual bonuses and equity compensations.
- Improve European firms’ access to investment opportunities in the Greater Bay Area by implementing rules that make the IIT incentive broadly applicable.

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to high-end talent employed by foreign entities; and minimise restrictions such as the number of applicable employees per company, job title/position, educational level and industry experience.

- Simplify the tax treatment and payment restrictions for salary cost reimbursement for assignees by the Chinese host enterprise to the overseas home enterprise.
- Ensure fair application of laws to both Chinese and foreign businesses, in particular social security contributions for foreign employees.

2. Clarify Regulations on Customs Valuation Rules and Transfer Pricing, and Eliminate Inconsistencies in Cross-Border Movement

Concern

Current General Administration of Customs (GAC) rules for customs valuation of dutiable items do not provide specific cases for guidance on implementation and inconsistent transfer pricing (TP) evaluation approaches by taxation authorities increase tax burdens on European firms.

Assessment

In December 2013, the GAC issued the Measures on Determination of Dutiable Value for Imports and Exports (Order [2013] No. 213), which sets customs valuation adjustments on royalty payments and various non-trade payments. According to Order [2013] No. 213, when customs authorities determine the dutiable value of imported goods based on transaction prices, an adjustment is made to the dutiable price by including any royalties that meet certain criteria outlined in the dutiable value. This causes both the payable import tax and the VAT to rise. As taxpayers face growing uncertainty, and disputes with the authorities increase, the working group recommends that the GAC issues a list of reference cases by which to clarify ambiguities, a practice often adopted in the European Union (EU) for technical consistency and ease of interpretation.

Order [2013] No. 213 states that any royalties paid under a licensing agreement are deemed as non-dutiable, provided that they are either: 1) not related to imported goods; or 2) do not constitute a sales condition for imported goods. The first criterion applies to any royalties that are paid on intellectual property rights (IPR) relating to imported goods. These are considered dutiable if the imported goods consist of IPR; are produced through the use of IPR; or are specifically designed to apply IPR. As for the second criterion, royalty payments are considered a precondition for the sale of imported goods, meaning that either: 1) the imported goods cannot be purchased without paying royalties; or 2) the imported goods cannot be delivered according to the terms of the contract without paying royalties.

The basis for royalty payments for multinational business around the world is derived by subtracting inter-company purchases from revenue, as royalties paid in each market are utilised toward onshore manufacturing activities. Although these criteria are generally adopted by the World Trade Organization (WTO), Chinese customs authorities have on occasion disregarded technologies purchased inter-company for onshore manufacturing and other commercial arrangements, which raises the tax burden on firms. The working group encourages the GAC to align with State Administration of Taxation (SAT) criteria on the substance of commercial arrangements for TP purposes, which would help the GAC mitigate risks caused by customs non-compliance.

In addition, European firms face barriers to adjusting the price of imported goods as Chinese customs authorities hardly ever permit it. When, in rare cases, customs authorities do authorise such an adjustment, it has no retroactive effect and leads to a mismatch in the pricing mechanism.

Some companies may turn to banks or the State Administration of Foreign Exchange (SAFE) to apply for TP compensation, but this alternative is complicated by the absence of clear SAFE rules regulating TP. Ambiguous SAFE rules, an improper TP adjustment system and a non-harmonised approach between the customs and tax authorities can cause double taxation, which significantly increases tax costs for European firms in China.

Key Recommendations

- Issue reference cases on dutiable and non-dubitable item adjustments to clarify customs valuation rules.
- Reflect WTO criteria on royalties and consider
economical and commercial arrangements for customs valuation of dutiable items.

- Eliminate the ‘double tax’ effect of customs valuation adjustments for non-trade payment-related items.
- Harmonise the TP evaluation approach adopted by the customs and tax authorities.
- Issue clear SAFE rules and enable TP adjustments between local and overseas firms, including pay-in and pay-out.

4. Further the Implementation of Value-added Tax (VAT) Reform

Concern
Although important reforms have already taken place, China’s VAT system still needs to be further amended to align with international norms.

Assessment
China’s tax system underwent a major overhaul in 2016, when VAT was implemented as the country’s single indirect tax. Overall, the VAT reform has resulted in positive outcomes for businesses in the service sector, and constitutes a valuable case study of tax implementation. Although the government has since issued several documents to clarify VAT polices—e.g., Caishui [2016] 36 (Circular 36)—foreign firms still face challenges when it comes to implementation.

Align Chinese VAT Place of Supply Rules with the Destination Principle
VAT neutrality in cross-border trade follows the destination principle laid out in OECD guidelines (i.e., taxes should be collected in the country where the service is consumed). China, however, adopts a wider definition of VAT place of supply rules: the place of supply of services is considered to be in China if either the service provider or the service recipient is located in China. While some cross-border services are zero-rated (i.e., taxpayers do not pay VAT on the services performed and are entitled to full input VAT credits for the expenses incurred), claiming zero-rating in China is a cumbersome process, with government agencies often arbitrarily denying applications. As a result, the VAT is borne by the domestic supplier, in clear violation of the destination principle.

Whereas OECD guidelines exempt exports of services in a business-to-business context so as to ensure that foreign firms do not incur irrecoverable VAT, Circular 36 provides no category of VAT exemption for financial services exports, with the exception of limited, fee-based services and financial consulting services. A financial institution located in China, therefore, is subject to Chinese VAT even though the non-resident headquarters cannot claim input VAT credits; this misalignment between China and other countries on the destination principle gives rise to double taxation, or the levying of tax by the origin country as well as by the recipient country.

Expand the Scope of Zero-Rating and Provide Clearer Guidance
Circular 36 specifies the VAT zero-rating and the VAT exemption for cross-border services. These apply when the service is consumed outside China, namely when: 1) the service recipient is located outside China; 2) the service is not related to goods or immovable properties in China; or 3) the IPR are used outside China and are not related to goods or immovable properties in China. These conditions lead to disputes between authorities and taxpayers, as it is often difficult to establish whether the service or the IPR relate to goods inside or outside China (e.g., the IPR generated by a Chinese firm for its overseas headquarters under R&D service contracts may be licensed to global companies that are present in China, too). The working group therefore recommends that a list of reference cases be provided to clarify any ambiguities.

Both the application of VAT to exported financial services and a limited VAT zero-rating concession make China’s financial services sector less competitive internationally. Expanding exemptions, enforcing the destination principle and simplifying the claiming process would enhance the competitiveness of Chinese service providers, particularly vis-à-vis jurisdictions in which exports of services enjoy zero-rating VAT refunds, such as Singapore and Australia.

Provide a Unified Tax Standard to Avoid Irrecoverable VAT on Overseas Warranty Claims
The VAT is irrecoverable not only on the export of financial services, but also on the export of warranty claims. Chinese law requires subsidiaries of European firms to arrange for their distributors to provide warranty services to end customers. Distributors, in turn, charge...
warranty costs to the Chinese subsidiaries. The Chinese entities then pass warranty-related costs on to the European companies without any margin. The VAT treatment on European firms’ compensation for warranty claims is currently uncertain, with different tax authorities applying different methods. Some tax authorities treat warranty claims as VAT-exempt commercial compensation; others treat them as consideration for warranty management services and impose a six per cent VAT; and still others treat them as consideration for repair services and levy a 13 per cent VAT. As well as the VAT not being recoverable, these clashing treatments unnecessarily complicate the tax system and impose significant tax burdens on European companies. To avoid such dissonance in practice, the working group urges authorities to issue unified application rules and to provide related application guidance.

Chinese VAT rules generally allow for a company that is engaged in multiple business segments to enjoy the corresponding VAT treatments. In practice, however, companies encounter difficulties due to inconsistent IT system requirements and restrictions by local authorities. For example, the VAT refund system only enables a taxpayer to register one type of VAT refund method (i.e., ‘VAT exempt, credit and refund’ or ‘VAT exempt and refund’). This becomes problematic because companies that simultaneously engage in export trading and offshore services need to apply for the VAT refund and VAT zero-rating through different refund methods.

**Carry Back/Forward Trading Losses of Financial Products Indefinitely**

Chinese VAT rules generally allow VAT credit balances to be carried forward for use against output VAT in future tax periods. Yet Circular 3612 limits financial services businesses to carrying forward their trading losses within the same year only; the same losses cannot be carried back to earlier tax periods. Applying more restrictive VAT rules to offset trading gains against trading losses contradicts China’s more general policies; as a result of the inability to carry back losses to earlier tax periods, financial institutions that realise a trading loss at the end of the year cannot be refunded on the VAT paid. The impermissibility of refunds is inconsistent with the principle of fiscal neutrality that underpins OECD VAT guidelines.13

** Expedite the Implementation of the Electronic Special VAT Invoice**

To meet its fiscal modernisation needs, and as per SAT Announcement [2015] No.84,14 the SAT launched the electronic general invoice for VAT, which is now issued by a new management system. This has helped create a fairer taxation environment by reducing operating costs, facilitating invoice use and saving resources. Yet a major obstacle remains in converting the transaction information printed on VAT invoices to an electronic version that is used for accounting and online VAT verification purposes of special VAT fapiao15 (fapiao issued by large taxpayers for business-to-business transactions). Overcoming this obstacle would dramatically improve efficiency and reduce taxpayers’ burden regarding special VAT invoice delivery, recognition, verification and filing. Deeper reforms to the electronic special VAT invoice would also benefit China’s booming e-commerce industry. The working group suggests it may be worthwhile to first implement the system in the e-commerce industry on a trial basis in specific cities or industries, and then extend it nationwide.

** Allow Taxpayers to Claim the Input VAT Incurred on Loan Interest**

The VAT reductions and preferential treatments implemented in April 201916 are aimed at reducing tax costs, promoting capital investment and spurring production upgrades to facilitate economic restructuring. Companies often rely on loans for R&D, and related financing costs become a significant business expense. Further expansion of VAT deductions, therefore, should include the interest as well as other expenses related to corporate loan services. This way, while the state reduces business operating costs, it also incentivises enterprises to increase production and R&D investment.

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15 A fapiao is a legal invoice issued by the SAT and provided by the seller for goods or services purchased within the country.

Allow Qualified Service Agencies to Issue Special VAT Invoices

As of April 2019, Bulletin [2019] No. 39 stipulates that the input VAT associated with passenger transportation can be deducted. However, both the collection and the handling of qualified transportation tickets with a passenger’s identity constitute a significant administrative burden. As large companies often book business travel through service agents, claiming input VAT on passenger transportation requires travel agents and taxpayers to not only collect qualified transportation tickets jointly, but to also handle special scenarios, such as changed or cancelled itineraries. High volumes of travel transactions demand considerable resources and effort; paper-ticket management, moreover, generates tremendous paper waste and runs counter to recent efforts; paper-ticket management, moreover, generates tremendous paper waste and runs counter to recent efforts to mitigate taxpayer administrative efforts on passenger transportation. As large companies often book business travel through service agents, claiming input VAT on passenger transportation requires travel agents and taxpayers to not only collect qualified transportation tickets jointly, but to also handle special scenarios, such as changed or cancelled itineraries. High volumes of travel transactions demand considerable resources and effort; paper-ticket management, moreover, generates tremendous paper waste and runs counter to recent efforts to mitigate taxpayer administrative efforts on passenger transportation.

Key Recommendations

- Align Chinese VAT place of supply rules with the destination principle; and provide clearer guidance and issue reference cases on the concept of ‘destination principle’.
- Expand the scope of zero-rating and ease administrative requirements for application.
- Upgrade the export refund system and adapt it to current regulatory requirements.
- Provide zero-rating for extra-territorial financial services.
- Provide a unified tax standard to avoid irrecoverable VAT on overseas warranty claims.
- Carry back/forward trading losses of financial products indefinitely, rather than simply forward within the same calendar year.
- Expedite the reform and implementation of the electronic special VAT invoice system through pilot programmes in specific cities/industries.
- Allow taxpayers to claim the input VAT incurred on loan interest, as loan interest is a business-related expense, too.
- Allow qualified service agencies to issue the special VAT invoice on specific passenger transportation to mitigate taxpayer administrative efforts on passenger itinerary management.

4. Take Prudent Steps in Consumption Tax Reform

Concern

Because the consumption tax regulations fail to adequately reflect China’s current economic development and consumer habits—as evidenced by the scope, tax base and tax collection channels—consumption tax reform should be accelerated.

Assessment

In 1994, a consumption tax was imposed on environmentally harmful goods, unhealthy products and luxury items. It is levied on consumer goods with high energy production costs, and is intended to help promote a sustainable economic growth model. In 2015, China announced a consumption tax on chemical-related products, such as certain types of batteries and paint, and a higher tax rate on similar products to encourage environmental protection. The working group welcomes these environmentally friendly developments, but remains concerned about efficiency and equality in the application of the revised consumption tax.

The current approach of collecting consumption tax at the production/manufacturing stage, rather than at the ultimate retail point, increases production costs, but tends to have no meaningful impact on consumer spending behaviour. Because consumers are generally unaware of the consumption tax imposed on the items they wish to buy, it is highly unlikely that they engage in a conscious evaluation when making purchase decisions. Public Notice [2012] No. 47 and Public Notice [2013] No. 50, for example, levy consumption tax on refined oil products (ROPs), which risks not only crippling the competitiveness of the petrochemical industry in China in light of how high the tax rate is (e.g., based on sales volume, the tax imposed on naphtha as of mid-2019 is Chinese yuan (CNY) 2.357 per tonne, including surcharges), but also lowering tax compliance due to raising costs. Expert involvement in the clarification of mid-2019 is Chinese yuan (CNY) 2.357 per tonne, including surcharges), but also lowering tax compliance due to raising costs. Expert involvement in the clarification of mid-2019 is Chinese yuan (CNY) 2.357 per tonne, including surcharges), but also lowering tax compliance due to raising costs.
of the principles underpinning consumption tax on ROPs is needed, since it is international practice that hydrocarbons used as feedstock in the production of petrochemical products are consumption-tax exempt. The European Energy Tax Regime, for instance, grants consumption tax exemption to hydrocarbons (including naphtha), and both the United States and Japan have similar regulations that exempt products employed in chemical production from consumption tax liabilities.

In addition, the current ‘pay-first-refund-later’ approval process for domestic and overseas ROPs’ procurement is excessively cumbersome and lengthy. Long-term pressure on liquidity increases the operating costs of taxpayers, while the ‘pay-first-refund-later’ treatment on imports, as compared to the direct exemption treatment granted to qualified domestic producers, is not conducive to a fair and open market.

Under current consumption tax rules, there exists no proper sub-code to categorise chemical products; as a result, whereas some domestically-produced chemical products are consumption-tax exempt, the same types of products imported from overseas are subject to consumption tax. This discrepancy in tax treatment affects numerous product categories, including light white oil, heat conducting oil and insulating oils. According to the prevailing consumption tax deduction policy, when taxpayers purchase taxed raw materials to be used in the continuous production of taxable finished goods, only the consumption tax paid on prescribed raw materials can be deducted in the consumption tax calculation for finished goods. Unless the raw material is on the prescribed list, the consumption tax cannot be deducted, meaning that the raw material is now subject to double consumption tax.

Clear consumption tax regulations on taxed import raw materials for commissioned processing are equally lacking; the import consumption tax cannot be deducted after the commissioned processing, which results in double consumption tax on the imported raw materials.

Key Recommendations
• Align the taxation point with the consumption of ROPs by end-users and move the taxation point to the end of supply chain (i.e., retail point of sale).
• Involve experts in discussions on standards and measurements (e.g., consumption tax rate, tax production stage or retail stage) in line with the development status of specific industries.
• Implement a unified direct exemption treatment for all ROP (including naphtha) purchases as feedstock to produce chemical products without restrictions, regardless of source (domestic or import).
• Update the taxation method based on international best practices on taxpayers, tax basis, tax collection channels and credit mechanisms.

5. Release the Potential of Research and Development (R&D) and Innovation

Concern
Creating and optimising further R&D incentives for businesses, such as the high and new technology enterprise (HNTE) status, is needed if China is to reach its goal of transforming into a global innovation hub.

Assessment
Since the implementation of the 2008 Corporate Income Tax Law,22 the Chinese Government has launched several preferential tax policies to encourage the development of HNTEs. These policies have reduced tax burdens and improved market competitiveness by allowing CIT super deduction of R&D expenses. However, this only applies to the engaging party, not to the R&D service provider in cases of a contract R&D model. R&D entities of foreign multinational corporations in China that generally perform contract R&D services for the overseas headquarters are thus unlikely to benefit from said deductions. Entities established by foreign companies may have only obtained the right to use core technologies through licensing agreements with their parent company. Foreign companies also grant licences to non-affiliated Chinese companies, which enable the latter to use advanced world-class technology and reduce the environmental impact. To optimise supply chains and global industrial production, companies should be allowed to manage their core IPR in a flexible and economical manner, such as through non-exclusive licences.

R&D activities generate employment opportunities for Chinese scientists and engineers. Furthermore, funds used in R&D projects, which are primarily provided by overseas entrusting companies, cut costs for local enterprises and relieve financial pressure. CIT

incentives for overseas firms developing R&D activities in China would therefore further boost innovation.

**Key Recommendations**

- Grant preferential tax policies to European companies that transfer the use right of core IPR to local firms.
- Encourage entrusted R&D activities by granting CIT incentives.
- Expand the scope of R&D expense super deduction to include contract R&D services provided to overseas entrusting parties.

**6. Modernise Tax Rules for Corporate Reorganisations**

**Concern**

Although China has a broad framework of rules regarding corporate reorganisations such as mergers, splits and transfers, certain rules are too restrictive for foreign investors and do not facilitate reorganisations that are commercially necessary.

**Assessment**

Both the Notice on Enterprise Income Tax Treatment of Enterprise Reorganisation (Caishui [2009] No. 59), released by the MOF, and the SAT’s Announcement Regarding Certain Corporate Income Tax Matters on Indirect Transfer of Properties by Non-tax Resident Enterprises (Public Notice [2015] No. 7) allow for transfers in return for equity compensation (share swap) as a preferential form of tax neutral reorganisation of a company’s shareholding. This share swap works well in situations in which the shareholder chain of Chinese subsidiaries needs to be prolonged (e.g., an upward share transfer from subsidiary to the parent company; or an additional shareholder joining the shareholder chain). However, no specific regulation is available in China to allow a shortening of the shareholder chain for sound commercial reason (i.e., the removal of a single shareholder from a group of stakeholders which otherwise stays the same). This limitation poses challenges for foreign investors, especially when acquisitions must be integrated into existing legal structures.

**SAT Public Notice [2015] No. 7** provides regulations for cases in which an ‘indirect transfer’ of shares in a Chinese enterprise is regarded as taxable transfer, yet no guidance is offered on how the Chinese capital gains taxation would result in an increased acquisition cost for the transferee. This could lead to double taxation of the same capital gain within a subsequent direct or indirect transfer.

**SAT Public Notice [2015] No. 7** also provides no guidance on how a deemed TP shall be derived in cases of a taxable ‘indirect transfer’ of shares in a Chinese enterprise that only agreed upon a single price for the complete transfer package. Potential conflicts may arise between a separate hypothetical valuation for the Chinese enterprise based on discounted cash flow methods, and the agreed overall third-party purchase price, which may lead to additional negotiations.

For dividend distributions under the preferential WHT rate of the double-tax treaty, **SAT Public Notice [2018] No. 9** requires a 100 per cent direct or indirect shareholding requirement to allow for look through to a shareholder with beneficial owner status. This

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26 Subject to preconditions, the look-through approach allows dividend recipients to leverage the beneficial ownership (BO) status of a parent company where the latter fails to qualify for BO status by its own means.
Key Recommendations

- Allow preferential tax treatment for direct and indirect share transfers for situations in which the shareholder chain of a Chinese subsidiary is shortened rather than prolonged, to facilitate legal reorganisation within European companies.
- Clarify and expand the scope of commercially driven reorganisations by providing further clarification on what is covered by preferential tax treatment; expand the tax neutral reorganisation rules to Chinese transfers triggered by commercially driven reorganisations overseas (e.g., overseas mergers resulting in share transfers within China).
- Guide tax authorities and companies on how to assess “reasonable commercial purpose” for reorganisations under special tax treatment; and provide clearer guidance on the substantive business requirements with regard to an overseas company’s beneficial ownership status so as to increase planning security for enterprises undergoing reorganisation.
- Provide guidance on how capital gains under an indirect share transfer lead to a stepped-up tax value of the shares in the hands of the transferee in order to avoid multiple taxations.
- Increase planning security for indirect share transfers by providing guidance on how to derive the capital gain relevant for China from the overall transaction price.
- Reconsider the ‘100 per cent ownership requirement’ when taking a look-through approach to determine the beneficial owner (as per Announcement [2018] No. 9), and replace it with a regulation that considers joint ventures and minority shareholders.

Abbreviations

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>BO</td>
<td>Beneficial Ownership</td>
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<td>CIT</td>
<td>Corporate Income Tax</td>
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<td>CNY</td>
<td>Chinese Yuan</td>
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<td>EU</td>
<td>European Union</td>
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<td>GAC</td>
<td>General Administration of Customs</td>
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<td>GBA</td>
<td>Greater Bay Area</td>
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<td>HNTE</td>
<td>High and New Technology Enterprise</td>
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<td>IIT</td>
<td>Individual Income Tax</td>
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<tr>
<td>IPR</td>
<td>Intellectual Property Rights</td>
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<tr>
<td>MNC</td>
<td>Multinational Corporation</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>R&amp;D</td>
<td>Research and Development</td>
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<td>ROP</td>
<td>Refined Oil Products</td>
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<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
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<td>State Administration of Taxation</td>
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<td>WHT</td>
<td>Withholding Tax</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Human Resources Working Group

Key Recommendations

1. Enhance Workforce Flexibility
   - Relax the restrictions on labour dispatch to allow employers to have more employment choices based on business needs.
   - Introduce measures regulating employers’ disputes when workers are hired under part-time and full-time contracts simultaneously to protect all parties’ benefits.
   - Grant more flexibility to employers in the employment and termination processes and consistently implement this policy across China.
   - Facilitate visa renewal for foreign employees that are looking to change career paths in order to retain needed talent in China.

2. Improve Social Security Policies for Part-time Employees and Foreigners
   - Distribute social security costs equally for part-time employees working for multiple companies, according to factors such as income or time spent with each company.
   - Adjust policies on unemployment and pension funds retrieval and deployment for foreign employees.
   - Reconsider social security as tax deductible item.

3. Simplify Visa and Work Permit Procedures and Relax Requirements on Acquiring a Visa
   - Raise the legal working age of non-A-level foreign employees that work in China to align with international standards.
   - Provide the necessary legal framework for companies to successfully recruit foreign personnel including interns, such as nationwide applicable internship visa policies.
   - Implement nationwide comprehensive and uniform work permit requirements for foreigners without university diplomas or for graduates that did not study at China-defined top overseas universities.
   - Provide information on relevant visa and work permit policies in English in a timely manner.
   - Optimise approval procedures when foreign workers change employer or are being seconded.
   - Issue regulations formulating the green card application procedures in a timely manner.

4. Support the Development of Practical Knowledge and Soft Skills in the Education System
   - Modernise curricula and teaching methodologies to reach international standards.
   - Promote more international exchanges in line with China’s goals for education and Chinese and international regional connectivity strategies.
   - Facilitate access to information on available government-subsidised professional skills training, self-organised training and commercial courses to increase universities and vocational centres’ collaboration with enterprises and ensure the development of highly skilled talent.
   - Provide subsidies or tax-related benefits to employers that offer project-based internship positions to university students.
5. Implement a Fairer System to Employ and Include People with Disabilities

5.1 Support Companies in their Efforts to Hire and Include Employees with Disabilities
- Establish a transparent recruitment system for people with disabilities.
- Facilitate access to proper educational and professional training for people with disabilities in order for them to be more involved in companies’ daily operations.

5.2 Improve the Transparency of the Disabled Persons’ Employment Security Fund
- Further reduce the contributions to the Fund to alleviate the burden of companies.
- Adopt a more transparent approach to the collection and use of the Fund.
- Provide financial support to companies hiring persons with disabilities.

Introduction to the Working Group

The function of human resources (HR) is to improve a company’s operations and productivity by helping the company to effectively utilise their workforce. HR departments were traditionally expected to play a facilitative role in corporate social responsibility, sustainability and workplace ethics. However, HR management’s primary role is the development of people. With the accelerating pace of technology, and changes to the socio-economic and demographic make-up of Chinese society, HR departments need to adapt faster to a dynamic work environment. The Chinese Government should strive to support companies in recruiting and retaining both domestic and international talent, as well as to provide relevant training to employees in order to better meet a company’s long-term business objectives.

The Human Resources Working Group provides a platform for exchanging information, experiences and best practices among member companies, as well as to promote awareness of HR- and labour-related issues through engaging in an open dialogue with both members and relevant Chinese authorities. The HR Working Group is currently active in Shanghai and South China (Guangzhou and Shenzhen), with fora representation in Beijing and Nanjing. The working group consists of HR professionals from European multinational corporations and small and medium-sized enterprises (SMEs) involved in a variety of industries. The working group represents European companies employing hundreds of thousands of people who contribute to social security funds and tax. The working group regularly organises events and facilitates training sessions to share with members their acquired knowledge and expertise.

Recent Developments

New Individual Income Tax Law Took Effect
The State Administration of Taxation (SAT) announced on 18th December 2018 that the Implementation Regulations of the Individual Income Tax Law of the People’s Republic of China will take effect on 1st January 2019. The new Individual Income Tax (IIT) Law takes into consideration an individual’s circumstances to a large extent by including six additional itemised deductions to taxable income. These comprise of costs for children’s education, continuing education, medical expenditure for serious illness, housing mortgage, rental and supporting elderly parents, thereby allowing employees to reduce their tax burden. The working group welcomes the introduction in the new IIT Law of measures that echo recommendations made in the Human Resources Position Paper 2018/2019 (i.e. “Adapt Social Insurance and Individual Income Tax Systems to Take into Consideration an Individual’s Circumstances”).

Updates on Foreigners’ Allowance Policy
On 27th December 2018, the State Council issued a Notice on the Convergence of Preferential Policies after the Revision of the Individual Income Tax Law. The Notice clarified that between 1st January 2019 and 31st December 2021, eligible foreigners can choose to enjoy additional itemised deduction under the new IIT Law, or continue to use the old policy – enjoy tax exemption policy on housing, language training, and children’s education allowance. The old policy will be abolished.

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from 1st January 2022. The working group is concerned that the phasing out of allowance tax exemptions for foreigners will decrease China’s capability to attract foreign high-level talent. Considering the relatively high education expenses for foreign children in different education systems from China’s, to facilitate talent attraction and retention, the working group recommends maintaining the non-taxable treatment under the old IIT conditions for reimbursement of additional costs for overseas assignees (i.e., children’s education, flights home and housing). For further analysis, see Key Recommendation 1 in the Finance and Taxation Position Paper.

Notice on Reducing Social Security Payment Rate
On 1st April 2019, the State Council released a notice on reducing social security payment rates, which took effect a month later. This measure aims to reduce company’s social security payment burden, especially for SMEs. The working group is pleased to see this measure and looks forward to its full and smooth implementation.

Change of Social Security Collection and Management Authority
From 1st January 2019, the social security collection and management authority has changed from the Ministry of Human Resources and Social Security (MOHRSS) to the SAT, in one of the key reforms of the state and local taxation system. The working group hopes the reform will help reduce companies’ tax burden and bring in real benefits.

Key Recommendations

1. Enhance Workforce Flexibility

Concern
The current Labour Law (issued in 1994 and most recently amended in 2018) and Labour Contract Law (implemented as of 2008) do not give clear guidelines and regulations on hiring employees in a flexible way capable of meeting companies’ needs in a dynamic market environment, which increases operation costs and slows down companies’ development.

Assessment
According to the European Business in China Business Confidence Survey 2019, respondents consider rising labour costs as the top HR challenge for European companies in China. Outsourcing labour would be an effective solution to this issue. However, current policies regulating labour dispatch impose a limit of 10 per cent of the total workforce, making labour outsourcing a difficult resource to rely on.

Although current regulations do not forbid employees to sign full-time and part-time contracts at the same time, there is a lack of a legal framework regulating disputes between employers in this context. Introducing such measures would protect all parties’ rights and allow higher work flexibility for both employers and employees.

In order to safeguard employees’ interests, the current Labour Contract Law sets stringent rules regarding contract termination by the employer. When a fixed-term contract is renewed for a second time, both parties shall sign an open-term labour contract unless the employee request to sign a fixed-term one. Termination of this contract presents several legal and financial risks under the current regulation. Also, the implementation by authorities of these rules is inconsistent across China, causing unfairness in the labour market. For these reasons, the working group sees the need to ease current policies regulating employee dismissal to lower employment costs and raise employment rates, so that companies can react to changes in the market more efficiently.

The working group notes a severe lack of flexibility for foreign workforce employment. The strict requirements

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of the flexible working hour system application imposed by the labour authority leads to a lengthy and difficult approval process. Furthermore, working group members report that foreign employees exploring job opportunities outside of their current area of expertise encounter difficulties in renewing their visas, while they do not face obstacles when looking for positions that require the same hard skills as their previous occupation. This demonstrates that hard skills are still much more valued than soft skills in China. However, the Preparing for the Future of Work report, conducted by the World Economic Forum, found that skills related to cognitive ability, such as critical thinking and problem-solving, will be amongst the most in demand by 2020. Also, research shows that going after a goal that is highly interesting for an individual dramatically increases their chances of success and performance in that field. Therefore, helping talented workers to pursue a career that appeals to them, even if it is not consistent with their previous experience, will be beneficial for companies and the economy as a whole.

**Recommendations**

- Relax the restrictions on labour dispatch to allow employers to have more employment choices based on business needs.
- Introduce measures regulating employers’ disputes when workers are hired under part-time and full-time contracts simultaneously to protect all parties’ benefits.
- Grant more flexibility to employers in the employment and termination processes and consistently implement this policy across China.
- Facilitate visa renewal for foreign employees that are looking to change career paths in order to retain needed talent in China.

2. Improve Social Security Policies for Part-time Employees and Foreigners

**Concern**

The current social security policies for part-time and foreign employees are not adequately or fairly regulated, resulting in financial burdens for both employers and employees.

**Assessment**

The new IIT Law effective as of 1st January 2019 has to a large extent taken into consideration the employee’s personal and familial background, which is a significant improvement to ensure fairness and reduce tax burdens for both employees and companies. However, the legal framework for part-time employees still needs improvement. Although part-time employees working for multiple companies are also subject to social security under the current law, their social security costs are not fairly distributed among employers. Only one of the employers covers the employee’s social insurance. Therefore, in an attempt to ease the regulatory burden, especially on SMEs, changes must be made to distribute costs among employers, based on the amount of time spent at the company.

Foreign employees are also required to pay for unemployment and pension insurance. However, current policies in many cases do not allow for retired or unemployed foreigners to reside in China. While bilateral agreements between China and several European countries regulate pension and unemployment insurance, a large portion of foreign employees do not benefit. The working group suggests that the MOHRSS adjust the system for retrieval of unemployment and pension funds. When retrieval is not possible, it is recommended to put in place regulations allowing foreigners to stay in China for a period of time that corresponds to the amount of funds deposited. This would allow foreigners to look for new employment opportunities, while putting their funds to use. It is in China’s interest to retain top foreign talent by helping them to be more flexible in their professional life.

For all the time foreigners stay in China, the employer as well as the employee are liable for contributing to social security; however, according to the new IIT Law, social security costs become a non-deductible item, which causes an increase in tax.

**Recommendations**

- Distribute social security costs equally for part-time employees working for multiple companies, according to factors such as income or time spent.

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11 Grit: Psychologist, Author Angela Duckworth Explains the Science Behind Success, Elon University, 5th April 2018, viewed 8th May 2019, [https://www.elon.edu/e-net/Article/160637](https://www.elon.edu/e-net/Article/160637)


with each company.

- Adjust policies on unemployment and pension funds retrieval and deployment for foreign employees.
- Reconsider social security as a tax-deductible item.

3. Simplify Visa and Work Permit Procedures and Relax Requirements on Acquiring a Visa

Concern
With the adoption of the foreigners’ work permit (FWP) system, the application requirements are more complex for non-A-level talent, which constitute the majority of foreigners working in China and continue to be also very much needed by foreign and local companies.

Assessment
The FWP came into force on 1st April 2017. As a result, a unified application system for foreigners applying for work permits in China has been implemented. This system grades foreign workers on an ‘ABC’ scale based on their qualifications. Higher-level talent that obtains A-level status can enjoy more benefits from the new work permit system, such as not being subject to limitations on age, educational background or work experience. Unfortunately, these benefits do not apply to most foreigners, who also contribute to China’s growth and need more convenience in their visa application process. Furthermore, the FWP system needs to be further developed so it is more convenient and efficient.

Working Age
The working group notes that under the FWP system, the upper working age limit for non-A-level talent is 60. However, the average retirement age in most EU countries is 65. This means that experienced employees who are eligible to work in their home countries cannot be employed by foreign-invested enterprises in China. Senior personnel are highly valuable to enterprises since they bring high-level expertise. Due to such limitations, senior employees are not able to contribute to China’s growth. The working group notes that in Beijing the situation has improved, as non-A-level talent over 60 years of age can extend their work and residence permits. It would be appreciated if this practice could be applied nationwide.

Internship Visa
China eliminated the F-visa category for interns in 2013. This poses a challenge to companies offering young students and graduates from overseas internships in their business. Despite a series of developments in recent years to provide avenues for foreign students to take up internships in China, the scale of the policies adopted is quite limited. For example, in 2016 the French Government reached an agreement with the Chinese Government to exchange 1,000 interns each year. However, this is a limited amount and a bilateral programme. In a Shanghai policy initiative starting from 2nd May 2018, international students who graduated from domestic or overseas ‘famous’ universities can obtain a two years’ residence permit in Shanghai to be an intern or entrepreneur. In a promising development, according to policies announced by the Ministry of Public Security (MPS) in 2017, in some special areas such as Zhongguancun Science Park, the Zhangjiang National Innovation Demonstration Zone, and the Shanghai, Fujian and Guangdong Free Trade Zones, foreign university students that receive an invitation from a company can carry out internships by obtaining an S2-visa at the port of entry with an ‘internship’ note on their passport. However, the working group notes that this type of visa presents potential risks for both interns and companies, as neither receive any guarantee the prospective intern will actually be granted the visa before he or she arrives in China. Therefore, better implementation measures for the S2-visa are called for to facilitate the visa-issuing process and offer assurances to both employers and interns.

The nationwide rolling out of a risk-free S2-visa at the port of entry with an ‘internship’ note policy—providing the legal framework to guarantee before the intern arrives in China that the prospective internship will be able to take place—has the potential to facilitate connectivity and mobility among students and fresh graduates, and effectively attract and retain young talent that can contribute to China’s development.
Qualification Requirements
The FWP has set a bachelor’s degree as the educational threshold to qualify for a B-level visa. However, some EU countries have successfully adopted a dual education system for decades, combining vocational education and apprenticeship. For instance, in Germany, students enrolled in the vocational education and training system do not receive a bachelor’s degree but instead a certificate issued by the local chamber of industry and commerce. This model has proved to be very effective and has successfully filled skill-gaps in the country’s workforce. People equipped with professional skills and experience develop into high-level managers. Although the Shanghai government has made efforts in accepting certain types of vocational education certificates issued by some countries, this does not apply to many countries or in other locations.

Secondment
Furthermore, the new FWP allows foreigners to work in China by means of being seconded from their overseas headquarters, requiring the applicant to submit a secondment letter instead of a local employment contract. This policy applies in some locations, such as Beijing or Shanghai, but not in many other locations. The working group recommends that the government adopts uniform standards nationwide. The working group also notices that the government requires the secondment letter to be issued only by the shareholders of the Chinese subsidiary. This is not feasible, especially for multinational groups with complex operation systems where personnel flow among affiliates. The working group advocates allowing the secondment of personnel to China from affiliates within one company group.

Missing Official English Translations of Regulations Affecting Foreign Employees
The online Service System for Foreigners Working in China has been operating for two years already, and the website has become one of the most important platforms announcing updated policies concerning foreigners working in China. However, English versions of updates are as yet not available, which causes inconvenience for the great majority of foreigners. The working group urges the government to provide an English version of the website, including translations of relevant regulations and critical information for foreigners in a timely manner, so that the non-Chinese-speaking workforce has prompt access to them.

More Efficient Approval Procedures
The HR working group notes that the government already simplified the application procedures for foreigners’ work permits by waiving the requirements to provide invitation letters and making an effort to shorten approval procedures. However, foreigners who change employers are not able to directly transfer their work permits from the original employer to the new employer, but must go once again through the entire work permit application process, with the exception of a job change within the company group. This practice is very time-consuming and inefficient. During this period, foreigners cannot work and may have to leave China if they are unable to obtain the new work permit in time. The working group urges the government to facilitate the approval procedures for foreigners’ work permits when they change employers in China.

Green Card
Starting from 2016, the MPS has begun to issue permanent residence cards (green cards) to foreigners who have been working in China for four consecutive years and staying here for no less than six months every year, with income fulfilling the statutory standards, and who are recommended by qualified recommenders. For example, in the Shanghai Free Trade Zone, top scientific research teams are qualified to make such recommendations. Furthermore, the approval process time-length has been halved from the original six months to the current three months. However, the procedures are not transparent, as the draft Regulations on the Permanent Residence of Foreigners in the People’s Republic of China issued by the MPS on June 2016 have not yet been officially released. The working group urges the government to issue the regulations in a timely manner to formulate the green card application procedures.

19 Service System for Foreigners Working in China, SAFEA, viewed 26th June 2019, <http://fwp.safea.gov.cn/htHtmlCmsArticleDisController.do?comsArticleContentPage&artId=8b7f365b7c4632015b0b39057fbdd5a>
21 Opinion on Strengthening the Administration of Permanent Residency Services for Foreigners, State Council, 18th February 2016, viewed 26th June 2019, <http://www.gov.cn/xinwen/2016-02/18/content_5043448.htm>
Recommendations

- Raise the legal working age of non-A-level foreign employees that work in China to align with international standards.
- Provide the necessary legal framework for companies to successfully recruit foreign personnel, including interns, such as nationwide applicable internship visa policies.
- Implement nationwide comprehensive and uniform work permit requirements for foreigners without university diplomas or for graduates that did not study at China-defined top overseas universities.
- Provide information on relevant visa and work permit policies in English in a timely manner.
- Optimise approval procedures when foreign workers change employer or are being seconded.
- Issue regulations formulating the green card application procedures in a timely manner.

4. Support the Development of Practical Knowledge and Soft Skills in the Education System

Concern

One year before the expiration of China’s National Outline for Medium and Long-term Education Reform and Development (2010–2020), much still remains to be done to ensure education quality and a skilled labour force that is aligned with market demand and China’s development goals, without which companies spend large amounts of time and money on training to compensate.

Assessment

Despite initiatives such as the National Outline for Medium and Long-term Education Reform and Development (2010–2020)—aimed at modernising Chinese education and turning China into a country rich in human resources by the year 2020—curricula quality, overall preparation of academics and teachers, paperwork and bureaucracy, and access to Internet and information are not aligned with the expectations set or international standards.

This is reflected in the European Business in China Business Confidence Survey 2019, where attracting the right talent is reported as one of the top challenges for European companies doing business in China. Also, more efforts are needed to promote international people-to-people exchanges in line with China’s goals for education, as well as Chinese and international regional connectivity strategies such as the Belt and Road Initiative and the European Union strategy for connecting Europe and Asia.

In a positive development, in 2018, a national pedagogical standards system for vocational education with Chinese characteristics was created. The system encourages stronger partnerships among educational authorities, business and institutions, permitting business to play a more prominent role in vocational education by ensuring institutions stay up to date with the latest technology and processes in use, as well as indicating industry-specific skills requirements for future graduates. Additionally, enterprises are encouraged to establish professional training institutions. Under the system, training institutions are eligible to take part in government-subsidised training programmes.

However, these programmes are neither sufficient nor easy to access, mostly favouring large firms to the detriment of SMEs. Both gaining access to information on these programmes and the application procedure is complex and time-consuming, with the majority of companies not being aware of their existence.

At the same time, there remains a need for project-based internships specifically aimed at students, to ensure that internships are related to students’ major and offer appropriate training. To achieve this, the working group recommends offering subsidies or tax-related benefits to employers that provide project-based internship positions. This calls for a mechanism to be

put in place to evaluate the nature of such positions in order to direct funds to companies in a fair way.

**Recommendations**

- Modernise curricula and teaching methodologies to reach international standards.
- Promote more international exchanges in line with China's goals for education and Chinese and international regional connectivity strategies.
- Facilitate access to information on available government-subsidised professional skills training, self-organised training and commercial courses to increase universities and vocational centers' collaboration with enterprises and ensure the development of highly skilled talent.
- Provide subsidies or tax-related benefits to employers that offer project-based internship positions to university students.

### 5. Implement a Fairer System to Employ and Include People with Disabilities

#### 5.1 Support Companies in their Efforts to Hire and Include Employees with Disabilities

**Concern**

Companies are facing multiple challenges when it comes to identifying, hiring and including skilful people with disabilities in their team.

**Assessment**

Companies are confronted with a lack of effective support when it comes to hiring people with disabilities in China. In 2007, China adopted a mandatory pro rata system for hiring people with disabilities. Companies are obliged to proportionally hire people with disabilities so they make up no less than 1.5 per cent of their total staff. If they are unable to do so, companies must contribute to the Disabled Persons' Employment Security Fund (Fund). Most companies are willing to hire people with disabilities but, in reality, they find it difficult to do so.

Of the 9.4 million people certified as having disabilities in 2018, 813,000 were hired by companies that meet China's statutory hiring ratio, while the rest are either self-employed, hired by non-profit organisations, or employed by factories that are specifically designed for hiring people with disabilities. Therefore, there is still room for businesses to recruit more employees with disabilities. Although the China Disabled Persons' Federation makes efforts to maintain lists of the people with disabilities of working age, it is still very difficult for companies with the intention to hire people with disabilities to find proper candidates.

Even though some companies find relevant candidates, in many cases disabled job applicants do not have the appropriate skill set required because they were not provided with substantial professional training. In order to hire them, companies must train them. Unfortunately, the training programmes offered by the relevant disabled persons' federations are limited, and companies have to organise the training for disabled employees on their own, incurring additional costs.

**Recommendations**

- Establish a transparent recruitment system for people with disabilities.
- Facilitate access to proper educational and professional training for people with disabilities in order for them to be more involved in companies' daily operations.

#### 5.2 Improve the Transparency of the Disabled Persons' Employment Security Fund

**Concern**

It remains difficult for companies to hire the mandatory quota of people with disabilities, which leads to the obligation of making contributions to the Disabled Persons Employment Security Fund as compensation, however, companies are unaware of how the Fund is currently being used.

**Assessment**

With the issuance of the *Methods on Levyng, Use and Management of the Disabled Persons Employment Security Fund (Methods)* in September 2015, the

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35 Ibid.
Fund is now formally levied by local governments. Companies unable to hire a sufficient number of people with disabilities must make contributions to the Fund on the basis of their employees’ average annual salaries from the previous year.

The working group notes that during the Standing Committee meeting of the State Council on 4th April 2018, Premier Li Keqiang mentioned that the contribution amount to the Fund will be further reduced, with a cap of two times the average annual salary of employees from the previous year on contributions expected. Most cities implemented this policy accordingly. However, the Fund contributions still represent a considerable burden for companies. The working group advocates for the adoption of measures that would further reduce this burden. For example, in Shenzhen, the contribution basis of the Fund has been reduced to 60 per cent of the average annual salary of employees for the previous year. Furthermore, small companies with no more than 30 employees are exempted from paying contributions to the Fund.36 It is recommended that such policies be rolled out nationwide.

According to the Methods, the Fund can be used for occupational training, education or the recovery of expenses incurred from employees with disabilities. Subsidies can also be allocated to companies that hire persons with disabilities for expenses incurred from purchasing facilities, undergoing renovation work or providing other supporting services in order to meet the needs of disabled hires. The working group is eager to understand in more detail how the Fund is being collected and how it is being used. Unfortunately, no relevant public information can be found to answer these questions. Furthermore, with the exception of certain training subsidies, companies hiring persons with disabilities are unable to get financial support for facilities, renovation or other supporting services. The working group welcomes more transparency in this regard.

**Recommendations**

- Further reduce the contributions to the Fund to alleviate the cost burden for companies.
- Adopt a more transparent approach to the collection and use of the Fund.
- Provide financial support to companies hiring persons with disabilities.

**Abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>FWP</td>
<td>Foreigner’s Work Permit</td>
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<tr>
<td>HR</td>
<td>Human Resources</td>
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<tr>
<td>IIT</td>
<td>Individual Income Tax</td>
</tr>
<tr>
<td>MOHRSS</td>
<td>Ministry of Human Resources and Social Security</td>
</tr>
<tr>
<td>MPS</td>
<td>Ministry of Public Security</td>
</tr>
<tr>
<td>SAT</td>
<td>State Administration of Taxation</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium-sized Enterprise</td>
</tr>
</tbody>
</table>

Key Recommendations

1. Patents
   1.1 Introduce Patent Term Extensions to Promote Innovation
       • Introduce a mechanism that allows patent term extensions to compensate for the duration of premarket regulatory approval processes.

   1.2 Follow the ‘Three-step Approach’ to Evaluate the Inventiveness of an Invention
       • Strictly follow the ‘three-step approach’ when evaluating the inventive step to determine if there is a motivation that would prompt a person skilled in the art to apply the distinguishing feature(s) to the closest prior art and thus to reach the claimed invention.
       • Provide evidence to support the alleged common knowledge when rejecting inventions.
       • Take the ‘unexpected effect’ as one consideration but not a prerequisite for granting a patent.

2. Civil Litigation
   2.1 Expand the Scope of Written Submissions, Set Evidence Exchange Proceedings Well in Advance of Hearings and Adopt Deadlines for Judgments in Foreign-related Cases
       • Adjust civil procedures to become essentially written procedures, with a hearing to orally discuss only the main arguments and main evidence.
       • Adopt a rule that courts only have to make a decision on arguments that have been put in writing.
       • Exchange all written submissions between litigants before the hearing.
       • Introduce a formal timeline, after the hearing, to issue a judgment in foreign-related cases.

       • Ask the IP Appellate Court or IP Courts to provide ordinary courts with clear, uniform guidelines and by publishing past case decisions.
       • Consider publishing all cases in a free, online database maintained by the IP Tribunal of the Supreme People’s Court, so that best practices can be disseminated and promptly adopted.

3. Trademarks
   3.1 Create a Right to Request the Cancellation of a Trademark that Becomes Infringing after Transformation in Practical Use
       • Amend Article 49.1 of the Trademark Law so any person has the right to apply to the China National Intellectual Property Administration (CNIIPA) to cancel a registered trademark if it becomes infringing after transformation.
       • Lower the threshold for a registered trademark to sue another registered trademark, and specify that an action may be based on Article 7 of the Trademark Law.

   3.2 Allow the Applicant to Question and Reply on the Evidence Provided by the Trademark Registrant During the Revocation Examination Stage
       • Allow applicants to question and reply to the evidence provided by the trademark registrant during the revocation examination stage.
Introduction to the Working Group

Intellectual property (IP) laws protect human intellectual achievements by granting rights holders the exclusive privilege to control and obtain benefits for what they have created. Effective intellectual property rights (IPR) enforcement is crucial for innovating and competing in any market and for the facilitation of transnational partnership agreements. If there is a lack of trust in IPR protection, companies and individuals will be reluctant to introduce their most valuable IP and will not be willing to develop cutting-edge IP creations.

The Intellectual Property Rights Working Group represents a wide range of European interests in China’s IP regulatory framework and its enforcement of IPR. With a presence in Beijing, Shanghai and South China, the working group serves as a platform for
companies to share best practices on IP matters. It is a bridge between China’s IP authorities and European business, and offers support primarily through recommendations aimed at improving the efficiency and effectiveness of China’s IPR protection system.

Recent Developments

2019 Key Legislation Plan
The State Administration for Market Regulation (SAMR) put forward the 2019 Legislative Work Plan regarding the reform of IPR registration processes. According to the plan, the China National Intellectual Property Administration (CNIPA) will draft the Trademark E-application and E-sending Regulation in 2019. In order to strengthen IP protection and application, in accordance with the plan the CNIPA has already drafted the Provisions on Standardising Applications for the Registration of Trademarks and published them for public consultation on 12th February 2019, and published the Measures for the Management of Patent Agents on 4th April 2019. The Measures for the Qualification Examination for Patent Agents came into effect on 1st June 2019, and the CNIPA will further draft the Measures for the Protection of Official Marks on Record and the Interim Measures for Trademark Agency Supervision. The amendment of the Rules for the Implementation of the Patent Law is also under the plan. The working group is pleased to see that the SAMR has made IPR legislation one of its priorities.

Supreme People’s Court (SPC) IP Court
On 26th October 2018, the National People’s Congress (NPC) decided that all appeals against judgments rendered by lower courts in cases involving a technological aspect should be submitted to the SPC. Following this decision, the SPC created the Intellectual Property Court, a detached tribunal of the SPC (SPC IP Court). The SPC IP Court started to operate for a trial period of three years, on 1st January 2019. On 27th December 2018, the SPC issued the Provisions on Several Issues Concerning the Intellectual Property Tribunal, which detail the scope of the competence of the SPC IP Court. The main purpose is to centralise the appeal of all patent-related cases, including technical know-how, computer software and monopoly, and to unify the standards of judicial adjudication in China. This applies to both civil and administrative litigation.

The SPC further indicated that decisions of the SPC IP Court will still be subject to retrial, but that cases will be handled by another tribunal of the SPC.

Amendment of the Patent Law
The fourth revision of the Patent Law is still pending but is expected to be passed in 2019. In addition to the extension of the protection term for design patents (to 15 years), the draft introduces an extension of the protection term for innovative drugs, various measures for the promotion of patent exploitation, an increase in the statutory damages for infringement (up to Chinese yuan (CNY) 5 million), measures facilitating the administrative enforcement of patents in different regions of China, the liability of network service providers, and the good faith principle in patent filing and enforcement.

Revision of the Trademark Law
On 23rd April 2019, China promulgated the amended Trademark Law, which will become effective on 1st November 2019. The new amendments include:

1. A crack down on bad faith filings: Article 4 states that “any application for trademark registration that is malicious and is not filed for the purpose of use shall be rejected”. Articles 19, 33, 44 and 68 were also amended with reference to Article 4.
2. Strengthening trademark protection: Article 63 raises the standard of punitive damages for trademark infringements from the previous one to three times, to one to five times the determined amount of damage caused. It also raises statutory damages from up to CNY 3 million to up to CNY 5 million. In addition, Article 63 empowers the courts to order the destruction of both infringing goods and the materials and tools used for making them.

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6 The Revision of the Patent Law is Expected to be Completed This Year, Xinhua, 11th March 2019, 30th July 2019, <http://www.xinhuanet.com/politics/2019-03/11/c_1201078558.htm>
Revision of the Anti-unfair Competition Law

On 23rd April 2019, a newly amended Anti-unfair Competition Law became effective, a positive development for trade secret protection. The amendments mainly broadened the scope of infringing activities, expanded the definition of the liable party for infringement, increased liabilities for infringement, and shifted the burden of proof to the defendant when the plaintiff has produced prima facie evidence of infringement of a trade secret and of having taken precautionary measures.

Key Recommendations

1. Patents

1.1 Introduce Patent Term Extensions to Promote Innovation

Concern
Innovative pharmaceutical companies are facing increasing threat from generic drug companies under the current policy that favours the latter, which is obstructing drug innovation.

Assessment
The 20-year term for invention patent protection is intended to promote innovation by allowing patent owners to recoup their investment and derive a profit. However, the actual duration of protection in the pharmaceutical industry is much shorter, as a drug needs to experience up to ten years of clinical trials and regulatory approval before entering the market. In order to encourage continued innovation and accelerate the introduction of new medicines for patients, many countries or regions, including the European Union (EU), the United States (US), Japan, Korea and Australia, allow a patent term extension (up to five years), which compensates patent owners for delays in obtaining regulatory approval. In these countries or regions, Bolar exemption is also present to allow generic companies to quickly launch their product once the patent is expired.

Patent term extension and Bolar exemption constitute a balanced patent protection system for pharmaceuticals favouring generic companies and innovator companies equally.

Recommendation

- Introduce a mechanism that allows patent term extensions to compensate for the duration of premarket regulatory approval processes.

1.2 Follow the ‘Three-step Approach’ to Evaluate the Inventiveness of an Invention

Concern
The CNIPA and the Patent Re-examination Board (PRB) enforce high standards, and sometimes take a wrong approach when evaluating the inventive step, resulting in a patent application being granted in the EU or the US but not in China, by citing the same prior art.

Assessment
The inventive step or non-obviousness is the most fundamental requirement in patent laws. In China, patent examiners follow the logic of a ‘three-step approach’ to evaluate the inventive step of an invention. Step three is the most crucial, but also subjective and the most difficult step. In this step, examiners or judges will determine if there is a motivation that would prompt a person skilled in the art to apply the distinguishing feature(s) to the closest prior art and thus reach the claimed invention. However, the working group believes that the CNIPA, the PRB and courts could take a more balanced approach when judging the inventive step, as many applications continue to be rejected or patents invalidated. The SPC’s position on the Daiichi-Sankyo case underlined the importance of conducting the ‘three-step approach’

11 The approach consists of 1) determining the closest prior art; 2) determining the distinguishing features of the invention and the technical problem actually solved by the invention; and 3) determining whether or not the claimed invention is obvious to a person skilled in the art. Guidelines for Patent Examination, State Intellectual Property Office of the People’s Republic of China, 2010, viewed 19th March 2019, <http://www.sipo.gov.cn/zswhpt/zswhpt/201003/article_141784.html>

In China, the Bolar exemption was only introduced in 2009. On its own, this does not create a balanced patent protection system as the Bolar exemption only favours generic companies. With rapid growth of the economy and a strong need for pharmaceutical innovation, it would be far more beneficial to introduce patent term extensions. Only by doing so will companies that produce innovative drugs, those that produce generic drugs, and those that innovate in the pharmaceutical industry in general, all benefit.
during the inventiveness judgment on Markush claims. The SPC stated that only when the ‘three-step approach’ review and judgment cannot reach a clear conclusion on whether the patent application involves an inventive step, can the unexpected technical effect be used in the inventiveness judgment.\(^{13}\)

One common mistake is that, in step three, when a person skilled in the art may have certain possibilities to reach the claimed invention, the examiners or judges will consider that any of the possibilities provided lack the inventive step. The logic being that the person would be motivated to try all these possibilities and thus all these possibilities as claimed are obvious, which is a typical conclusion when employing the ‘could approach’. The correct way is to stick to the ‘would approach’, as detailed in the Patent Examination Guidelines, i.e. the invention is considered obvious only when there is a direct motivation to achieve the claimed invention among all these possibilities.\(^{14,15}\)

Another common mistake observed in the pharmaceutical or chemical industries is that the CNIPA and the PRB often reject inventions for lacking the inventive step, as the distinguishing feature(s) is(are) readily perceivable based on common knowledge without providing any evidence, while asking the applicant to provide an unexpected technical effect to prove the inventive step of the invention. The working group believes that the CNIPA and the PRB should provide ample evidence in this regard, and that the ‘unexpected technical effect’ is one of considerations but not the prerequisite to evaluate the inventive step of the invention.

Recommendations

- Strictly follow the ‘three-step approach’ when evaluating the inventive step to determine if there is a motivation that would prompt a person skilled in the art to apply the distinguishing feature(s) to the closest prior art and thus to reach the claimed invention.
- Provide evidence to support the alleged common knowledge when rejecting inventions.

- Take the ‘unexpected effect’ as one consideration but not a prerequisite for granting a patent.

2. Civil Litigation

2.1 Expand the Scope of Written Submissions, Set Evidence Exchange Proceedings Well in Advance of Hearings and Adopt Deadlines for Judgments in Foreign-related Cases

Concern

Procedural practices make it difficult to guarantee full transparency in the judicial debate and, indirectly, increase the workload of China’s courts.

Assessment

IP enforcement by means of civil litigation reached an all-time high of approximately 283,400 new first-instance cases filed in 2018, a 40.97 per cent increase over 2017.\(^{16}\) This significant increase in litigation has not been accompanied by an equivalent increase in judicial resources, meaning that courts in some jurisdictions have only a single day to conduct both the evidence exchange and the hearing on the merits. This clearly does not offer sufficient time to consider the often-complex issues arising in IP cases, and especially patent cases.

Recommendations

- Adjust civil procedures to become essentially written procedures, with a hearing to orally discuss only the main arguments and main evidence.
- Adopt a rule that courts only have to make a decision on arguments that have been put in writing.
- Exchange all written submissions between litigants before the hearing.
- Introduce a formal timeline, after the hearing, to issue a judgment in foreign-related cases.

2.2 Ensure Consistency and Uniformity in IP Decisions Throughout the Entire Judicial System by Asking IP Courts to Provide Clear Guidelines on IP Decisions to all Courts, and by Publishing Court Decisions

Concern

While the expertise of China’s IP court system is highly


\(^{14}\) The ‘could-would approach’ means asking not whether the skilled person could have carried out the invention, but whether he/she would have done so in the hope of solving the underlying technical problem or in the expectation of some improvement or advantage.


regarded, the expertise and experience gathered by IP courts are not shared among a wider group of courts.

Assessment
The IP court system, especially the newly established IP Appellate Court, provides a robust enforcement avenue for IP disputes. However, when leveraging this enforcement avenue from the specialised courts into other courts, there is a need to develop expertise to manage the workload while ensuring consistency in case-handing. This is a key challenge faced by China’s judicial system.

Recommendations
• Ask the IP Appellate Court or IP Courts to provide ordinary courts with clear, uniform guidelines and by publishing past case decisions.
• Consider publishing all cases in a free, online database maintained by the IP Tribunal of the Supreme People’s Court, so that best practices can be disseminated and promptly adopted.

3. Trademarks

3.1 Create a Right to Request the Cancellation of a Trademark that Becomes Infringing after Transformation in Practical Use

Concern
It is increasingly worrisome that intentionally transformed registered trademarks infringe existing ones, and that with no administrative solution available, judicial solutions are subject to conditions resulting from the Supreme People’s Court’s judicial interpretations.

Assessment
During the third revision of the Trademark Law (Version 2001), 17 a draft was proposed by the State Administration for Industry and Commerce (SAIC) in 2007, 18 which stated in Article 48 that whenever a registered trademark is altered to be either identical or similar to another party’s registered trademark in respect of the same or similar goods—which may cause confusion or misidentification—any person may apply to the Trademark Review and Adjudication Board (TRAB) to cancel the altered registered trademark.

The 2013 text stated that if a trademark registrant unilaterally alters the trademark, “the local administrative department for industry and commerce shall order him to rectify the situation within a specified period; if the situation is not rectified within the said period, the trademark office may revoke the registered trademark”.

Another solution for cancelling a trademark that becomes infringing after transformation is to sue the transformed trademark in court. However, pursuing this option is challenging due to two judicial interpretations published by the SPC—Article 1.2 of the Provisions of the Supreme People’s Court on Issues Concerned in the Trial of Cases of Civil Disputes over the Conflict between Registered Trademark or Enterprise Name with Prior Right published on 18th February 2008, and Article 11 of the Interpretation of the Supreme People’s Court on Several Issues Concerning the Application of Law to the Trial of Cases of Civil Disputes over the Protection of Famous Trademarks published on 22nd April 2009. 19 The draft amendment was not adopted and not publicly available online as of 26th July 2019.

21 These articles provide that where a registered trademark wishes to sue another registered trademark, it should seek its invalidation first unless under special conditions, such as in cases where the transformation of the trademark changes its distinctive character, or if it is a well-known trademark. Another obstacle is that Article 7 of the Trademark Law, which provides for the principle of good faith in filing and using trademarks, is considered only as a general principle which cannot serve as the sole basis for taking legal action.

Recommendations
• Amend Article 49.1 of the Trademark Law so any person has the right to apply to the CNIPA to cancel

19 Article 48 of the Trademark Law does not specify to what degree a trademark would be considered ‘similar’.
20 The draft amendment was not adopted and not publicly available online as of 26th July 2019.
22 Interpretation of the Supreme People’s Court on Several Issues Concerning the Application of Law to the Trial of Cases of Civil Disputes over the Protection of Famous Trademarks, Wikisource, 23rd April 2009, viewed 10th June 2019, <https://zh.wikisource.org/wiki/%E6%9C%80%E9%AB%98%E4%BA%BA%E6%81%9B%E6%80%87%E9%8F%96%E6%A0%87%E4%BF%8D%E6%8A%A8%E7%9A%84%E6%80%87%E4%BA%BA%E7%9A%84%E6%80%87%E9%8F%96%E6%A0%87%
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18 After the government restructuring in April 2018, the SAIC was dissolved, and its function now falls within the responsibility of the SAMR.
a registered trademark if it becomes infringing after transformation.

• Lower the threshold for a registered trademark to sue another registered trademark, and specify that an action may be based on Article 7 of the Trademark Law.

3.2 Allow the Applicant to Question and Reply on the Evidence Provided by the Trademark Registrant During the Revocation Examination Stage

Concern
When an unused registered trademark is filed for revocation, the CNIPA does not allow the applicants to review the evidence of trademark use, which often results in cases being referred to the Trademark Office of the National Intellectual Property Administration for a second round of examination.

Assessment
The annual number of trademark applications in China increased from over 5.7 million in 2017, to over seven million in 2018. By comparison, less than 650,000 applications were filed with the United States Patent and Trademark Office in 2018, the world’s second-busiest trademark office. Many trademarks in China are filed without any intention of actually using them. This creates obstacles for those who wish to protect identical or similar trademarks, hence applications for trademark revocation are filed frequently to cancel these unused trademarks. However, during the revocation examination stage, current legislation does not support cross-examination of the evidence, leading to cases going to a second round of examination, needlessly prolonging procedures. It is therefore necessary to eliminate these evidentiary obstacles on trademark use.

Recommendation
• Allow applicants to question and reply to the evidence provided by the trademark registrant during the revocation examination stage.

3.3 Take into Account the Size of the Inventory of Infringing Goods when Calculating the Amount of Damages in Trademark Infringement Cases

Concern
It is extremely hard for trademark holders to prove the amount of goods that have already entered the market, thus in many cases only very low damages are available to trademark owners even when infringers are caught with a large inventory of infringing goods.

Assessment
In most IP infringement cases, the calculation of damages only takes into consideration the products sold by the infringer. The inventory is mostly not considered because it is argued that infringers do not make profit from them and the right holders do not suffer loss since the goods have not entered the market. However, in most cases, infringers claim that no products have been sold, even after being caught by the local Administration for Market Regulation or the Public Security Bureau with a large inventory of infringing goods. It is extremely hard for trademark holders to prove the amount of goods that have already entered the market. The size of the inventory actually reflects the sales amount in a certain way: if not caught, goods from the inventory would enter into the market anyway. The working group is encouraged to see that in some court cases, judges have begun to consider the inventory of goods when calculating the amount of damages, and hopes that this will become common practice.

Recommendation
• Take into account the size of the inventory of infringing goods when calculating the amount of damages in trademark infringement cases.

3.4 Extend the Review Application Period of Trademark Rejection, Opposition, Invalidation and Cancellation where Circumstances Require

Concern
The 15 days currently allowed for filing a review application for trademark rejection, opposition, invalidation or cancellation is not always sufficient to prepare the required materials.
Assessment
When filing a review application of rejection, opposition, invalidation or cancellation, the applicant only has 15 days of preparation time (articles 34, 35, 44 and 54 of the Trademark Law), which is not always sufficient. Even though it is permitted for evidence to be supplemented within a three-month period, the 15 days given for the procedure at the CNIPA and the 30 days for the court procedure are not enough for an adequate review of the case and for making a decision, especially under complicated circumstances.

Recommendation
• Extend the prescribed period for filing review applications/appeals of rejection, opposition, invalidation or cancellation where circumstances require.

4. Strengthen Online IP Protection
4.1 Verify the Legal Status of Social Media E-shopping Channels

Concern
Most of the major e-commerce platforms have set up comprehensive IP protection policies, however there is now an emerging trend of infringers moving their business to social media platforms, which are not tightly regulated.

Assessment
The E-commerce Law, effective on 1st January 2019, regulates all e-commerce related activities, and contains definitions for both the ‘E-commerce Business Operator’ and the ‘E-commerce Platform Operator’. According to Article 42 of the law, the E-commerce Business Operator is responsible for setting up the Rule of Notice and Takedowns. However, according to the definition, social media platforms are not included in this scope, and there is now a proliferation of infringing or counterfeit products being promoted through social media e-shopping channels.

Recommendation
• Verify the legal status of social media e-shopping channels, and stipulate their liabilities.


4.2 Clarify How E-commerce Platforms Should Provide Necessary Information to Assist Infringed Parties in Cases of IP Infringement

Concern
It is difficult for IP owners to obtain business licence information of e-commerce business operators, even though such information should be verified by the e-commerce platform according to the new E-commerce Law.

Assessment
Article 9 of the E-commerce Law outlines the liabilities of e-commerce business operators to display their business licence information. Article 17 outlines the liabilities of e-commerce business operators to provide comprehensive and accurate information of the goods and services they provide. However, despite this, it is not easy for IP owners to either obtain this information or to locate repeat infringers, because in order to protect their users’ privacy e-commerce platforms are unwilling to disclose such information in case legal action is taken.

Recommendations
• Outline the liabilities of e-commerce platform operators, and outline the responsibility of e-commerce platforms for providing necessary information to assist infringed parties in cases of IP infringement.
• Clarify the definition of the exclusion clause contained in Article 10 of the E-commerce Law, which prescribes that individuals conducting small deals are waived from the liability of displaying a business licence.
• Explore different methods of deterring repeat infringers on online portals and platforms.

5. Relax Collaboration on Human Genetic Resources
5.1 Provide Contractual Freedom on Ownership of Results Generated from International Collaborative Projects Related to Chinese Human Genetic Resources

Concern
The parties to international collaborative projects in the field of human genetic resources have less contractual autonomy than the parties to domestic ones, even if the subject matter is the same, meaning some foreign
companies have to delay the launch of clinical studies in China to avoid unnecessary IP sharing.

**Assessment**

Article 19 of the *Interim Measures for Management of Human Genetic Resources (Measures)*\(^{28}\) contains a mandatory provision on joint filing and joint ownership of patentable results. As a consequence, parties to international collaborative projects on human genetic resources are not allowed to freely negotiate clauses concerning the ownership of patentable results. This provision contradicts the basic principles of the Contract Law and the Patent Law, which provide the contractual freedom for the parties to agree upon IP ownership for development results.

The working group is happy to see that Article 27 of the *Regulations on Technology Import and Export Administration*, which states that the achievement made in improving the technology concerned belongs to the party making the improvement, was removed in consideration of the economic development of China and the strong need for the free flow of technology.\(^{29}\) The working group believes that Article 19 of the *Measures* should also be deleted, as it will affect companies’ strategies to launch their clinical studies in China if they do not want to surrender their IP right. Late launches of clinical studies may circumvent unwanted IP sharing as the results were already produced in foreign countries and protected, but will delay drug approval process in China and in the end affect the use of the drug.

**Recommendation**

• Remove Article 19 from the *Measures*, or modify its wording in line with the basic principles and provisions of the Contract Law.

6. **Copyright**

6.1 **Introduce Specific Criminal Liability for Offences Related to Technical Prevention Measure (TPM) Circumvention**

Technological protection measures (TPMs), deployed by many content owners, are often circumvented by devices and/or software components (circumvention devices) that have been developed and distributed for commercial gain, and the lack of specific criminal liability for trade in such devices means that redress for rights owners and deterrence for infringers is significantly limited.

**Assessment**

Content businesses suffer considerable economic harm from piracy. Rights owners, including those in the video games and publishing industries, use TPMs to protect their content from unauthorised copying and use.

The legal basis for protection originates from the World Intellectual Property Organisation (WIPO) Copyright Treaty 1996 (WCT), Article 11 of which states that: “Contracting Parties shall provide adequate legal protection and effective legal remedies against the circumvention of effective technological measures that are used by authors in connection with the exercise of their rights under this Treaty or the Berne Convention and that restrict acts, in respect of their works, which are not authorised by the authors concerned or permitted by law.”

The WCT entered into force in the People’s Republic of China on 9\(^{th}\) June 2007.

Devices that circumvent TPMs to allow for illegal use of copyrighted video games are produced in China on a commercial scale and distributed throughout the world. In the publishing industry, circumvention devices are distributed commercially to allow for illegal use of copyright content. Businesses in both industries suffer considerable economic harm from the circumvention of TPMs and the resulting piracy.

Legal provisions provide some form of civil and administrative liability, but they are wholly inadequate in seeking to tackle organised and well-funded criminal networks. Those remedies simply do not represent a sufficient deterrent.

When the primary commercial illegal trade is not in the reproduction, distribution or communication to the public of the copyright works themselves, but in circumvention devices to allow others to do so, then existing criminal

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remedies are not adequate. Criminal liability directly for the trade in circumvention devices is therefore appropriate.

**Recommendation**
- Introduce specific provisions regarding the manufacture, distribution and sale of TPM circumvention devices.

### 7. Geographical Indications
#### 7.1 Harmonise the Legal Protection of Geographical Indications (GIs) with other IP Rights

**Concern**
Currently, it is impossible to enforce geographical indications (GIs) through existing legal mechanisms, such as administrative, civil or criminal actions, or through customs enforcement.

**Assessment**
With the new organisation of the CNIPA, now responsible for the protection of collective marks and GIs, and the SAMR, now responsible for supervising the fight against counterfeiting of trademarks and GIs, there is an opportunity to harmonise the legal protection of GIs in China so that all systems can effectively combat usurpation and counterfeiting (this is currently the case for collective trademarks but not for GIs).

Unlike most countries, China has put in place three separate systems for the protection of GIs: 1) GI collective and certification marks by the CNIPA; 2) CNIPA GI for foreign products and transformed Chinese products; and 3) Chinese Ministry of Agriculture and Rural Affairs (MARA) GI for Chinese agricultural products.

Currently, the collective trademark GI system used in the EU is the most effective for preventing application of identical or similar marks to a European GI. It combats counterfeiting by all legal means, through both administrative and judicial actions, and customs seizure. The CNIPA system does not currently provide strong legal protection against identical or similar GI filings, nor does it provide a legal basis for infringement protection, since there is no specific law considering GIs as IP rights. Companies also experience difficulties gathering the evidence required for undertaking administrative and criminal action, and local authorities also lack knowledge and control. Thus, while the future EU-China agreement on the cooperation on and protection of GIs will contribute to improved IP protection, Chinese GIs that are protected in the EU will effectively benefit from a higher legal protection than those that are granted for European GIs in China because the GIs that are recognised are not sufficiently protected against counterfeits.

**Recommendation**
- Harmonise the legal protection of GIs in China with other IP rights, so that all GI systems can effectively fight against usurpation, infringement and counterfeiting.

**Abbreviations**
- AIC: Administration of Industry and Commerce
- CNIPA: China National Intellectual Property Administration
- CNY: Chinese Yuan
- EU: European Union
- GI: Geographical Indication
- IP: Intellectual Property
- IPR: Intellectual Property Rights
- MARA: Ministry of Agriculture and Rural Affairs
- NPC: National People’s Congress
- PRB: Patent Re-examination Board
- SAIC: State Administration for Industry and Commerce
- SAMR: State Administration for Market Regulation
- SPC: Supreme People’s Court
- TPM: Technological Protection Measure
- TRAB: Trademark Review and Adjudication Board
- US: United States
- WCT: WIPO Copyright Treaty
- WIPO: World Intellectual Property Organisation
1. Provide European Small and Medium-sized Enterprises (SMEs) in China with Better Access to Financing
   • Enhance the implementation of lending strategies to assist all SMEs, both European and Chinese, operating in China.
   • Increase incentives for the purpose of encouraging commercial banks to grant short-term overdrafts to SMEs facing temporary cash shortages.
   • Publish specialised credit risk assessment procedures or systems for providing both local and international SMEs with loans.
   • Encourage China to establish national funds for financing partnerships between European and Chinese SMEs.
   • Remove regulatory obstacles that limit SMEs’, especially foreign-invested enterprises’ (FIEs’), access to credit financing by relaxing foreign exchange debt quota requirements.

2. Promote Coordination Between Different Administrative Departments and Improve the Transparency, Clarity and Integrity of all Relevant Regulations for SMEs
   • Implement the ‘one-stop-service’ system in provincial/regional administrative departments to support all SMEs, both European and Chinese, in fulfilling their multiple registration and regulatory obligations.
   • Further develop official platforms—preferably online—to provide comprehensive, coherent and timely information to SMEs.
   • Continue efforts to alleviate administrative burdens for SMEs by reducing the number of government approvals required and simplifying the remaining approval and filing procedures.

3. Ensure Reasonable Payment Terms and Enforce Timely Payments to Alleviate Cash-flow Burdens for SMEs in China
   • Issue guidelines and implement effective industry supervision measures to ensure that state-owned enterprises (SOEs) and private sector players respect contractual payment terms when dealing with SMEs.
   • Set a maximum payment term that is lawfully allowed to be included in contracts.
   • Encourage SOEs to sign contracts with SMEs that have reasonable payment terms.
   • Improve legal debt collection procedures.
   • Develop further implementing measures to encourage banks to provide financing solutions to SMEs based on accounts receivable.

4. Promote the Value of Intellectual Property Rights (IPR) Protection and Enforcement Mechanisms at All Levels
   • Involve the general public and business community in awareness-raising campaigns to promote respect for IPR.
Introduction to the Working Group

Small and medium-sized enterprises (SMEs) constitute the foundation of most, if not all, national economies in the world.1 Smaller businesses generate around 50 to 70 per cent of all jobs and incomes, and they are usually key contributors to their country’s gross domestic product (GDP).2 Furthermore, the dynamism of SMEs enables them to act as some of the main drivers for entrepreneurship and development. Without a strong SME base, countries will not only have their competitive edge dulled in terms of creativity and innovation, but their overall economic development and social welfare could be seriously compromised as well.

The Inter-Chamber Small and Medium-sized Enterprise Working Group was established in 2014 as a new advocacy element of the European Union (EU) SME Centre (Phase Two),3 with the objective of strengthening advocacy for European SMEs. The working group is based on the European Chamber’s Small and Medium-sized Enterprise Forum. It brings together European SMEs to create a strong channel where concerns over the business challenges faced in China can be expressed.4 The working group organises a series of regular working group and policy meetings to provide practical solutions and policy advice to European SMEs and their stakeholders.5

Definition of SMEs in Europe and China

An SME by the European definition is an enterprise that employs less than 250 people and has an annual turnover not exceeding euro (EUR) 50 million or total assets greater than EUR 43 million.6 On 6th February 2018, the European Commission launched a public consultation European on the review of what the definition of an SME should be, which closed on 5th May the same year.7 On 4th July 2018, the European Parliament voted on and approved a resolution stating that while the 2003 definition of SMEs should be preserved, more attention should be paid to the different types of structure encompassed within the definition, as well as to start-up and scale-up initiatives, and to structures such as midcaps, which do not fit into the SME definition.8 The Commission has yet to adopt a final recommendation,9 in any case, SMEs remain the backbone of the EU’s economy. In the non-financial business sector, they account for 99.8 per cent of the total number of businesses throughout the EU and 66.4 per cent of its employment, and they generate 56.8 per cent of the bloc’s added value.10

In China, SMEs are defined according to the SME Promotion Law as companies that “have a relatively

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3 About EU SME Centre, EU SME Centre, viewed 12th July 2019, <http://www.eusmc.euractiv.com/about-centre>
4 The Inter-Chamber SME Working Group Position Paper presents the recommendations of SMEs from 28 EU Member States regardless of their membership status with the European Chamber.
5 EU SME Centre implementation partners and EU State embassies, <www.eusmecentre.org.cn>
small size in personnel and scope of business”. The standards for classifying SMEs are formulated by relevant departments of the State Council, and the identification of a company as a micro, small or medium-sized enterprise is dependent upon a series of variables, such as the industry it belongs to, its operating income, its total assets and its number of employees.

**EU SME Projects in China**

The EU SME Centre (Phase Two) runs from July 2014 to April 2020. Its main objectives are: assisting European SMEs in establishing and developing a commercial presence in the Chinese market by providing EU added-value support services; improving corporate synergies and increasing best practice sharing at the national and regional EU business association levels, with the ultimate goal of benefitting EU SMEs intending to do business in China; and strengthening advocacy efforts on behalf of the EU business community to help create a better business environment. The China IPR SME Helpdesk supports European SMEs to both protect and enforce their intellectual property rights (IPR) in or relating to Mainland China, Hong Kong, Macao and Taiwan through the provision of free information and services. The China IPR SME Helpdesk project is funded by the European Union and builds on the achievements of a pilot project carried out from 2008 to 2010. Phase V commenced in September 2018.

**Recent Developments**

**SMEs in China**

SMEs play a very important role in China’s economic and social development. Not only do they represent more than 99 per cent of all companies in China but they contribute to more than half of the country’s GDP. They also create more than 80 per cent of the jobs, hold more than 70 per cent of the patents and contribute more than 50 per cent of the taxes.

Regarding European SMEs, according to EU SME Centre data, the sectors with the highest number either investing, exporting or operating in China (or planning to do so) are food and beverage, commercial services, education, information and communication technologies and healthcare. Of the more than 4,200 business inquiries from SMEs received by the EU SME Centre between 2010 and 2019, the most common are on business development, legal, standards and conformity and human resources.

**European Business in China Business Confidence Survey 2019**

The European Business in China Business Confidence Survey (BCS 2019) is one of the European Chamber’s key publications. The BCS 2019 was completed by a total of 585 European companies based in China, out of which 52 per cent were SMEs. Responses show that SMEs are getting the short end of the stick in a majority of areas. For instance, 15 per cent of SMEs reported decreasing revenues in 2018, compared to six per cent of bigger companies. Furthermore, 39 per cent of SMEs do not expect to ever see meaningful opening in their sectors, and half of SME respondents report having encountered unfavourable treatment by the government compared to domestic firms.

**The 9th EU-China SME Policy Dialogue**

The 9th EU-China SME Policy Dialogue took place on 26th October 2018 in Brussels. The event was chaired by Wang Jiaping, vice minister of the Ministry of Industry and Information Technology (MIIT), Irmfried Schwimann, deputy director general of the European Commission’s Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW), and Kristin Schreiber, director of DG GROW. The dialogue touched upon key issues for SMEs such as access to financing, entrepreneurship, late payments and internationalisation.

**Regulatory Updates**

- **SMEs in China’s key policy documents**

The development of SMEs features in most, if not all, of the major policy strategies in China, such as the 13th Five-Year Plan, China Manufacturing 2025 (CM2025), the Belt and Road Initiative (BRI) and the Internet Plus Action Plan. Some of the main action areas within the supporting documents related to SMEs include the promotion of innovation and entrepreneurship, the internationalisation of SMEs, the reduction of financial and administrative burdens and the provision of services to SMEs, among others.

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13 About Us, EU SME Centre, viewed 12th July 2019, <http://www.eusmecentre.org.cn/about-centre>

14 About Us, China IPR SME Helpdesk, viewed 18th April 2019, <http://www.chinaiprhelpdesk.eu/content/about-hd>

Some of the key areas include the following:

- Financing and reducing financial burden

Public financing is to be provided by the government at all levels through the establishment of special funds for SME development, with a particular focus on small and micro enterprises. When it comes to reducing the financial burden of SMEs, the law provides for the implementation of preferential tax policies for qualified SMEs, the simplification of the administrative procedures for taxation, and the reduction of administrative fees. As the Chinese Government leans toward fiscal policies in order to tackle issues like the economic slowdown, there has been a strong emphasis on tax reduction for SMEs. For instance, the State Administration of Taxation’s October 2017 decision that small businesses with a monthly sales volume of between Chinese yuan (CNY) 20,000 and CNY 30,000 would be exempted from value-added tax (VAT) was expanded by the State Council in January 2019, with an increase of the threshold to CNY 100,000. During that same meeting, the State Council also announced that for SMEs with taxable income below CNY 1 million/year, only 25 per cent of that income would be considered taxable, and in the case of enterprises with between CNY 1 to 3 million/year of taxable income, only 50 per cent of this income would be considered taxable.

The SME Promotion Law also encourages the direct and indirect financing of SMEs through measures such as the development of a multi-level capital market system and the use of bond markets and equity financing as funding channels, as well as the promotion of movable property and accounts receivable as collateral for financing, and the use of credit guarantee issuance. While there is still much room for improvement on this issue, the Chinese leadership is aware of the challenges related to SME indirect financing, which is why the State Council’s Guiding Opinions on Promoting the Healthy Development of Small and Medium-sized Enterprises mentioned a number of measures geared at improving access to financing for SMEs, including developing financing policies, broadening financing channels, promoting direct financing, reducing the financing burden and establishing measures for supervision and assessment.

- Innovation/entrepreneurship

The SME Promotion Law encourages innovation and entrepreneurship by setting a series of measures that span from preferential tax policies for enterprises and investors in the area of technological innovation, to the simplification of administrative procedures such as registration, approvals and deregistration. Various articles also promote the usage of new technologies like big data and cloud computing, the development of new technologies using SMEs’ independent intellectual property, and cooperation with universities and research centres. While the working group considers these additions to have positive effects on the development of SMEs, it suggests that authorities make sure that these measures and procedures are open and equally accessible to foreign SMEs.

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17 The annual meetings of the National People’s Congress and the Chinese People’s Political Consultative Conference.


Section Two: Horizontal Issues

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Inter-Chamber Small and Medium-sized Enterprise Working Group

Government procurement

The law also establishes a series of measures to encourage SME participation in government procurement. Some of these include reserving more than 30 per cent of the total government procurement budget for SMEs and other mechanisms such as the formulation of purchase requirement standards, the establishment of preferential price evaluation and the reservation of procurement shares. The working group encourages the Chinese Government to ensure equal and inclusive implementation for local and international SMEs.

In early 2019, stock-taking exercises for the implementation and enforcement of the SME Promotion Law were launched by both the MIIT and the National People's Congress (NPC). In April 2019, the NPC announced that, in addition to inspections carried out by entrusted local legislative authorities in eight regions, inspection teams would be sent to six provinces.23 The working group looks forward to the follow-up actions derived from the special inquiry that took place on 28th June 2019.24

Recommendations

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

Concern

European SMEs operating in China still struggle to access financing, an obstacle that prevents them from reaching their full potential and limits their ability to further contribute to China’s economy.

Assessment

Having sufficient access to financing is crucial for enterprise development. It is well-known that SMEs face different challenges when accessing financing compared to larger companies. China’s slowing economic growth, coupled with the fact that European SMEs are facing increasingly fierce competition, means that financing now plays an even larger role in business operations. While some plans such as the 13FYP and the SME Promotion Law aim to create favourable conditions for SMEs to gain access to financing, in practice it still remains a major challenge, especially for international SMEs. The key reasons for this are that SMEs are generally considered high-risk/low-return clients, and domestic companies tend to be preferred because of their closer relationships with local banks.

The Survey on the Access to Finance of Enterprises,25 published by the European Central Bank in November 2018, broke down the financing sources for European SMEs. The most relevant sources of financing, according to SMEs, are bank loans and credit lines (51 and 52 per cent), leasing or hire-purchasing (45 per cent) and grants and subsidised loans (35 per cent).26 Contrary to what is happening in China, access to finance is not a key issue for SMEs in Europe. In fact, the survey showed that access to financing was the least of the respondents’ concerns (only seven per cent of surveyed companies listed it as an issue). Furthermore, although less than a third of SMEs in the EU actually applied for a bank loan during the survey period, out of those that did, 74 per cent reported being successful in obtaining the full amount requested.

Compared to the variety of financial tools available to SMEs in the EU, China has limited options for SME financing. For example, bank loans for foreign-invested enterprises (FIEs) must be obtained against guarantees from banks outside of China, which typically require further risk assessment by European headquarters. However, foreign exchange loans, which theoretically should be easier for FIEs to access, are limited by the so-called ‘borrowing gap’ – this is the difference between the total amount invested and the minimum amount of required capital that corresponds to the investment. The obstacles international SMEs encounter when it comes to obtaining funding are illustrated in the following case study:

A successful European SME in the service sector operating in China tried to apply for a loan in order to cover its cash flow. However, it encountered a series of difficulties that ultimately made it impossible to be granted any credit from financial institutions, both Chinese and non-Chinese.

The process followed by this SME was to first look

26 Ibid.
for financing from Chinese banking institutions. However, due to the small size of the company, it was not able to meet the financial requirements Chinese banks had established in order to provide a loan. The next step the company took was to try and obtain assistance from a financial institution in its home country. However, as the SME’s holdings were not based in its home country, it did not have any relationship with the financial institutions there. Given that non-Chinese banking institutions in China can grant loans only through their local partners, therefore ensuring they are financially covered in their home country, it was impossible for them to grant a loan to the SME. This cannot happen if the SMEs holdings are not based in the bank’s mother country and do not have a financial history with a non-Chinese bank there.

According to that SME, the only avenues for financing they were left with were to ask its shareholders for a capital injection, to look for a Chinese partner providing the capital or to work with accelerators and incubators that would provide financing on a project-by-project basis.

The working group is aware of the steps taken by the Chinese authorities to tackle issues with SMEs’ access to financing with pieces of legislation such as the SME Promotion Law. Throughout 2018, the intention to improve access to financing for SMEs was stated in a number of high-level meetings, and this trend has continued in 2019. For instance, one of the measures announced during the 2019 ‘Two Sessions’ was the implementation of targeted cuts to required reserve ratios for medium and small banks, the released funds of which would be lent to private enterprises and small and micro businesses. Also, the work report set a target of a 30 per cent increase in loans granted to small and micro businesses by state-owned commercial banks. The working group looks forward to the effective implementation of such measures and hopes they will have a positive impact on both local and international SMEs’ access to financing.

Recommendations

- Enhance the implementation of lending strategies to assist all SMEs—both European and Chinese—operating in China.
- Increase incentives for the purpose of encouraging commercial banks to grant short-term overdrafts to SMEs facing temporary cash shortages.
- Publish specialised credit risk assessment procedures or systems for providing both local and international SMEs with loans.
- Encourage China to establish national funds for financing partnerships between European and Chinese SMEs.
- Remove regulatory obstacles that limit SMEs’, especially FIEs’, access to credit financing by relaxing foreign exchange debt quota requirements.

2. Promote Coordination Between Different Administrative Departments and Improve the Transparency, Clarity and Integrity of All Relevant Regulations for SMEs

Concern

Despite recent policy developments, China’s regulatory and licence approval system—particularly at the implementation level—still creates added difficulties for international SMEs in China, which impairs their development.

Assessment

After receiving a business licence from the State...
Administration of Market Regulation (SAMR) to establish as a legal entity in China, FIEs must then obtain various permits or registration licences from additional government agencies before they can become operational, depending on their scope of business. The whole process can last several months, during which time expenses related to renting office space will be incurred, even though the FIE is not yet eligible to conduct business. After an enterprise starts operating, annual re-registrations also then need to be carried out with several government agencies, which requires considerable resources. The complexity of the registration and re-registration processes constitutes one of the largest challenges for European small businesses and entrepreneurs, and thus, it is essential that they receive prompt and clear responses from competent authorities.

Throughout 2018, the municipal administrations of various cities published policies aimed at improving the local business environment. One city where substantial progress is being made on paper is Beijing. Under the umbrella of the 9+N initiative, on 18th March 2018, the Beijing Administration of Industry and Commerce (AIC) published the Bureau Notice on Further Optimising the Business Environment and Improving the Efficiency of Enterprise Start-ups. This document develops an online business registration system, which would shorten the registration time from an average of 22 to approximately five working days. Similarly, at the national level, the State Council published on 17th May 2018 the Opinions on Further Compressing the Timeline for Starting a Business. These efforts aimed at reducing the administrative burden of private enterprises in 2018 were acknowledged at an international level through China’s considerable rise in ranks in the World Bank’s index on ease of doing business. Following the intensified push for improving the business environment announced during the 2019 Two Sessions, the intention to reduce the timeline for starting a business was recently echoed by government officials themselves.

While foreign SMEs have reported experiencing an improvement in the reduction of registration and closing-down duration in the past few years, the time required is still substantially longer than the targets set by the Chinese Government in 2018, let alone 2019. Moreover, these processes also take longer for foreign businesses than for domestic companies – an issue acknowledged by government officials themselves. This is partly caused by the additional steps foreign companies have to take for registration, and partly because some services offered to Chinese businesses—such as certain online processes—have not been made available to international enterprises. The result is that foreign businesses experience additional administrative burdens compared to domestic companies. Thus, while the working group welcomes the recent policy developments aimed at reducing administrative burdens, it also encourages Chinese authorities to step up its efforts to ensure equal implementation for both domestic and foreign companies, and to take into account the added difficulties faced by international companies.

Recommendations

- Implement the ‘one-stop-service’ system in provincial/regional administrative departments to support all SMEs, both European and Chinese, in fulfilling their multiple registration and regulatory obligations.
- Further develop official platforms—preferably online—to provide comprehensive, coherent and timely information to SMEs.
- Continue efforts to alleviate administrative burdens for SMEs by reducing the number of government approvals required and simplifying the remaining approval and filing procedures.


35 During a meeting on 4th April 2018 organised by Invest Beijing on the policy interpretation of digitalisation of business registration and the optimisation of Beijing’s business environment, the European Chamber asked a series of questions regarding the impact of these new measures on business registration for foreign companies. According to the Chinese officials in attendance, foreign companies can do part of the registration online, with the help of their legal counsel or Chinese employees. However, they mentioned the process would likely take longer than for Chinese companies.
3. Ensure Reasonable Payment Terms and Enforce Timely Payments to Alleviate Cash-flow Burdens of SMEs in China

Concern
Many European SMEs in China frequently face liquidity problems due to an absence of maximum contractual payment terms, non-negotiable payment terms with state-owned enterprises (SOEs) or private sector players, and late/non-payments from clients.

Assessment
Since access to financing is limited for SMEs in general, and international SMEs in particular, substantial reserve assets are a prerequisite for business operations in China. Usually, SMEs have limited bargaining power during negotiations, which often result in customers imposing onerous contractual payment terms. In addition, many customers do not comply with these terms and pay late.

SMEs who conduct business with SOEs or large Chinese privately-owned enterprises (POEs) have limited negotiating power when discussing payment terms. At the same time, SMEs are often required to pay a 30 per cent down payment and 70 per cent of the total cost, prior to the goods being delivered to their own suppliers. When dealing with SOEs and large POEs, there are a number of obstacles that limit the overall chances of SME success. For example, SMEs in the industrial sector typically receive a 20 per cent down payment, 30 per cent at onsite delivery, 40 per cent at the commissioning and the remaining 10 per cent at the end of the warranty period (24 months). This means that only 20 per cent of the total payment is secured, while the remaining 80 per cent is fully dependent on the clients’ willingness to comply with pre-existing payment obligations.

In China, most industries do not have guidelines to ensure that market players respect contractual payment terms and so they set a maximum payment term that can be included in contracts (e.g. 30 calendar days if the customer is a public authority or state-owned company and 60 days if the customer is a privately-owned company, subject to certain exceptions). Unlike in the EU, Chinese law has limited provisions on late payments (the existing ones are mostly referred to in Article 114 of the Contract Law and in the Supreme Court’s Interpretation on the Adjudication of Contract Disputes, and relate to liquidated damages).

Debt collection services are available, but these are often not practical given the length of time it takes, and, most importantly, the high costs involved. China’s Civil Procedure Law contains well-intended, low-cost summary proceedings for undisputed debts, but contains several flaws and is therefore seldom used in practice. The revised SME Promotion Law includes a new article prescribing that state organs, public institutions and large enterprises shall not default on the payment of goods, services and projects to SMEs, and that SMEs are entitled to claim arrears and demand compensation from parties that pay late or default all together.

Notwithstanding the aforementioned measures, the fact is that SMEs—lacking the negotiating clout to establish favourable payment terms, as well as the means to put pressure on unwilling debtors—continue to experience situations where they are not paid in a timely manner. Even more worrisome is the fact that cases of late payments by SOEs—and even by local governments—continue to be reported by SMEs. This common occurrence has been documented in a recently-launched MIIT platform where SMEs can report payment defaults from the government or SOEs, and has generated widespread concern. The working group is pleased that such a step is being taken to monitor and process the cases of late payments to SMEs. The working group also encourages the Chinese authorities to continue developing measures to effectively protect the rights of private businesses and make sure they have enough legal and policy support to prevent or, in the worst-case scenario, be properly compensated for any situation related to late payments.

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36 For fixed payment periods in the EU, 30 calendar days are referenced when customers are a public authority and 60 calendar days are referenced when the customer is another company; this is done to determine when late payment interest can be claimed. The EU has further clarified this by publishing a table with the statutory interest rates for late payments, by country. Late Payments Directive, EUR-Lex, 16th February 2011, viewed 18th April 2019, <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1413903005068&uri=CELEX:32011L0007>
Recommendations

- Issue guidelines and implement effective industry supervision measures to ensure that SOEs and private sector players respect contractual payment terms when dealing with SMEs.
- Set a maximum payment term that is lawfully allowed to be included in contracts.
- Encourage SOEs to sign contracts with SMEs that have reasonable payment terms.
- Improve legal debt collection procedures.
- Develop further implementing measures to encourage banks to provide financing solutions to SMEs based on accounts receivable.

4. Promote the Value of IPR Protection and Enforcement Mechanisms at the Consumer, Business and Local Government Levels

Concern

A lack of public awareness of the value of intellectual property (IP) and ineffective IPR enforcement at the local level has limited the impact of recent positive changes to China’s IPR legislative environment.

Assessment

European SMEs face a general lack of IPR system awareness at the personnel grassroots level, and consequently they do not often take advantage of it. China struggles with a poor reputation regarding respect for IP. The challenges related to protecting IP and the generally negative international perception associated with IPR in China deter many European SMEs from entering the Chinese market.

Difficulties related to navigating the Chinese IP system pose a significant challenge for many European companies, as they struggle to uphold their reputation and return on investment for innovation in an environment where counterfeit products are sold online and offline, and bad-faith registrations of IPR are still commonplace. These phenomena not only discourage European investment in China but also cast a dark shadow over China’s reputation. They can also prevent promising business activities. Effective enforcement of IPR protection also creates a transparent environment for business transactions to take place and nurtures EU-China business relations through licensing, technology transfers and joint research and development (R&D) activities. Effective enforcement of IPR not only protects companies, but also serves as a quality and safety guarantee for consumers.

Since the IP Courts were established in 2014, China has been developing improved IP regulations and measures on both administrative examinations and on judicial protection. One of the most positive developments related to IP in recent years was the establishment of the Specialised IP Courts Pilot Project and IP tribunals in various provinces in China. On 1st January 2019, an IP Tribunal at the appellate level was officially established by the Supreme People’s Court (SPC), which will centralise jurisdiction over appeals involving patent infringement/invalidation and other high-tech or antitrust IP disputes.42

The establishment of internet courts in Hangzhou, Beijing and Guangzhou—which are able to process cases in connection to internet copyright ownership and infringement disputes—also has the potential to facilitate some of the IP-related dispute processes. In June 2018, the Hangzhou Internet Court for the first time accepted blockchain as a way of fixing copyright.43 44 and on 6th September 2018, the SPC confirmed that blockchain can be used—along with other means like electronic signatures—as a way of validating evidence.45 In April 2019, the first blockchain-enabled notary opened in Beijing.46 These developments are especially significant for SMEs, as the outcomes can considerably reduce the costs associated with IP dispute processes.


44 Hangzhou is famous for having one of the highest numbers of online writers in China; this is most likely the reason for the implementation of this procedure in that specific court.

45 Understanding and Application of the Provisions of the Supreme People’s Court on Several Issues Concerning the Trial of Cases in Internet Courts, ChinaCourt, 8th September 2018, viewed 2nd July 2019, <https://www.chinacourt.org/article/detail/2018/09/id/3489797.shtml>

In general, China’s push for innovation and entrepreneurship has led to a significant improvement in IPR enforcement, as perceived by European companies. At the political level there have also been a number of high-level statements regarding the protection of IP in China and, more concretely, the condemnation of forced technology transfer. For instance, the Foreign Investment Law (FIL) stipulates that “no administrative agency or its employee may force the transfer of any technology by administrative means.” However, as pointed out by the European Chamber in a public statement on the draft FIL, “this [vague wording] leaves open the possibility for any non-administrative body to use any other means to compel technology transfers. Instead, the Foreign Investment Law should simply prohibit forced technology transfer by any means.” Meanwhile, in the 2019 EU-China Summit Joint Declaration, both sides agreed that “there should not be forced transfer of technology.” The working group expects that such a high-level statement will be followed by effective enforcement. When it comes to EU-China relations, the working group also welcomes the declaration that there will be a conclusion of the Agreement on Geographical Indications, and hopes both sides will be able to produce a final document by the stated deadline.

While the working group acknowledges that a number of positive developments have taken place, IPR enforcement remains a challenge for SMEs operating in China. Among the major concerns members report are the high burden of proof for infringements and damages. However, even this concern is significantly lower than the loss of reputation and market share experienced by the claimant company. Many SMEs face numerous significant obstacles, and a lack of cooperation from local enforcement agencies and local courts effectively deters companies from doing business in China.

Recommendations
• Involve the general public and business community in awareness-raising campaigns to promote respect for IPR.
• Intensify efforts to tackle the bad-faith registration of trademarks by addressing loopholes in the current legislation.
• Engage local enforcement agencies, customs and local courts to take effective action against counterfeiting.
• Improve online access to IPR-related agencies in order to make it easier for SMEs to enforce their rights in a more affordable way.
• Further consolidate the Specialised Intellectual Property Court Pilot Programme.

Abbreviations
13FYP  13th Five-year Plan  
AIC  Administration for Industry and Commerce  
BRI  Belt and Road Initiative  
CM2025  China Manufacturing 2025  
CNY  Chinese Yuan  
EU  European Union  
EUR  Euro  
FIE  Foreign-invested Enterprise  
FIL  Foreign Investment Law  
GDP  Gross Domestic Product  
IP  Intellectual Property  
IPR  Intellectual Property Rights  
R&D  Research and Development  
MIIT  Ministry of Industry and Information Technology  
NPC  National People’s Congress  
POE  Privately-owned Enterprise  
SAMR  State Administration of Market Regulation  
SME  Small and Medium-sized Enterprise  
SOE  State-owned Enterprises  
SPC  Supreme People’s Court  
VAT  Value-added Tax

50 Ibid.
Investment Working Group

Key Recommendations

1. Ensure that the European Union (EU)-China Comprehensive Agreement on Investment (CAI) Guarantees Reciprocity
   - Enshrine the notion of reciprocity in the EU-China CAI, guaranteeing European businesses that have invested in China have the same rights as Chinese businesses that have invested in the EU.
   - Address issues related to transparency, licensing and authorisation procedures, and provide a high level of protection for European investors in China, along with their investments, by establishing an Investor-State Dispute Settlement (ISDS) mechanism.

2. Ensure Smooth Implementation of the New Foreign Investment Law (FIL) by Formulating Necessary Detailed Rules and Minimise any Potential Negative Impact on Foreign Business
   - Formulate in a timely manner necessary implementation rules to clarify the uncertainties and ambiguities caused by the launch of the new FIL, particularly where gaps may be created after the abolishment of the old foreign investment laws, and also adjust all other pertinent laws and regulations to maintain a coherent legal framework in the field of foreign investment.
   - Maintain transparency while the FIL is being implemented by presenting to the public a clear implementation timeframe as well as the stakeholders in charge of rule-making, and allow sufficient time throughout for public comments reflecting business concerns to be fully considered in the rule-making process.
   - Further accelerate and effectively implement the opening of industry sectors where foreign ownership is currently restricted or prohibited.
   - Consider fundamentally changing the existing foreign investment management approach without further differentiating between Chinese and foreign investment, to ensure both a level-playing field and non-discriminatory access to the market.
   - Clarify and limit the review of indirect investment.
   - Remove restrictions on foreign investment currently included in other investment-related laws and regulations and special policies (e.g. in the areas of mergers and acquisitions (M&A), foreign exchange and financing).

3. Enforce a Level Playing Field, Specifically with regards to China Manufacturing 2025 (CM2025) and the Belt and Road Initiative (BRI)
   - Ensure that foreign companies can participate in CM2025 and the BRI, and guarantee full market access to the sectors involved.
   - Accelerate and deepen reform in state-led sectors to level the playing field for SOEs and privately-owned enterprises, including Foreign-invested Enterprises (FIEs).

   - Clarify the minimum threshold percentage of state-owned shareholding triggering mandatory valuation and listing requirements, particularly when there are multiple levels of shareholding, as mandatory
valuation and listing requirements should not apply where the state does not have a controlling stake.

• Extend the cases of transfer by agreement to cases where a foreign investor will purchase equity in a foreign-invested joint venture (JV) company from a state-owned partner (provided that the price to be paid will be at least 90 per cent of the value determined by a qualified People’s Republic of China (PRC) audit company), instead of stipulating a mandatory state-owned asset listing procedure.

• Encourage valuation companies to use internationally approved valuation methods beyond only looking at the net value of the JV.

5. Further Open China’s Capital Market to Foreign-invested Enterprises (FIEs)

• Improve market regulation by the China Securities Regulatory Commission (CSRC) and its sister financial regulators.

• Create a fair and level playing field for FIEs seeking to issue debt securities, including bonds and asset-backed securities.

• Grant FIEs national treatment and allow them to list their shares on a Chinese stock exchange.

• Establish an ‘international board’ to allow international enterprises achieve a secondary listing of their equity securities in China’s A-share market.

• Simplify the rules for foreign investors selling shares of listed JVs, so they are in line with the principle of national treatment highlighted by the FIL.

• Remove the additional disclosure requirements on investments by foreign investors in listed companies so as to correspond to the national treatment principle.

6. Ensure a Level Playing Field with regard to ‘New Economy’ Sectors

• Provide clear and consistent guidance when implementing the Cybersecurity Law and ensure an effective two-way exchange over potential market access barriers.

• Ease data localisation requirements.

• Allow European companies to provide internet resources collaboration (IRC) services (i.e. Infrastructure as a Service (IaaS) and Platform as a Service (PaaS)) in China.

• Ease the restrictions on internet content provider (ICP) licences.

Introduction to the Working Group

Foreign investment plays an important role as one of the contributors to China’s economic growth. All companies exist to solve a specific problem in society or satisfy a particular need, and corporate investments are necessary for facilitating these tasks. The more the market demands solutions to societal problems, the more investment is needed. In China’s case, its rising middle class, and growing needs from all other parts of society, are likely to result in an increasing demand for investment – whether from domestic or international players. The regulatory environment plays a significant role here: it can help to improve trust in the marketplace, but it can also create uncertainty, which is a deterrent to investment.

The Investment Working Group addresses European investor concerns in China, a particularly relevant task considering the ongoing negotiations for a European Union (EU)-China Comprehensive Agreement on Investment (CAI), the implementation of the new Foreign Investment Law (FIL) and the range of challenges that China faces in reforming its capital markets. The working group seeks to achieve a level playing field for foreign investors and to provide a credible platform for exchanging expertise among active international investors in China.

Recent Developments

Foreign Investment Law

On 15th March 2019, the FIL was approved by China’s
National People’s Congress. In the lead up to the promulgation of the law, the European Chamber provided feedback. While the Investment working group maintains that it would be preferable to have no legal distinction between foreign and local companies—unless it is to provide exceptions for legitimate reasons such as specific national security concerns—it also recognises that certain aspects of the new FIL do constitute a positive development.2 When the FIL comes into force on 1st January 2020, according to Article 39, the three main laws that currently govern foreign investment—the Chinese-Foreign Equity Joint Ventures Law, the Wholly Foreign-Owned Enterprises Law and the Chinese-Foreign Contractual Joint Ventures Law—will be simultaneously abolished.3,4 Now that the FIL has been passed, the working group will closely monitor its implementation. Please see Key Recommendation (KR) 2 of this paper for more information.

Negative Lists

There are three negative lists in force at the moment. The first is the Negative List for Market Access (2018),5 jointly issued by the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) on 25th December 2018, and effective on the same date, which is applicable to both domestic enterprises and foreign-invested enterprises (FIEs). It includes two categories—prohibited and permitted—and includes a total of 151 items. Second is the Special Administrative Measures for Access of Foreign Investment (2019 Edition) (2019 Negative List),6 jointly issued by the NDRC and MOFCOM on 30th June 2019, which applies only to FIEs. Third is the Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones (2019 Edition), jointly issued by the NDRC and MOFCOM on 30th June 2019 and effective as of 30th July 2019.7

Encouraged Foreign Investment Industrial Guidance Catalogue

On 30th June 2019, the Encouraged Foreign Investment Industrial Guidance Catalogue (Encouraged Catalogue) was released, and took effect on 30th July 2019.8

Key Recommendations

1. Ensure that the EU-China Comprehensive Agreement on Investment (CAI) Guarantees Reciprocity

Concern

European companies that invest in China do not enjoy the same market access rights as Chinese companies that invest in the EU.

Assessment

Bilateral negotiations between the EU and China for a CAI started at the end of 2013,9 with the 22nd round of negotiations having taken place in July 2019.10 Encouragingly, at the 21st EU-China Summit on 9th April 2019, a joint statement was signed, which included a commitment to conclude CAI negotiations by 2020.11 The working group considers it significant that the joint statement states that a conclusion to the negotiations should result in improved market access and the promotion of a level playing field, among others.

The working group hopes that any future agreement will substantially improve market access for European investors in China, by developing improved regulatory and market access conditions to invest and by guaranteeing that there will be no discrimination against European companies. Particular focus should be placed on reciprocity by the Chinese side to open its domestic market to European investment, as it is still significantly

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3 Ibid.


closed – particularly when compared to how open the EU’s internal market is. CAI negotiations should also focus on issues related to transparency, licensing, certification and authorisation procedures, while providing for a high level of protection for European investors in China through an investor-state dispute settlement (ISDS) mechanism. In this regard, China acceding to the Hague Apostille Convention would be a significant step forward in order to facilitate reciprocal acknowledgment of powers of attorney and other documents that are key to carrying out investments. The current burdensome and time-consuming process to legalise documents such as powers of attorney, not only makes foreign investments in China more difficult, but also weakens the position of Chinese companies in controlled auction processes of sale, which are more and more frequent in Europe.

Furthermore—even though government procurement is outside of the scope of the CAI negotiations—the EU should look to address the often-privileged position held by Chinese state-owned enterprises (SOEs). The EU’s international procurement instrument could be a useful mechanism to achieving this end.

Recommendations

- Enshrine the notion of reciprocity in the EU-China CAI, guaranteeing European businesses that have invested in China have the same rights as Chinese businesses that have invested in the EU.
- Address issues related to transparency, licensing and authorisation procedures, and provide a high level of protection for European investors in China, along with their investments, by establishing an ISDS mechanism.

2. Ensure Smooth Implementation of the New Foreign Investment Law (FIL) by Formulating Necessary Detailed Rules and Minimise any Potential Negative Impact on Foreign Business

Concern

A number of sections in the FIL create unnecessary uncertainties for foreign investors, which may actually result in a reduction of foreign investment throughout China.

Assessment

It is widely acknowledged by the Chinese Government that China is looking to increase foreign direct investment (FDI). In 2018, overall EU FDI to China increased, largely thanks to deals such as BASF’s United States dollar (USD) 10 billion investment in Guangdong, and BMW’s USD 4 billion investment to increase its share in its joint venture in Shenyang. But it is still unclear whether the recent openings that allowed these deals to take place are actually part of a systemic plan or are just isolated episodes. Furthermore, according to many surveys, including the FDI Regulatory Restrictiveness Index produced by the Organisation for Economic Co-operation and Development (OECD), the FDI environment in China is still highly restrictive.

The FIL continues to differentiate foreign companies from Chinese companies in the field of investment. The eventual abolishment of the three main foreign investment laws, will also create many technical uncertainties for both new and particularly for those existing foreign investment projects in China. These new uncertainties may actually result in a reduction of foreign investment throughout China. Although the working group believes there are no compelling reasons to regulate companies differently by its ownership structure or by the nationality of its investors, the forthcoming FIL is still generally perceived by European investors to be an improvement over the previous situation. There are 42 articles in the final FIL, compared to 170 in the previous version, and the provisions in many areas are brief and broadly principled. It also attempts to address many key concerns of foreign investors, such as intellectual property rights (IPR) protection, pre-establishment

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12 The Hague Apostille Convention is an international treaty drafted by the Hague Conference on Private International Law. It specifies the modalities through which a document issued in one of the signatory countries can be certified for legal purposes in all the other signatory states.
Section Two: Horizontal Issues

National treatment and negative list management, equal support policies and equal participation in government procurement. However, the brevity of the FIL is also its weakness — many articles still require more detailed implementation rules to ensure operability, and to coordinate with other relevant laws and regulations, in order to truly reflect the good intention of the law. In this respect, the working group notes the State Council’s positive move on 22nd March 2019, when it deleted some restrictive, technology-transfer-related provisions under the Technology Import and Export Administrative Regulations, and the Implementation Regulations of the Chinese-Foreign Equity Joint Ventures Law. The working group encourages and expects more, similar efforts from the various stakeholders to facilitate successful implementation of the FIL.

Negative List

The FIL abolishes the ‘case-by-case’ approval system under the old three FDI laws, and establishes instead a ‘pre-establishment national treatment and negative list’ administration system. Foreign investment in industry sectors not included in the 2019 Negative List issued by the NDRC and MOFCOM on 30th June 2019 enjoy national treatment, whereas foreign investment in restricted industry sectors are still subject to case-by-case approvals, by either the MOFCOM or its local counterpart.19 While differing from previous promises related to further opening up of the education and financial sectors, the Investment Working Group acknowledges the reduction of items on the 2019 Negative List and hopes that complementary regulatory reforms will be carried out in order to render this opening up meaningful.

Indirect Investment

Unlike the three FDI Laws, the term ‘foreign investment’ under the FIL also includes ‘indirect investment’. This has the potential to significantly expand the scope of the FIL, e.g. to cases where a transaction takes place outside China but indirectly involves a Chinese entity. In the EU, overseas transactions are not regulated directly. The working group recommends that the Chinese Government, when further defining the term ‘indirect investment’, does not place additional restrictions on foreign investors’ offshore transactions.

Recommendations

- Formulate in a timely manner necessary implementation rules to clarify the uncertainties and ambiguities caused by the launch of the new FIL, particularly where gaps may be created after the abolishment of the old foreign investment laws, and also adjust all other pertinent laws and regulations to maintain a coherent legal framework in the field of foreign investment.
- Maintain transparency while the FIL is being implemented by presenting to the public a clear implementation timeframe as well as the stakeholders in charge of rule-making, and allow sufficient time throughout for public comments reflecting business concerns to be fully considered in the rule-making process.
- Further accelerate and effectively implement the opening of industry sectors where foreign ownership is currently restricted or prohibited.
- Consider fundamentally changing the existing foreign investment management approach without further differentiating between Chinese and foreign investment, to ensure both a level-playing field and non-discriminatory access to the market.
- Clarify and limit the review of indirect investment.
- Remove restrictions on foreign investment currently included in other investment-related laws and regulations and special policies (e.g. in the areas of mergers and acquisitions (M&A), foreign exchange and financing).

3. Enforce a Level Playing Field, Specifically with Regards to China Manufacturing 2025 (CM2025) and the Belt and Road Initiative (BRI)

Concern

Foreign businesses have an ongoing concern that they will be left out of China’s main strategic plans – CM2025 and the BRI.
Assessment

China is losing its relative labour cost advantage and now needs to transform its economic model. Broad reforms are needed to maintain reasonably high economic growth, i.e. sustainable growth at current levels. Both CM2025 and the BRI are seen by China as key tools in this regard, however there are concerns among European businesses that they will be left out of these plans.  

Even though mentions of CM2025 have by mid-2019 largely disappeared from government documents, the working group remains concerned that the national preference philosophy which guided the drafting of this plan still remains. It is noteworthy that several of the industries listed in CM2025, such as aviation and value-added telecommunications, are already restricted or prohibited to foreign investors, as per the 2019 Negative List. Foreign investors in these sectors will therefore still require Chinese partners and will likely face numerous hurdles, such as forced or compelled technology transfers, requirements for indigenous intellectual property (IP) or import substitution schemes.

SOE Reform

In the European Chamber’s Business Confidence Survey 2019 (BCS 2019), 70 per cent of polled companies reported that SOEs are present in their industries and that they also hold significant advantages in areas such as “government procurement, the ability to influence policy, and access to financing and licences.” China is still attempting to further reform its SOEs through large-scale consolidation in various sectors, and this is set to continue until 2020.

However, the working group is concerned that not enough effort is being made to reduce SOEs’ involvement in non-strategic sectors of the Chinese economy. This situation could be improved by selling majority ownership of relevant state-owned assets to the private sector, including foreign capital. Similarly, even though ‘competitive neutrality’—which by its simplest definition means ‘equal treatment’—has recently become a buzzword among Chinese officials, European firms still have a mixed outlook as to whether the Chinese Government will successfully pursue such a policy: a third of the member companies polled in the BCS 2019 “believe it will be realised in the next two to five years, while another third expect it will never happen.”

CAI Negotiations

It is so far unclear how CM2025 and the BRI will relate to the CAI negotiations and whether any sectoral and horizontal agreements in these negotiations will override any current market access restrictions in the sectors outlined in these initiatives.

Recommendations

- Ensure that foreign companies can participate in CM2025 and the BRI, and guarantee full market access to the sectors involved.
- Accelerate and deepen reform in state-led sectors to level the playing field for SOEs and privately-owned enterprises, including FIEs.


Assessment

Foreign investors are subject to burdensome administrative procedures when selling or acquiring equity in People’s Republic of China (PRC)-incorporated entities (domestic or foreign-invested) to or from Chinese partners, such as a security review (where relevant), NDRC approval, MOFCOM approval or registration, and State Administration of Foreign Exchange (SAFE) registration.

Equity acquisitions from SOE JV partners require...
a mandatory valuation of the transferred equity and a listing procedure open to third-party bidders. The listing procedure creates inefficient constraints, as in most cases only the JV partner will be in a position to purchase equity from a commercial or industrial standpoint. In addition, the transfer of equity results from a clause that has already been through the entire approval process. This happens when the liquidity option (including its triggering events and pricing conditions) is set forth in a foreign-invested JV contract, which is always reviewed and approved by the MOFCOM. As a result of these numerous procedural steps, the binding effect of equity transfer clauses may be in doubt, and their enforcement not fully secured, even when the terms of the clauses and the initial intent of the involved parties are clear. Any party acting in bad faith may efficiently use the regulatory framework to escape its obligations. Furthermore, government-sanctioned valuation companies do not use internationally approved valuation methodologies. Most of the time, they base their pricing valuation mainly, if not exclusively, on the net book value of the JV (and not on methods such as discounted cash flow). As such, should an international company wish to sell its stakes in a JV, the price is abnormally low, and the international firm has no choice but to accept it without recourse.

Ultimately, the uncertainties surrounding equity transfer clauses harm both Chinese and foreign investors. Equity transfer clauses are indeed a classic and powerful tool with respect to both governance (e.g. solving deadlocks and ironing out contract breaches) and financial matters (e.g. ensuring liquidity for an investor) in JV companies. Similarly, the existence of special regulations regarding SOEs is, in principle, not in line with the EU’s five criteria by which to gauge a market economy.  

Recommendations

- Clarify the minimum threshold percentage of state-owned shareholding triggering mandatory valuation and listing requirements, particularly when there are multiple levels of shareholding, as mandatory valuation and listing requirements should not apply where the state does not have a controlling stake.
- Extend the cases of transfer by agreement to cases where a foreign investor will purchase equity in a foreign-invested JV company from a state-owned partner (provided that the price to be paid will be at least 90 per cent of the value determined by a qualified PRC audit company), instead of stipulating a mandatory state-owned asset listing procedure.
- Encourage valuation companies to use internationally approved valuation methods beyond only looking at the net value of the JV.

5. Further Open China’s Capital Market to Foreign-invested Enterprises (FIEs)

Concern

There are still many restrictions hampering FIEs’ access to all parts of China’s capital markets, including equity, debt and structured products, which is detrimental to China’s economy.

Assessment

FIEs still face many access restrictions to China’s capital markets – a situation that is detrimental to both them and the Chinese economy, as it contributes to the continued underdevelopment of the domestic capital markets.

A-share Markets

Currently, it is possible for an FIE to be listed on China’s established stock markets by incorporating itself as, or converting itself into, a foreign-invested company limited by shares (FICLS), and then applying for a listing on the exchange of its choice in accordance with the relevant regulations. However, the requirements FICLSs and their investors must satisfy are more stringent than those for a domestic company. Some examples include the following: obtaining approval of the MOFCOM for at least one foreign sponsor; requiring at least half of the shareholders to be Chinese domestic permanent residents; and maintaining a foreign shareholding of at least 10 per cent post listing. Therefore, it is not possible to list a wholly foreign-owned enterprise (WFOE) on the A-share market.

Even if it were possible to list WFOEs, the China Securities and Regulatory Commission’s (CSRC’s) regulations would require the listed entity to own its own IPR and be free to compete on a global basis. This essentially precludes an international company from listing a local subsidiary, which differs from common practices in other financial markets, where a foreign investor can raise capital and control and operate a

locally-listed company without requiring the company’s global business to become a domestic public entity. In the renovation of China’s capital markets, the working group recommends access be made available to all economic actors, including foreign investors operating successful businesses in Mainland China.

The working group suggests that any additional requirements that apply to FICLSs and their investors should be removed and that international businesses should be free to list on the A-share market in the same way as domestic companies. This would reflect the nationwide trend of harmonising regulatory requirements that are applicable to both domestic entities and international businesses, and the replacement of many filing requirements in the field of FDI. It would also encourage foreign private equity investment in domestic companies, by facilitating their ability to subsequently exit their investments through a Chinese initial public offering.

To this end, domestic stock exchange listing rules should be amended to make it easier for foreign companies to list on Chinese stock exchanges, thereby increasing the attractiveness of China’s capital markets while leading to greater diversification from new, high-quality issuers. This would also be conducive to establishing the much-anticipated international board on the Shanghai Stock Exchange, which would enable international enterprises to achieve a secondary listing of their equity securities in China’s A-share market. In June 2018, the inclusion of Chinese A-shares into the MSCI indices, first announced in July 2017, came into effect.

Debt Market
It has become easier for FIEs to routinely issue renminbi (RMB)-denominated debt securities, so-called ‘panda bonds’. In 2018, the People’s Bank of China (PBOC) and the Ministry of Finance jointly published new interim administrative rules for bond issuance by foreign entities (i.e. panda bonds), which clarify and simplify a number of issues and delegate registration for non-financial enterprises to the National Association of Financial Markets Institutional Investors (NAFMI). According to these administrative rules, panda bonds need to be filed with the NAFMI, and require programme documentation under the relevant Chinese laws as well as a domestic credit rating. The rules also formally introduce the concept of ‘equivalent accounting standards’, allowing enterprises reporting under other accounting standards—such as the International Financial Reporting Standards (IFRS)—to access the panda bond market without converting their financial statements to Chinese Generally Accepted Accounting Principles (GAAP). This had previously been a requirement for foreign companies incorporated in other jurisdictions that report their balance sheets globally according to IFRS.

At present, the relevant rules do not list specific requirements on the use of proceeds from a panda bond issuance, and instead refer to relevant regulations by the PBOC and the SAFE as far as account openings and foreign remittances are concerned. That said, while the remittance of panda bond proceeds is in principle allowed, there is apparently still a strong preference for the onshore use of said funds, such as for funding shareholder loans to domestic subsidiaries.

Inclusion into Global Bond Indices
There have recently been some significant efforts made to internationalise China’s debt capital markets, particularly with regard to the inclusion of Chinese bonds into global indices. The working group approves this trend. On 31st January 2019, Bloomberg confirmed that Chinese RMB-denominated government and policy bank securities would be added to the Bloomberg Barclays Global Aggregate Index starting in April 2019, and phased in over a 20-month period.

Recommendations
• Improve market regulation by the CSRC and its sister financial regulators.
• Create a fair and level playing field for FIEs seeking to issue debt securities, including bonds and asset-backed securities.
• Grant FIEs national treatment and allow them to list their shares on a Chinese stock exchange.

29 Ibid.
30 Ibid.
32 Please note: neither the European Chamber nor its Banking and Securities Working Group have a position on the index providers mentioned or any other index providers. The mention in this paper is only meant for informational purposes.
• Establish an ‘international board’ to allow international enterprises achieve a secondary listing of their equity securities in China’s A-share market.
• Simplify the rules for foreign investors selling shares of listed JVs, so they are in line with the principle of national treatment highlighted by the FIL.
• Remove the additional disclosure requirements on investments by foreign investors in listed companies so as to correspond to the national treatment principle.

6. Ensure a Level Playing Field with Regard to ‘New Economy’ Sectors

Concern
There are many restrictions that hamper the development of international companies in the information and communications technology (ICT) industry, such as internet resources collaboration (IRC) services, and others.

Assessment
European ICT companies operating in China are currently restricted from investing in a variety of key sectors such as IRC services. China has placed many restrictions on digital trade. In fact, the Digital Trade Restrictiveness Index, published in April 2018 by the European Centre for International Political Economy (ECIPE), ranked China as the most restrictive country.33

Investment-related Aspects of the Cybersecurity Law
The Cybersecurity Law came into effect in June 2017, and has had a “significant impact on the operations of both domestic and international companies [in China].”34 Due to the vagueness of its provisions and those of a host of supporting rules, the European Chamber is concerned about the law’s general lack of transparency, consistency, non-discrimination and proportionality, both in rule-making and enforcement.35 These concerns present a real deterrent to foreign investment in China’s ICT sector.

Extensive Data Localisation Requirements
All companies encounter a host of problems within the Chinese regulatory environment with regard to their IT systems, many of which pertain to the Cybersecurity Law. Issues include the requirement for critical information infrastructure (CII) operators to store within Chinese territory the personal information and important data collected and generated during their operations in China, and for all network operators to conduct a cross-border transfer security assessment when exporting data for business needs. Together, these effectively serve as investment constraints, something that is particularly felt in the financial services sector. For more information, please see the Banking and Securities Working Group Position Paper.

Cloud Computing
Foreign companies are restricted from providing IRC services in China, including infrastructure as a service (IaaS) and platform as a service (PaaS), by various provisions. These include the existing licensing and foreign direct investment restrictions on international IRC service operators in China under the Classification Catalogue of Telecommunications Services (2015),36 and the restrictions on technical cooperation models, data localisation and cross-border data flows outlined in the draft Notice on Regulating the Operation of Cloud Service Market and the Notice on Cleaning Up and Regulating the Internet Access Service Market,37 published by the Ministry of Industry and Information Technology (MIIT) in 2016 and 2017 respectively.

These restrictions matter, as China is set to become the world’s largest cloud market by as early as 2023, and the market is thus a high priority for the global growth of foreign companies. The working group hopes that China will ease restrictions on certain cloud service operators in the fields of IaaS and PaaS, including issuing more licences to IRC service operators, and that it will lift the 50 per cent foreign investment cap. For more information on these documents, please see the position papers for the Information and Communication Technology and Cybersecurity working groups.

Internet Content Provider (ICP) Licences
Foreign companies intending to have a web presence in China need to apply for an ICP licence if it is for a

35 Ibid.
commercial website, or undertake a record-filing if it is for a non-commercial, informational website. While ICP filing can be done relatively easily, ICP licences remain restricted under the existing telecoms regulatory framework, with foreign investment in most segments of the internet content services sector subject to a 50 per cent shareholding cap.

Recommendations
• Provide clear and consistent guidance when implementing the Cybersecurity Law and ensure an effective two-way exchange over potential market access barriers.
• Ease data localisation requirements.
• Allow European companies to provide IRC services (i.e. IaaS and PaaS) in China.
• Ease the restrictions on ICP licences.

Abbreviations
BCS  Business Confidence Survey
BRI  Belt and Road Initiative
CAI  Comprehensive Agreement on Investment
CII  Critical Information Infrastructure
CM2025 China Manufacturing 2025
CSRC China Securities Regulatory Commission
ECIPE European Centre for International Political Economy
EU  European Union
EUR  Euro
FDI  Foreign Direct Investment
FICLS Foreign-invested Company Limited by Shares
FIE  Foreign-invested Enterprise
FIL  Foreign Investment Law
GAAP  Generally Accepted Accounting Principles
IaaS  Infrastructure as a Service
ICP  Internet Content Provider
ICT  Information and Communications Technology
IFRS  International Financial Reporting Standards
IP  Intellectual Property
IPI  International Procurement Instrument
IPR  Intellectual Property Rights
IPO  Initial Public Offering
IRC  Internet Resources Collaboration
ISDS  Investor-state Dispute Settlement
IT  Information Technology
JV  Joint Venture
KR  Key Recommendation
M&A  Mergers and Acquisitions
MOFCOM Ministry of Commerce
NAFMII National Association of Financial Markets Institutional Investors
NDRC National Development and Reform Commission
OECD Organisation for Economic Co-operation and Development
PaaS Platform as a Service
PBOC People’s Bank of China
PRC People’s Republic of China
RMB Renminbi
SAFE State Administration of Foreign Exchange
SOE State-owned Enterprise
USD United States Dollar
WFOE Wholly Foreign-owned Enterprise
Key Recommendations

1. Continue to Strengthen the Rule of Law
   - Continue to focus on advancing the rule of law and implementing the reform blueprint set out in the Fourth Plenum’s Decision in a timely fashion.
   - Enhance the judiciary’s independence and impartiality, preventing any improper political influence.
   - Remove all unnecessary opening clauses from relevant legal documents.
   - Ensure an equitable, transparent, predictable and nationwide impartial implementation and enforcement of laws and regulations.
   - Define further the scope of state secrets.
   - Permit foreign nationals to attend civil and commercial hearings in the People’s Courts.
   - Ensure prompt, comprehensive and correct enforcement of judicial decisions and arbitral awards, by providing enforcers and relevant right owners with relevant information.
   - Enhance compliance with terms and deadlines, even with the provision of pecuniary sanctions and/or limitation and prescription periods.
   - Ensure that all judgments issued by a court can be accessed by any interested party, not only the litigants or their counsels.
   - Ensure that the Regulation Concerning the Publication of People’s Courts Judgments and Rulings on the Internet (2013 Regulation) will be implemented by individual People’s Courts, including cases involving local government interests.
   - Publish all laws and regulations before they enter into force, improve the online publication of laws and regulations, allow sufficient transitional periods and provide English translations of important rules and regulations.
   - Standardise the public consultation process, allow at least eight weeks for comments on drafts of laws and regulations, and publish stakeholders’ comments and regulators’ feedback.
   - Ensure the deadline for the consolidation of the Civil Code set for 2020 is respected and promote initiatives to accelerate the process of codifying People’s Republic of China (PRC) laws into a single document.

2. Ensure Smooth Implementation of the New Foreign Investment Law (FIL) by Formulating Necessary Detailed Rules, and Minimise Potential Negative Impact on Foreign Business
   - Formulate in a timely manner necessary implementation rules to clarify the uncertainties and ambiguities caused by the launch of the new FIL, particularly the gaps created by abolishing old laws.
   - Adjust all other pertinent laws and regulations to maintain alignment of the whole legal framework in the field of foreign investment.
   - Ensure transparency in the process by presenting to the public a clear enactment timeframe including information on the respective stakeholders in charge of rule-making, and allow sufficient time throughout the process for public comments to reflect business concerns.
   - Consider fundamentally changing the existing foreign investment management approach so that there is no further differentiation between Chinese and foreign investment, so as to ensure a level playing field and non-discriminatory access to the market.
• Clarify the requirements and terms of the investment review that requires approval and remove conditional approvals.

3. Eliminate Restrictions on Foreign Legal Services
- Allow foreign law firms to fully practise PRC law in non-contentious areas through the employment of individuals who are qualified and licensed to practise PRC law.
- Allow lawyers in foreign law firms to fully represent their clients before Chinese government authorities as long as they have proper powers of attorney.
- Increase cooperation under the Pilot Work Plan, particularly in permitting the establishment of more closely integrated Sino-foreign joint venture (JV) firms to practise both Chinese law and foreign law in their own name.
- Ensure consistent and transparent implementation and enforcement of laws and regulations concerning foreign investments.
- Streamline the registration procedures and requirements for foreign lawyers.

4. Adopt Regulations that Encourage Fair Enforcement of the Anti-monopoly Law (AML)
- Support the efforts of the Supreme People’s Court (SPC) in promoting cases brought under the AML, as well as the consistent interpretation, application and enforcement of the AML by China’s enforcement authorities.
- Adopt standard publication channels, such as websites, for all information relevant to AML enforcement, including new measures and decision.
- Ensure that the AML is implemented and enforced equally among all companies, domestic or foreign.
- Ensure that the application and enforcement of the AML is consistent with international competition law (ICL) policy and practice, while adopting policies and approaches suited to the Chinese context.

Introduction to the Working Group
Legal professionals play an important role in society in helping people avoid or resolve conflict. They serve the private interests of clients while promoting integrity and justice throughout society, defining public order. Legal professionals help to link public and private life, putting limits on the effects that private interests may have.

Created in 2000, the Legal and Competition Working Group fosters greater legal transparency and awareness of legal developments that affect foreign trade and investment in China. It also advocates for the strengthening of the rule of law and foreign business’ better access to the Chinese market, including the legal market. It is now comprised of approximately 500 individuals that represent over 180 member companies.

Recent Developments
The working group highlights the following regulatory developments that have recently taken place:

Foreign Investment Law
On 15th March 2019, the National People’s Congress (NPC) adopted the Foreign Investment Law (FIL), which will go into effect on 1st January 2020. The FIL aims to streamline existing legislation by unifying the foreign investment framework in China. The law plays an important role in formalising the legal foundation for the shift from the old foreign investment catalogue to the new-market access system based on a negative list. It also addresses some of the biggest challenges faced by foreign businesses, such as unfair technology transfers, intellectual property rights (IPR) protection and equal opportunities in government procurement. However, full implementation of the law will now require both extensive follow-through from the administrative authorities at all levels of government, and full support...
of the legal system in cases where protections found within the FIL are not respected.

Special Administrative Measures (Negative List) for the Access of Foreign Investment in Pilot Free Trade Zones (2019 Version) and the Special Administrative Measures (Negative List) for the Access of Foreign Investment (2019 Version)

On 30th June 2019, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) jointly announced the latest negative lists for foreign investment for the free trade zones and nationwide. In the 2019 version of both negative lists, the provision of legal services for Chinese law-related matters is expressly prohibited (except for providing assistance in connection with delivering information on the impact that China’s legal environment is having). The working group notes that no further improvements have taken place in this respect.

Updates to the Anti-monopoly Law (AML)

On 13th March 2018, the State Council announced a major restructuring of governmental agencies. This was approved by the 13th NPC on 17th March 2018. Due to this change, the three existing antitrust enforcement units within the NDRC, the former State Administration for Industry and Commerce (SAIC) and MOFCOM were transferred to the new market regulator – the State Administration for Market Regulation (SAMR).

Recently, SAMR published Order No. 10, Order No.11 and Order No.12, which are the Interim Provisions on the Prohibition of Monopolistic Agreements, the Interim Provisions on the Prohibition of Abuse of Dominant Market Position and the Interim Provisions to Stop Acts of Abusing Administrative Power for the Purpose of Eliminating or Limiting Competition respectively. These three new regulations are to provide unified and clear guidance for the administrations for market regulation at all levels, and improve legal enforcement. They will come into effect on 1st September 2019.

Updates to the Anti-unfair Competition Law (AUCL)

On 23rd April 2019, the NPC Standing Committee adopted an amendment to the AUCL, in order to further protect trade secrets:

- The scope of trade secrets was expanded to ‘commercial information’.
- The amendment includes new types of trade secret violations, especially the acquisition of trade secrets through “cyber invasion”.
- From now on, all “natural persons, legal persons, and other non-legal person organisations” could be considered as potential violators, covering a larger scope than the previous version that only concerns business operators.
- The amendment also increased the civil and administrative liability of the infringer. For instance, it introduced punitive civil damage for malicious infringement, for which the compensation awarded shall be between one and five times the actual loss suffered by the right holder or the benefit obtained by the infringer. The maximum amount of compensation available for the court to award at its discretion was increased from Chinese yuan (CNY) three million to five million. The maximum administrative penalty was also raised.

Updates to the Trademark Law

On 23rd April 2019, the NPC Standing Committee adopted amendments to Trademark Law, with the purpose of effectively tightening restrictions on bad-faith registration and stockpiling behaviours. It will come into force on 1st November 2019.

The amendment signifies a crackdown on counterfeiting by increasing the cap on punitive damages awarded by civil courts from CNY 3 million to 5 million. This comes as a response to the understanding that infringement

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would not stop until profits of infringement are lower than litigation costs.

The amendment also regulates that trademark agencies shall follow the principles of good faith. And if an agency knows or should have known that the registration application falls any prohibited circumstances, it may not accept the authorisation.

The amendment regulates the disposal of counterfeit registered trademarks, goods and materials – as well as the tools used in their manufacture. The new articles stipulate that, in the case of trademark disputes and at the request of the right holder, courts may order the destruction of the counterfeits. Goods with counterfeit registered trademarks may not enter the market even after the offending marks have been removed.

Key Recommendations

1. Continue to Strengthen the Rule of Law

Concern
Despite China’s efforts to adopt international standards, European companies operating in China still face challenges in cooperating with Chinese legislative, judiciary and administrative bodies due to a lack of legal and regulatory transparency.

Assessment
As a member of the World Trade Organization (WTO), China is obliged to comply with the transparency requirements in its accession protocol. A key element in China’s accession to the WTO relates to laws, regulations and other rules on trade and investment. While there has been significant progress in the quality of drafting, timeliness of issuance and ease of interpreting People’s Republic of China (PRC) laws and regulations since China’s WTO accession, further attention still needs to be paid to issues of transparency, uniform applicability and broad administrative discretion when applying laws and regulations, and judicial review of administrative decisions. With its accession, China has committed to mass legal reform. The government announced many measures on the rule of law that are heading in the right direction, such as the fight against judicial corruption and ensuring that people respect the constitution. While foreign investors understand that it will take time and effort to fully implement these reforms, the Legal and Competition Working Group places high expectations on the continuous reform of China’s legal regime towards advancing the rule of law, particularly in areas such as civil and corporate law.

Judicial Independence
In February 2017, the president of the Supreme People’s Court (SPC) delivered a speech that cast doubt over the transparency and retroactive application of the law, resulting in legal operators becoming concerned over the independence of the judiciary. While some judges aimed to display independence in their decisions, the president of the SPC reminded them that China’s court system is not independent from the Communist Party of China (CPC) and that any attempt to make it so shall be rejected. This is undoubtedly a worrying sign as the working group supports the concept of an independent judiciary – judges should be third parties that make decisions free from any interference by the Party, politics, or any other outside force.

Vagueness of Laws and Regulations: Opening Clauses
A lack of precision is an undesirable element in lawmaking. One of the vaguest parts of Chinese law, at all levels, is the ‘opening clause’ that appears in the articles of almost all normative documents.

When disciplining a subject, it is normal to provide a number of actions, sanctions and requisites through numbered, itemised lists. Such lists provide a specific opinion on the intention of the legislator or regulator. In addition, such lists set forth well-defined norms, principles and sanctions in order to establish the parameters for application of the law or regulation. In Chinese law, the opening clause is the last item, which usually states: “[…] and others, as provided by other/ relevant laws and regulations.” Such opening clauses add vagueness and a sense of uncertainty to the normative document in which they are included. This is in sharp contrast to the rule of law. It has to be noted, however, that the most recent national laws exclude these opening clauses almost entirely. The working group warmly welcomes this new style of lawmaking and expects the relevant legislators and regulators to reform the entire legal system, adapting it so it complies with the rule of law.

Implementation of Laws and Regulations
A predictable, transparent and impartial legal system is the basis for fostering both domestic and foreign investment. Where laws and regulations are applied and enforced without consistency in regard to parties, location or sector, the system is perceived as unpredictable and unequal. Therefore it is difficult for investors – and even so more for European investors accustomed to mature and sophisticated systems – to assess risks. This adds to the uncertainties of investing in a country where implementation of the rules is not transparent and predictable.

State and Commercial Secrets
The foreign business community continues to be concerned about several PRC laws regarding state and commercial secrets. On one hand, foreign companies doing business in China want to fully comply with PRC laws in all of their activities. In this respect, the 2014 version of the Implementing Regulations to the PRC Law on the Protection of State Secrets has been disconcerting to foreign investors. Foreign investors and their advisors still lack sufficient legal certainty to fully understand the original and excessive scope of state secrets, in order to determine with confidence if they are in breach of such regulations. On the other hand, China saw significant developments in laws that address trade secrets. In 2017, China’s AUCL strengthened trade secret protection in civil and administrative proceedings. On 23rd April 2019, the Standing Committee of the NPC passed a bill amending the AUCL. The newly introduced punitive damages rules and the shifting of the burden of proof of not violating the trade secret right onto the infringer will further enhance protection for trade secret right holders.

Enforcement of Judgments and Awards
The problems related to the enforcement of judgments and arbitral awards in China are unfortunately not limited to a lack of rigidity in terms of deadlines. Procedural rights serve substantive rights. This implies that without the granting of the former, the latter would be left ineffective. In the same way, without enforcement functioning as a tool for the practical application of procedural rights, substantive rights will be left void of meaning.

Furthermore, the People’s Courts and the winning parties in proceedings are too often not provided with the adequate means to follow up on enforcement proceedings. This, in effect, constitutes a missing cog in an otherwise well-oiled legal apparatus. For the rule of law’s effective and correct application, all elements need to be equally considered.

Terms and Deadlines
For the Chinese judiciary, it appears that terms and deadlines set forth are often treated as ‘soft deadlines’. In the everyday experience of the Legal and Competition Working Group, terms and deadlines in civil trials and administrative proceedings are often not complied with, leading to an unacceptable degree of uncertainty in legal proceedings.

As is the case in everyday business dealings, any breach of a contract clause (including those covering terms and deadlines) will be met with concrete repercussions. Similarly, any violation of deadlines in legal proceedings should be sanctioned properly and effectively by using the limitation periods of relevant rights and pecuniary sanctions. The working group, aware of the ever-solidifying rule of law in China, hopes that the necessary steps will be taken to resolve this important issue.

Court Judgments
European businesses welcome the increase in transparency and publicity of court judgments. They also appreciate the efforts that have been put into improving and expanding the websites of the SPC and local courts, through which a growing selection of court judgments has now been made available. However, the search capabilities and user-friendliness of these tools need to be further invested in and improved. Doing so would be beneficial to the entire business and civil community.

The publication of Guiding Cases by the SPC is also a very welcome development towards a comprehensive approach to jurisprudence and should contribute to consistently interpreting and implementing laws and regulations throughout the country’s courts.

The amendment to Article 156 of the Civil Procedure
Law is a positive development to the extent that it expressly guarantees the public the rights to check and review effective civil judgments and rulings, except those involving state and commercial secrets and personal privacy. However, in addition to this, foreign nationals should have full public access to commercial and civil hearings in the People’s Courts without the need to pre-register or be specially authorised.

Retroactive Application of Laws and Regulations
On occasion, regulations and circulars issued by PRC institutions have been applied retroactively, creating uncertainties on a law’s state at any given time. In order to preserve legal certainty and meet the legitimate expectations of business operators, PRC institutions and regulators should apply the general principle of non-retroactivity to laws and regulations, and refrain from issuing regulations with retroactive effect. Predictability is one of the key requisites to the rule of law, as it increases trust in the legal system and allows companies and individuals to plan their activities, which increases business confidence. In China, predictability, and therefore business confidence, is negatively affected by the practice of retroactively applying laws and regulations in draft form, which in turn has an adverse effect on investment decisions.

Official Publication of Laws and Regulations
Upon its accession to the WTO, China made a commitment to establish an official journal dedicated to the publication of all laws, regulations and other measures concerning or affecting trade in goods and services, or the Agreement on Trade-related Aspects of Intellectual Property Rights. This has been achieved to some extent through a website maintained by the Ministry of Justice (MOJ). However, this tool remains basic and insufficiently user-friendly. The working group encourages the Chinese Government to further invest in this tool by including professional search and hyperlinking features and ensuring same-day publication of all laws and regulations. This would enhance the rule of law by providing greater accessibility to laws and regulations for both foreign and domestic enterprises, instead of them having to rely on costly commercial alternatives. Finally, the working group regrets that the official website does not offer links to essential laws and regulations in any of the languages used by officially recognised ethnic groups in China (e.g., Mongolian, Tibetan, Uyghur, Zhuang and others).

Public Consultation Process
Public consultation is a crucial element in the law-making process, as it facilitates the resolution of potential problems in the practical implementation of laws before their official promulgation, and therefore facilitates better legislation.

Despite efforts to improve transparency and maintain the public consultation website by the MOJ, many ministries and commissions, especially at the provincial level and below, still do not allow for a period of at least 30 days for public consultation on draft regulations, despite it being committed to by China in the Regulation on the Procedures for the Development of Administrative Regulations. In addition, this public consultation process should be made more transparent by publishing major contributions received from stakeholders on draft laws and regulations, together with feedback from regulators on the stakeholders’ comments, in a manner similar to the European Commission website. The current lack of transparency renders the current consultation process little more than a ‘black box’. Even though China allows non-Chinese nationals to participate in public consultations on draft laws, foreign stakeholders may be discouraged from providing comments because no comprehensive assessment is provided when regulations are published in their final form.

First Steps Towards the Civil Code: the General Provisions of the Civil Law
China experienced a turning point in 2017 in its path towards creating a comprehensive Civil Code. On March 2017, the NPC passed the General Provisions of the Civil Code (General Provisions), which came into effect on October 2017. The General Provisions constitutes the first chapter of a broader project that regulates all aspects of civil law, namely contracts,

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14 The MOJ website of call for comments, <http://zrzyj.chinalaw.gov.cn/index>
16 The European Commission website, <https://ec.europa.eu/info/consultations_en>
property, torts, marriage, family and inheritance. The other five chapters that compose the Civil Code are scheduled to be adopted and promulgated by the 13th NPC in 2020. These General Provisions regulate the basic principles of civil activities, i.e. natural persons’ capacity, status and civil rights; legal persons and associations; civil legal acts; and agencies. The Legal and Competition Working Group welcomes the promulgation of the General Provisions and deems it a good sign regarding the modernisation of China’s legal system. The working group expects that as soon as the entire Civil Code, including all six chapters, enters in force, it will help to provide European enterprises with more legal certainty when conducting business in China.

Recommendations
• Continue to focus on advancing the rule of law and implementing the reform blueprint set out in the Fourth Plenum Decision in a timely fashion.
• Enhance the judiciary’s independence and impartiality, preventing any improper political influence.
• Remove all unnecessary opening clauses from relevant legal documents.
• Ensure an equitable, transparent, predictable and nationwide impartial implementation and enforcement of laws and regulations.
• Define further the scope of state secrets.
• Permit foreign nationals to attend civil and commercial hearings in the People’s Courts.
• Ensure prompt, comprehensive and correct enforcement of judicial decisions and arbitral awards, by providing enforcers and relevant right owners with relevant information.
• Enhance compliance with terms and deadlines, even with the provision of pecuniary sanctions and/or limitation and prescription periods.
• Ensure that all judgments issued by a court can be accessed by any interested party, not only the litigants or their counsels.
• Ensure that the Regulation Concerning the Publication of People’s Courts Judgments and Rulings on the Internet (2013 Regulation) will be implemented by individual People’s Courts, including cases involving local government interests.
• Publish all laws and regulations before they enter into force, improve the online publication of laws and regulations, allow sufficient transitional periods and provide English translations of important rules and regulations.
• Standardise the public consultation process, allow at least eight weeks for comments on drafts of laws and regulations, and publish stakeholders’ comments and regulators’ feedback.
• Ensure the deadline for the consolidation of the Civil Code set for 2020 is respected and promote initiatives to accelerate the process of codifying PRC laws into a single document.

2. Ensure Smooth Implementation of the New Foreign Investment Law (FIL) by Formulating Necessary Detailed Rules, and Minimise Potential Negative Impacts on Foreign Business

Concern
The FIL continues to differentiate foreign companies from Chinese companies in the field of investment, and the abolishment of the three main foreign investment laws, namely the Chinese-Foreign Equity Joint Ventures Law, the Wholly Foreign-Owned Enterprises Law, and the Chinese-Foreign Contractual Joint Ventures Law, creates many uncertainties for both new and (in particular) existing investment projects in China.

Assessment
The European Chamber places high expectations on the continuous reform of China’s legal regime for foreign investment in terms of creating a level-playing field, expanding market access and opening-up, transparency and fair competition. At the same time, the willingness of Chinese authorities to enhance foreign investment promotion, protection and management is welcomed. It has been a constant position of the European Chamber to support the needs of foreign-invested companies in order to avoid any discrimination between domestic and foreign players. This is the best way to provide a level playing field and non-discriminatory access to the market.

The FIL embodies China’s positive attitude of further promoting reform and opening up and protecting foreign investment, but it does not fundamentally abolish the distinction between foreign and domestic investment, making European businesses feel that genuine national treatment and a level playing field

18 According to the WTO, national treatment means treating foreigners and locals equally, i.e. imported and locally-produced goods should be treated equally – at least after the foreign goods have entered the market. (Principles of the Trading System, WTO, viewed 1st August 2019, <https://www.wto.org/english/tratop_e/whatis_e/tif_e/fact2_e.htm>)
are far from guaranteed. The European Chamber believes there are no compelling reasons to regulate companies differently due to their ownership structure or by the nationality of the investors. By contrast, EU countries have adopted a market economy that does not have a special law specifically treating foreign capital differently. Considering China is now the world’s second largest economy, and is increasingly sharing international responsibilities in more and more areas, real consideration should be given to fundamentally changing the existing foreign investment management approach in favour of a more confident and open attitude. In particular, this should entail ceasing to differentiate between Chinese and foreign investment.

The new FIL, while eliminating the three JV-related laws, is creating substantial uncertainties for all those that have established constructive and functioning specific governance models. The new FIL allows for a five-year transition period for those that need to adjust their governance models. The period until the 1st January 2020 may potentially create confusion for the foreign business community, as so far no implementation rules have been published.

Compared to the 170 articles in the 2015 draft, there are 42 articles in the new FIL, and the provisions on many areas are brief and broadly principled in nature. It addresses many key concerns of foreign investors; highlighting IPR protection, pre-establishment national treatment and negative list management, equal support policies and equal participation in government procurement. However, many regulations still require more detailed implementation rules to ensure operability, as well as to link with relevant laws and regulations to truly reflect the intention of the law. In this respect, the working group notes the positive move of the State Council on 2nd March 2019 when it deleted some restrictive technology transfer-related provisions under the Technology Import and Export Administrative Regulations and the Implementation Regulations of the Chinese-Foreign Equity Joint Ventures Law. The working group encourages and expects more, similar efforts from relevant stakeholders to facilitate successful implementation of the FIL.

There are requirements in the FIL that are already pursuant to existing laws and regulations, such as Article 15’s stipulation that mandatory standards apply to foreign-invested businesses and Article 8’s requirement for establishing labour unions. The working group believes there is no need to re-state provisions that have been stipulated by legal documentation issued by the same level of authorities.

Interference with other Existing Foreign Investment Laws and Regulations and Special Policies
Despite abolishing the three foreign direct investment (FDI) laws, the FIL is silent as regards the validity of other foreign investment regulations, rules and policies which impose restrictions on foreign investors compared to domestic investors (e.g. in the area of foreign exchange and financing). Such other regulations focus on areas such as re-investment of foreign-invested enterprises (FIEs) inside China; foreign-invested holding/investment companies; the administration of total investment, registered capital and foreign debt of FIEs; and mergers and acquisitions (M&A) by foreign investors in domestic enterprises.

The working group hopes that, in the course of implementing the FIL, the existing restrictions under these other regulations will be also abolished to create a true level-playing field for foreign investors. The working group further hopes that transparency in the process will be maintained by presenting to the public a clear enactment timeframe, including information on the respective stakeholders in charge of the rule-making, and allow sufficient time throughout the process for public comments to reflect business concerns.

Recommendations
• Formulate in a timely manner necessary implementation rules to clarify the uncertainties and ambiguities caused by the launch of the new FIL, particularly the gaps created by abolishing old laws.
• Adjust all other pertinent laws and regulations to maintain alignment of the whole legal framework in the field of foreign investment.
• Ensure transparency in the process by presenting to the public a clear enactment timeframe, including information on the respective stakeholders in charge of rule-making, and allow sufficient time throughout the process for public comments to reflect business concerns.
• Consider fundamentally changing the existing foreign investment management approach so that there is no further differentiation between Chinese and foreign investment, so as to ensure a level-playing field and non-discriminatory access to the market.
• Clarify the requirements and terms of the investment review that requires approval and remove conditional approvals.

8 3. Eliminate Restrictions on Foreign Legal Services

Concern
The working group continues to be concerned about the restrictions placed on foreign lawyers and foreign law firms operating in China, including those that apply in any area of practice and those that apply in instances of cooperation with PRC firms and lawyers.

Assessment
The Legal and Competition Working Group welcomes the registration and control of foreign law firms and lawyers by the appointed authorities. However, the failure to eliminate restrictions on the provision of legal services, at least in certain areas of the law—including foreign investment, contractual and commercial matters, employment matters, mergers and acquisitions, competition law, banking and finance, and capital markets law (i.e., the ‘non-contentious areas’)—is an increasingly significant issue when it comes to fostering economic progress and working relationships between European Union (EU) Member States and China. The working group is concerned that in the 2019 Negative List the provision of legal services has been kept in the ‘prohibited’ category. This does not reflect the strengthening market positioning of Chinese law firms in the global arena, as can be seen in their fast growth and expansion in European markets, as well as in other important jurisdictions outside Europe.

Further opening up the legal services sector—especially cooperation between foreign and Chinese law firms and the practice of non-contentious areas—in cross-border investments, would permit the clients of Chinese law firms to have better access to the guidance of international laws and practices. It will also broaden the career prospects of PRC-licensed lawyers, allowing them to grow and gain expertise in an international environment, which will benefit Chinese investors abroad.

i. Employment of Chinese-licensed lawyers by EU law firms
Currently, when European law firms hire licensed PRC lawyers, those individuals’ qualifications and licences to practise PRC law in non-contentious areas are suspended. Allowing Chinese-licensed lawyers to practise in foreign law firms operating in Mainland China would permit these lawyers’ clients—both Chinese and foreign—to access the full range of legal services, including those that are provided by EU law firms. This would not only benefit EU law firms but also enhance the career prospects of PRC-licensed lawyers, allowing them to grow and gain expertise in an international environment.

ii. Participation of lawyers from foreign law firms in meetings with the Chinese Government
Appearance, participation, and representation by lawyers from foreign law firms (including PRC-licensed lawyers) before non-judicial Chinese administrative authorities on behalf of their clients is permitted occasionally on a case-by-case basis. Furthermore, this lack of a transparent and consistently enforced right of access and representation for lawyers working in foreign law firms often reduces the quality of the information exchanged with the Chinese authorities, limits the sharing of experience by foreign law firms with European investors, and sometimes results in misunderstandings between the Chinese government authorities and European investors. As a result, it is often difficult for foreign investors to understand the Chinese Government’s proceedings.

iii. Access to joint venture (JV) firms
The Closer Economic Partnership Arrangements signed between Mainland China and the Hong Kong and Macao special administrative regions in November 2015 indicate that China is committed to opening part of its legal market to Hong Kong law firms and Chinese permanent residents of Hong Kong. Further developments under the Pilot Work Plan issued by the MOJ in 2014, and its implementing rules, have yet to be rolled out in free trade zones other than in Shanghai. While a few pilot JV firms have been established since 2015, such developments still appear

References:
20 Agreement on Trade in Services to the Mainland and Hong Kong Closer Economic Partnership Arrangement, Invest in China, 2015, viewed 9th June 2019, <http://www.fdi.gov.cn/1800000121_23_72641_0_7.html>
21 Ibid.
quite limited, as existing rules only allow a ‘one office, two teams’ model and not a ‘fully integrated joint venture model’ that combines the strengths of the Chinese and foreign firms’ partners.

In the 2019 Negative List, the provision of consultancy services on Chinese law-related matters remains prohibited. The Legal and Competition Working Group considers this to go against the publicly-stated intention to open up China’s market. It puts foreign law firms at a competitive disadvantage compared to Chinese firms. Furthermore, the working group sees enforcement problems associated with the 2019 Negative List, since some foreign lawyers (as foreign law firms and foreign investors) have in some cases decided not to register with the MOJ. They chose to practise Chinese law by either setting up foreign investment consulting companies or controlling smaller Chinese law firms which use a foreign brand.

iv. Registration procedures and requirements
Registration of a new foreign lawyer in the PRC can take several months, as the procedure is still two-fold; i.e. local and central. Requirements for a chief representative to have at least three years of foreign bar registration and six months domicile in the PRC, plus the requirement of at least two foreign representatives for each firm, are different from immigration requirements for foreign representatives working in other sectors, and are very burdensome when compared to international practice.

Recommendations
• Allow foreign law firms to fully practise PRC law in non-contentious areas through the employment of individuals who are qualified and licensed to practise PRC law.
• Allow lawyers in foreign law firms to fully represent their clients before Chinese government authorities as long as they have proper powers of attorney.
• Increase cooperation under the Pilot Work Plan, particularly in permitting the establishment of more closely integrated Sino-foreign JV firms to practise both Chinese law and foreign law in their own name.
• Ensure consistent and transparent implementation and enforcement of laws and regulations concerning foreign investments.
• Streamline the registration procedures and requirements for foreign lawyers.

4. Adopt Regulations that Encourage Fair Enforcement of the AML

Concern
Many aspects of AML application remain unclear, detailed reasoning in important cases remains unpublished.

Assessment
The Legal and Competition Working Group welcomes the increased enforcement of the AML across a number of sectors, as it sends a strong message from the Chinese authorities about their intention to promote market-orientated reforms and safeguard fair competition. This is in line with China’s reform agenda as laid down in the third and fourth plenums of the 18th CPC Congress. If handled properly, these enforcement cases have the potential to provide China with an opportunity to demonstrate that investigations are carried out fully in accordance with the rule of law, one of the central themes of the Fourth Plenum. However, for this to happen, legal best practices must be embraced in order to ensure that administrative law enforcement is carried out impartially, transparently and consistently. The working group regrets that these principles, essential to any competition regime with a market economy, are still not generally applied.

The working group welcomes the Chinese government restructuring of the three agencies responsible for antitrust enforcement into a single department under the SAMR. However, despite this change and some recent progress, there is still uncertainty among businesses regarding AML enforcement processes. This uncertainty stems from the lack of clarity with regard, but not limited, to: 1) the standards, fairness and proportionality of proceedings; and 2) the time allowed to notify different parties, and the number and type of additional implementing regulations/guidance that can be expected from the SAMR. As a result, lawful business operators in China continue to face challenges and more companies are stepping up their demands for clarity and transparency. The absence of such clarifications may reduce or even eliminate the positive economic benefits that an effective competition law
In the area of merger control, the Legal and Competition Working Group acknowledges the important progress that resulted from the creation of the 'simple case' procedure. This normally allows cases to proceed fairly quickly to acceptance, as the stakeholder process is done through the publication of a notice on the SAMR’s website. This has resulted in a higher level of transparency for businesses. The Legal and Competition Working Group continues to encourage the SAMR to expand the benefits of this system to all kinds of merger cases. In particular the working group encourages the SAMR to publish notices of filings also for non-simple cases—immediately upon case acceptance—including basic information on the merging parties, the sector concerned and the indicative deadline for the SAMR’s decision.

Currently, the SAMR has only issued regulations/guidance on merger control, abuse of dominance and anti-monopoly agreements. There are an additional two areas that would benefit from improvement: 1) the application and enforcement of the AML by the SAMR, as well as law enforcement and rule-making between private litigation and administrative enforcement of the AML, could be more consistent; and 2) the SAMR’s review procedure should foster the development of a predictable review timetable and limit instances where merging parties are forced to withdraw and re-file their notification.

**Recommendations**

- Support the efforts of the SPC in promoting cases brought under the AML, as well as the consistent interpretation, application and enforcement of the AML by China’s enforcement authorities.
- Adopt standard publication channels, such as websites, for all information relevant to AML enforcement, including new measures and decision.
- Ensure that the AML is implemented and enforced equally among all companies, domestic or foreign.
- Ensure that the application and enforcement of the AML is consistent with International Competition Law (ICL) policy and practice, while adopting policies and approaches suited to the Chinese context.

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**Abbreviations**

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<tr>
<th>Acronym</th>
<th>Full Form</th>
<th>Description</th>
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<tbody>
<tr>
<td>AML</td>
<td>Anti-monopoly Law</td>
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<td>AUCL</td>
<td>Anti-unfair Competition Law</td>
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<td>CNY</td>
<td>Chinese Yuan</td>
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<td>CPC</td>
<td>Communist Party of China</td>
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<td>EU</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FIE</td>
<td>Foreign-invested Enterprise</td>
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<td>FIL</td>
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<td>ICL</td>
<td>International Competition Law</td>
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<td>Intellectual Property Rights</td>
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<td>JV</td>
<td>Joint Venture</td>
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<td>PRC</td>
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<td>Supreme People’s Court</td>
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<td>World Trade Organization</td>
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1. Improve the Overall Intellectual Property Rights (IPR) Legal System and Improve Enforcement in Order to Foster a Business Environment that Provides the Necessary Assurances to Enable World-Class Innovation in China
   - Give full play to free market forces and balance policies for the import and export of technologies to realise genuine innovation.
   - Involve international companies in the whole process of policy consultation on the Chinese IPR legal system, covering policy-drafting, policy-revising and integration of feedback on policy implementation.

2. Encourage International Companies to Contribute to Chinese Research and Development (R&D) Operations by Optimising the Financial Incentives Framework
   - Encourage international businesses to participate in national and regional key R&D projects by setting up fair and transparent regulation with a clear application process.
   - Provide European small and medium-sized enterprises (SMEs) in China with equal access to financing as domestic companies for joint international R&D activities.
   - Remove the restrictions prohibiting international businesses from applying for high and new technology enterprise (HNTE) status to ensure that all internationally-qualified R&D institutions can benefit from participation in the Chinese innovation system.

3. Invest in China’s Living Environment to Facilitate Sustainable R&D Activities, Particularly Green Technology Development
   - Establish regional cooperation platforms which are open to international companies with research operations on an equal footing with Chinese companies.
   - Provide foreign-invested enterprises with equal access to incentives and preferential policies on environmentally friendly technological development as domestic companies.
   - Set up incentive programmes to facilitate the creation of pilot and demonstration areas for environmentally friendly technologies and their commercialisation.

4. Facilitate the Exchange of Scientists at all Levels as Part of a Joint Effort with the European Union (EU)
   - Accelerate the pace of rolling out innovation-friendly reforms and implement policies nationwide after they are piloted successfully in free trade zones (FTZs).
   - Provide more flexible visa application processes that allow foreign scientists to work in China on short-term, joint R&D projects, and make the process more transparent.

5. Improve International Companies’ Access to Data in China to Foster Digital Innovation and Enhance China’s Innovation Capability
   - Clearly define the scope and proportion for international joint research activities to encourage international businesses’ participation in China’s Internet Plus projects.
   - Formulate a guideline on industrial data access for R&D purposes in China.
   - Provide an industrial data-sharing platform for all players, including both domestic and foreign multinational corporations (MNCs) and SMEs.
Introduction to the Working Group

Research and development (R&D) involves the innovation, promotion and improvement of products and processes, pushing the limits of technology and continuously improving technological services and solutions. Companies use their R&D to quickly respond to societal changes and market demands for the development of cutting-edge products, while also significantly improving the country’s economic growth and ability to create jobs. R&D contributes to the development of emerging technologies, like artificial intelligence (AI) and the Internet of things (IoT), which can be applied in various industries to improve people’s lives, such as through increasing efficiency in manufacturing, improving diagnostic rates in healthcare and providing equal education for children living in remote areas. At present, innovation capability is regarded as key for China to avoid the middle-income trap and to enhance overall technological strength. The Research and Development Working Group believes that in order for China to reach its goal of becoming a world science and technology (S&T) power by 2049, it must strengthen global S&T cooperation and engage the international R&D community.

The European Chamber’s Research and Development Working Group provides a platform for exchanging information, experiences and best practices among member companies and promotes dialogue and transparency in R&D policy. It was created to further develop the activities of the former Research and Development Forum, as members felt the need to engage directly with Chinese authorities at both the central and local levels. The working group is comprised of professionals directly involved in R&D operations, with representatives from more than 80 European multinational corporations (MNCs) that have R&D centres and large-scale R&D operations in China, with the majority located in and around Beijing and Shanghai. Various industries are represented in the working group, including automotive, chemicals and petrochemicals, information and communications technology, aerospace, energy, and pharmaceuticals.

Recent Developments

With the rapid development of S&T innovation, China has progressed further on its journey to becoming an innovation-foocussed country. The global innovation index, published by the World Intellectual Property Organization (WIPO) in 2018, ranks China 17th out of the 126 countries included. In 2018, China’s R&D spending amounted to Chinese yuan (CNY) 2 trillion, an 11.6 per cent increase over 2017.

As a supplement to capital investment, various innovation-specific policies and incentives have also been implemented to stimulate more innovation. On 15 May 2019, the National People’s Congress (NPC) adopted the new Foreign Investment Law of the People’s Republic of China (FIL), which will take effect from 1 January 2020. Chapter III of the FIL lists a few protective measures for foreign investment. Among them, Article 22 prohibits administrative bodies from forcing technology transfer by administrative measures. This echoes the language used in other high-profile policies that have been released in recent years, most notably State Council Document No. 19 [2018]. However, this leaves open the possibility for any non-administrative body to use any other means to compel technology transfers. Instead, the FIL should simply prohibit forced technology transfer by any means. The detailed implementation rules for this legislation are yet to be seen, and despite the pledges from the government, forced technology transfers still persist. According to the European Business in China Business Confidence Survey 2019 (BCS 2019), 20 per cent of respondents report feeling compelled to transfer technology in order to maintain market access, which is double the number of cases reported in 2017. This trend is particularly prevalent in high-tech industries, such as chemicals and petrochemicals, automotive and medical devices. It is concerning that 63 per cent of those that felt compelled to transfer technology said it took place in the last two years, and a quarter said the transfer was taking place during the time of the survey (January 2019). It is also notable that, in most cases, forced technology transfers do not take place through administrative means but in a business context.

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European businesses play an important role in China’s R&D development. Having gathered decades of localised experience and leadership in S&T, European technological enterprises are uniquely equipped to help improve China’s R&D ecosystem. China can utilise this experience to help improve its domestic innovation capacity. While 73 per cent of respondents in the BCS 2019 report that China’s innovation and R&D environment is more or as favourable as the worldwide average, more can be done to improve the transparency of incentives given for innovation, provide flexible access to global talent and to deliver greater legislative support.

At the third EU-China Innovation Cooperation Dialogue (ICD) in June 2017, the European Commission and the Ministry of Science and Technology (MOST) agreed to renew the EU-China Co-funding Mechanism on Research and Innovation for 2018–2020 to support joint research and innovation-related projects under the framework of Horizon 2020. From 2016 to 2020, over euro (EUR) 500 million from the European Union (EU) and Chinese yuan (CNY) 1 billion from China will be allocated to a variety of different sectors, including food, agriculture and biotechnology, environment, sustainable urbanisation, surface transport, space and healthcare, among others. In April 2019, during the fourth EU-China High Level ICD, the European Commission and MOST shared views on S&T collaboration and exchanged information about their latest plans and priorities; also the two sides confirmed their intention to renew the EU-China Science and Technology Cooperation Agreement. The EU side focussed on the Horizon Europe proposal for 2021–2027, while the Chinese side promoted its Medium- and Long-Term S&T Development Plan for 2021–2035.

During the Belt and Road Forum for International Cooperation (BRF) in May 2017, President Xi Jinping announced the launch of the Belt and Road Science, Technology and Innovation Cooperation Action Plan, which will entail China inviting 2,500 young scientists to engage in short-term R&D work, training up to 5,000 scientists and technicians, and investing in 50 jointly operated laboratories within five years. According to Chinese media, by the end of 2018, 269 projects outlined during the first BRF had been completed and 10 projects were underway, an implementation rate of 96.4 per cent.

In 2017, an enhanced R&D tax allowance rate was introduced for small and medium-sized S&T enterprises. This allows the firms to deduct 75 per cent of their R&D expenses, instead of the previous 50 per cent, from their total taxable income for the period from 1st January 2017 to 31st December 2019, provided no intangible assets have been developed. If any intangible assets are created as a result of R&D, 175 per cent of the intangible assets’ original costs shall, for the above period, be amortised. Other tax relief for R&D has also been provided from 2009 to incentivise and reward greater innovation in China.

Under the 2018 institutional restructuring plan, the original duties of the State Administration of Foreign Experts Affairs (SAFEA) and the National Natural Science Foundation of China (NSFC) were transferred to the MOST. This should facilitate the mobility of international talent by easing the visa application and approval process for both experienced and young researchers, while also improving the efficiency of allocating government funding for research purposes. The working group hopes that with this newly unified and streamlined ministry, the allocation of S&T resources can be optimised to retain talent and promote innovation.
Key Recommendations

1. Improve the Overall Intellectual Property Rights (IPR) Legal System and Improve Enforcement in Order to Foster a Business Environment that Provides the Necessary Assurances to Enable World-Class Innovation in China

Concern
Despite continuous improvements to China’s intellectual property (IP) system, international businesses still encounter difficulties in exercising their legal rights, which means they do not have the level of assurance they need to commit to investing in top-level technological innovation.\(^1\)

Assessment
In China, international businesses developing new technologies are making significant contributions to the country’s economic transformation – from ‘made in China’ to ‘created in China’. China has risen to become one of the most attractive global destinations for R&D investments, which benefits Chinese society as a whole. Top level researchers, senior scientists and skilled workers are being trained and developed, and technological upgrading is taking place in many domestic companies.

In December 2018, Premier Li Keqiang announced the approval of the Draft Amendment to the Patent Law of the People’s Republic of China in order to further protect property rights and combat infringements on innovation.\(^2\) This draft amendment focuses on enforcing the punishment on infringement of intellectual property rights (IPR), such as increasing the amount of compensation and fines for counterfeiting.\(^3\) It also creates a patent authorisation system that regulates the incentive mechanism for the inventor to reasonably share the benefits of inventions.\(^4\) However, the final approval of this amendment is still pending with the National People’s Congress (NPC).\(^5\) and implementation plans are vague and ambiguous, which is of great concern to foreign businesses. The working group therefore calls for urgent promulgation of the Patent Law along with implementing rules that are detailed and transparent.

At the same time, the process for transferring IP from Chinese firms to foreign parties has become progressively tighter, with transfers being strictly reviewed if they appear to affect ‘national security’ or core technology in key fields.\(^6\) European companies face restrictions on ownership of IP produced from research and commercialisation projects receiving Chinese Government funding, according to Article 21 of the Science and Technology Progress Law\(^7\) and industry specific/local regulations.

New IP produced by projects that receive Chinese state funding require the following:

- Approval from the relevant government authorities if IP is to be transferred or exclusively licensed to non-Chinese entities (including to international project partners that contribute background IP).
- That the new IP be ‘used’ first inside China (i.e. the first licence for the newly-produced IP must be in China).

On 2\(^{nd}\) March 2019, the State Council repealed three controversial articles within the Technology Import and Export Administrative Regulation (TIER).\(^8\) Although removing TIER provisions is a positive development in controlling forced technology transfer from a legal perspective, the repeal of these articles does not automatically mean that forced technology transfer is forbidden under all conditions and circumstances. The enforcement of IPR legislation should be further enhanced as well. The working group believes that involving international companies in the process of requesting foreign companies’ opinions on policy implementation and integrating their feedback in policy enforcement can help improve China’s IPR system, and further contribute to China’s innovation capability. Worth mentioning, during the 21\(^{st}\) EU-China Summit in April

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\(^{1}\) For more analysis on the IPR legal system, enforcement and other IP protection-related issues see the Intellectual Property Rights Working Group Position Paper.

\(^{2}\) Premier Li: Decides to Extend More Reforms to Promote Invitation, State Council, 5\(^{th}\) December 2018, viewed 9\(^{th}\) April 2019, <http://www.gov.cn/ premier/2018-12/05/content_5346016.htm>

\(^{3}\) Ibid.

\(^{4}\) Ibid.

\(^{5}\) For more analysis on the IPR legal system and patent issues in general, please see Key Recommendation 1 in the Intellectual Property Rights Working Group Position Paper.


\(^{7}\) Science and Technology Progress Law, Standing Committee of the National People’s Congress, 29\(^{rd}\) December 2007, viewed 10\(^{th}\) April 2019, <http://www.gov.cn/flfg/2007-12/29/content_847331.htm>

\(^{8}\) Administrative Decree No.709, State Council, 2\(^{nd}\) March 2019, viewed 17\(^{th}\) May 2019, <http://www.gov.cn/zhengce/content/2019-03/18/content_5374723.htm>
2019, the EU and China underlined the importance of following international standards in intellectual property protection and enforcement and committed to ensuring a legal environment in which creators, inventors and artists can license their rights on market terms and effectively enforce these rights before courts and relevant authorities.23

Recommendations

- Give full play to free market forces and balance policies for the import and export of technologies to realise genuine innovation.
- Involve international companies in the whole process of policy consultation on the Chinese IPR legal system, covering policy-drafting, policy-revising and integration of feedback on policy implementation.

2. Encourage International Companies to Contribute to Chinese R&D Operations by Optimising the Financial Incentives Framework

Concern

Despite being an essential part of the Chinese innovation ecosystem, foreign enterprises still face difficulties applying for tax deductions, public funding and grants for R&D in China in comparison to domestic companies.24

Assessment

International R&D is part of the Chinese national innovation system: international companies’ R&D centres employ Chinese nationals, generate Chinese patents and industrialise their innovations in China. They also collaborate with Chinese universities and academic laboratories. All in all, they are a crucial part of the Chinese innovation ecosystem.

China has a solid set of incentives in place to stimulate innovation, including ‘strategic support’ (long-term structural incentives like the high and new technology enterprise (HNTE) status and the super-deduction scheme) and ‘tactical support’ (focused grants for projects with a definite scope and target).

In order to maximise the potential of the Chinese innovation network, it is essential that all key stakeholders work together on an equal footing. This was emphasised during the China Development Forum 2018, when Premier Li Keqiang stressed that international companies and Chinese companies should not be treated differently while implementing China Manufacturing 2025 (CM2025).25

On 29th January 2016, the MOST, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) revised the criteria for HNTE status recognition.26 Although certain requirements were somewhat relaxed, such as the minimum R&D expense ratio and academic qualifications of staff, the standards for IP ownership have actually been tightened. Under the current rules, a global, exclusive IP ownership licence that is valid for over five years is no longer sufficient for obtaining HNTE recognition; instead the core IP needs to be owned by the company applying for HNTE status.

International companies run some of China’s largest R&D operations. However, in many cases, although they are domestically operated, international businesses initially developed some of their technologies outside of China, which is problematic for European companies looking to have their IP ownership recognised and attain/maintain HNTE status. The Research and Development Working Group therefore asks for HNTE recognition standards to take international ownership into consideration.

Regarding grant applications, international companies feel they are competing on an uneven playing field due to a lack of clarity and reliability in the selection process. For example, an extensive amount of materials need to be submitted, yet the grant application period is extremely short. The language that details are provided in is another issue that creates privileged access for Chinese companies to tender information, which then gives them a higher chance of obtaining grants.

In order to establish an efficient R&D ecosystem in China, engaging the international R&D community will be crucial. European companies can bring capital,


24 For more analysis and further recommendations on the financial incentives for R&D, please see Key Recommendation 4 in the Finance and Taxation Working Group Position Paper.


human resources, advanced equipment, ideas and know-how, as well as a culture of innovation. However, there are currently only a few joint international academic-industrial research programmes, with options especially limited for European SMEs.\textsuperscript{27} The difficulty of accessing financing in China is the main reason for the lack of R&D cooperation projects for SMEs between China and other countries. This in turn hinders China in leveraging international S&T cooperation to reach its goal of developing its technological strength. On 5\textsuperscript{th} March 2019, Premier Li Keqiang stated that China will optimise its innovation ecosystem and encourage all stakeholders—both domestic and foreign MNCs and SMEs—to proactively and collaboratively participate in innovation.\textsuperscript{28} As European SMEs form a significant part of China’s innovation ecosystem, the working group calls for them to be given equal access to financing as domestic companies.

Recommendations

- Encourage international businesses to participate in national and regional key R&D projects by setting up fair and transparent regulation with a clear application process.
- Provide European small and medium-sized enterprises (SMEs) in China with equal access to financing as domestic companies for joint international R&D activities.
- Remove the restrictions prohibiting international businesses from applying for HNTE status to ensure that all internationally-qualified R&D institutions can benefit from participation in the Chinese innovation system.

4. Invest in China’s Living Environment to Facilitate Sustainable R&D Activities, Particularly Green Technology Development

Concern

There is not enough government support in place to facilitate technological commercialisation from academic R&D to industrial application, slowing down China’s overall goal of green development.

Assessment

Green development is highlighted as one of the 13\textsuperscript{th} Five-year Plan’s fundamental principles,\textsuperscript{29} under which China has set stringent goals for itself. China aims to reduce its emissions per unit of gross domestic product by 40 to 45 per cent by 2020, compared to 2005 levels.\textsuperscript{30} China also aims to increase its share of non-fossil fuel energy to 15 per cent by 2020. Under the plan, China is set to revamp traditional manufacturing industries to adopt green technologies that can, for example, optimise waste heat recovery, recycle industrial water and reduce heavy metal pollution, as well as substitute harmful and toxic materials. Other goals include the adoption of green manufacturing systems, the promotion of eco-conscious products, and the establishment of green supply chains and logistics systems. During the 21\textsuperscript{st} EU-China Summit, the two sides announced plans to reinforce their cooperation on green finance in order to direct private capital flows towards a more environmentally sustainable economy.\textsuperscript{31}

A major instrument used by the Chinese Government to address environmental issues has been the implementation and enforcement of new regulations that impose stricter environmental standards. In 2015, the revised Environmental Protection Law was implemented. It is considered the strictest environmental protection law in China’s history, with more than 50 supporting measures having been enacted to secure its implementation.\textsuperscript{32} In 2019, the Ministry of Industry and Information Technology (MIIT) also issued a document to help establish a green data centre evaluation system.\textsuperscript{33} The working group believes that these measures are beneficial but should be complemented by additional incentives that focus on the long-term development of new breakthrough technologies.

Developing incentives for new, clean technologies should be further encouraged at the industrial level. Often new, cleaner technologies can be expensive.

\textsuperscript{27} For more analysis and further recommendations on the financial incentives for SMEs, please see Key Recommendation 1 in the Inter-Chamber Small and Medium-sized Enterprise Working Group Paper.

\textsuperscript{28} 2019 Government Work Report, State Council, 5\textsuperscript{th} March 2019, viewed 9\textsuperscript{th} April 2019, <http://www.gov.cn/zhuzhai/2019/03/07/content_5393952.htm>

\textsuperscript{29} The 13\textsuperscript{th} Five-year Plan for National Economic and Social Development of the People’s Republic of China, Xinhua, 17\textsuperscript{th} March 2016, viewed 30\textsuperscript{th} March 2019, <http://www.gov.cn/xinwen/2016-03/17/content_5054992.htm>

\textsuperscript{30} Over 50 Supporting Measures are Set to Guarantee the Implementation of the New Environment Protection Law, Time Weekly, 2\textsuperscript{nd} May 2017, viewed 2\textsuperscript{nd} April 2019, <http://www.time-weekly.com/html/20170502/37436_1.html>

\textsuperscript{31} Joint Statement of the 21\textsuperscript{st} EU-China Summit, Delegation of the European Union to the UN and other international organisations in Geneva, 10\textsuperscript{th} April 2019, viewed 19\textsuperscript{th} June 2019, <https://eeas.europa.eu/delegations/un-geneva/60836/joint-statement-21st-eu-china-summit_en>

\textsuperscript{32} Over 50 Supporting Measures are Set to Guarantee the Implementation of the New Environment Protection Law, Time Weekly, 2\textsuperscript{nd} May 2017, viewed 2\textsuperscript{nd} April 2019, <http://www.time-weekly.com/html/20170502/37436_1.html>

\textsuperscript{33} Guiding Opinion of Three Ministries on Strengthening Green Data Centre Construction, MIT, 12\textsuperscript{th} February 2019, viewed 9\textsuperscript{th} April 2019, <http://www.miit.gov.cn/newsweb/n1146295/n1652858/n1652930/n3757016/c6638620/content.html>
both to develop and operate, which slows down or even halts their formation. Putting targeted incentives in place could drastically improve the speed of the commercialisation of these technologies, from lab to market. Such incentive policies need not exclusively be in the form of monetary support (subsidies and tax reductions), but could also include creating regional R&D cooperation platforms, and establishing pilot and demonstration areas for environmentally friendly technologies.

Recommendations

• Establish regional cooperation platforms which are open to international companies with research operations, on an equal footing with Chinese companies.

• Provide foreign-invested enterprises with equal access to incentives and preferential policies on environmentally friendly technological development as domestic companies.

• Set up incentive programmes to facilitate the creation of pilot and demonstration areas for environmentally friendly technologies and their commercialisation.

5. Facilitate the Exchange of Scientists at all Levels as Part of a Joint Effort with the European Union (EU)

Concern

Despite some progress, particularly in free trade zones (FTZs) and some major cities, talent availability remains a major concern for international companies conducting R&D in China.

Assessment

In the European Chamber’s BCS 2019, respondents stated that international talent acquisition was one of the top three issues hampering China’s R&D environment, along with access to Internet services and IPR protection. The Research and Development Working Group has taken note of China’s efforts to alleviate administrative burdens and facilitate global talent mobility. In 2017 and 2018, a series of changes to the rules governing Chinese work permits and permanent residency status for foreigners were introduced. As the MOST now has a larger role in recruiting foreign experts, after taking over certain duties from the SAFEA, the working group expects further improvements in the reduction of employment hurdles for foreign workers and greater attempts to include more young and senior foreign talent in the Chinese workplace.

Bearing in mind China’s ambitious innovation goals, the Research and Development Working Group also recommends that any new policies relating to talent acquisition piloted in FTZs and newly-rebranded innovation zones that clearly benefit the innovation landscape be implemented nationwide as quickly as possible. Many of the top innovation-orientated enterprises operate outside the scope of these FTZs, which hampers their ability to access the talent they need to innovate at full speed.

Internal mobility programmes are commonly developed by MNCs to provide professional and personal opportunities for their employees. International mobility, exchanges and experimentation in different environments are essential for scientists and researchers to create and develop new products, processes and technologies. Short-term, joint R&D projects are a good way for junior staff to be trained as early as possible on all the essential equipment and processes used in labs the world over. Offering a favourable and stimulating environment for R&D talent is also essential to promote the emergence of innovative and creative ideas.

Recommendations

• Accelerate the pace of rolling out innovation-friendly reforms and implement policies nationwide after they are piloted successfully in FTZs.

• Provide more flexible visa application processes that allow foreign scientists to work in China on short-term, joint R&D projects, and make the process more transparent.

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5. Improve International Companies’ Access to Data in China to Foster Digital Innovation and Enhance China’s Innovation Capability

**Concern**

Due to China’s strict control of both population and industrial data, international businesses find it increasingly challenging to access information they need for R&D.

**Assessment**

If China is to reach its economic and social development goals, a collective effort from both domestic and international players will be required. International companies, especially those that have R&D operations in China, can help the country develop core technology and increase its overall innovation capability.

China has experienced a sweeping digital transformation since introducing the *Internet Plus Initiative* in 2015. The *Internet Plus Initiative* identifies the key role of the Internet in the digital transformation of agriculture, energy, finance, logistics, commerce, transportation, AI and public services. On the back of this initiative, a series of digital innovation plans and regulations were released, including the Cybersecurity Law issued in 2016, and the *Development Plan for the New Generation of AI*, issued in 2017. Many key regions and cities started implementing the *Development Plan for the New Generation of AI* from 2018 onwards. For example, Shanghai proposed 22 AI-related measures aimed at talent development, open access to data, collaborative innovation, industrial agglomeration and financing support. Since AI can be applied cross-industry, the *Development Plan for the New Generation of AI* and the corresponding implementation rules in local governments are necessary to lay a foundation to define the regulatory scope and mitigate potential risks linked to the use of data. However, given that policymakers do not have direct industrial experience, detailed implementation rules may still not be sufficient in identifying the source and owner of the industrial data for the purpose of R&D, leading to potential confidentiality issues in future. The working group believes that it is urgent to formulate a detailed guideline on industrial data access and data sharing in China.

From a technical perspective, AI, big data and the IoT are developing at an unprecedented pace across different industries. The availability of data therefore plays a significant role in whether innovation is successful or not. European enterprises have rich industrial expertise in data science, from data mining and aggregation to final analysis. The European experience can benefit China’s digital industry and by extension most other industries that rely on digitalisation. The working group therefore suggests the establishment of an industrial data-sharing platform for all players, including both domestic and foreign MNCs and SMEs, to facilitate R&D in industries that rely on digitalisation. Despite the large variation in types of industrial big data, there is still consensus among all market players for R&D sectors in different industries on gaining data access, because of their shared dependence on information and the Internet technologies in modern society.

**Recommendations**

- Clearly define the scope and proportion for international joint research activities to encourage international businesses’ participation in China’s Internet Plus projects.
- Formulate a guideline on industrial data access for R&D purposes in China.
- Provide an industrial data-sharing platform for all players, including both domestic and foreign MNCs and SMEs.

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38 Ibid.
Abbreviations

AI                  Artificial Intelligence
BCS               Business Confidence Survey
BRF               Belt and Road Forum for International Cooperation
CM                China Manufacturing
CNY               Chinese Yuan
EU               European Union
EUR               Euro
FIL               Foreign Investment Law
FTZ               Free Trade Zone
HNTE                High and New Technology Enterprise
ICD                Innovation Cooperation Dialogue
IoT                Internet of Things
IP                Intellectual Property
IPR                Intellectual Property Rights
MIIT         Ministry of Industry and Information Technology
MNC               Multinational Corporation
MOF               Ministry of Finance
MOST              Ministry of Science and Technology
NPC               National People’s Congress
NSFC         National Natural Science Foundation of China
OECD          Organisation for Economic Co-operation and Development
R&D               Research and Development
SAFEA         State Administration of Foreign Experts Affairs
SAT               State Administration of Taxation
SME              Small and Medium-sized Enterprise
S&T              Science and Technology
TIER          Technology Import and Export Administrative Regulation
WIPO           World Intellectual Property Organization
Standards and Conformity Assessment Working Group

Standards and Conformity Assessment Key Recommendations

1. Implement the Principles of the World Trade Organization Agreement on Technical Barriers to Trade (WTO/TBT) Related to Standards, Technical Regulations and Conformity Assessment Procedures
   • Ensure proper notification of all mandatory standards, technical regulations and conformity assessment procedures, including administrative licensing, that may impact market access.
   • Limit the scope of technical regulations and mandatory standards to issues related to the protection of environment, health and safety, according to the WTO/TBT Agreement.

2. Review Mandatory Market Access Requirements, Including the Simplification of Testing and Certification Procedures
   • Optimise the synchronisation of mandatory standards, compulsory certification schemes and administrative licensing schemes.
   • Support the recognition of test reports at the national level.
   • Allow more manufacturers to use their own testing laboratories, provided they meet all necessary accreditation requirements.
   • Ensure all mandatory-type approval schemes for market access are based only on national mandatory standards and are supervised by one standardisation committee in China to avoid breaching China’s WTO obligations.
   • Simplify the designation processes for China Compulsory Certification testing laboratories and certification bodies to allow more international laboratories or certification bodies to join the system.

3. Ensure that all Relevant Stakeholders Enjoy Equal Access to and Participation Rights in Standardisation Work
   • Grant fair access to all technical committees (TCs) for interested stakeholders.
   • Grant equal rights to all organisations/companies participating in TCs.
   • Encourage the participation of industry in standardisation strategies such as China Standards 2035.

4. Continue the Current Reform of the Standardisation System
   Mandatory national standards
   • Expand standardisation reform to include exempted areas.
   • Introduce reasonable transition periods for mandatory standards and implement the European concept of transition periods to more industries.

   Social organisation standards
   • Stick to the policy of independent development and free use of social organisation standards and strictly avoid the inclusion of administrative measures in social organisation standards.

   Enterprise standards
   • Ensure that the self-declaration of enterprise standards is limited to adopted mandatory national standards.
   • Protect the intellectual property rights (IPR) of enterprise standards.
5. Ensure Fair and Transparent Market Surveillance

- Align market surveillance and market access requirements with each other.
- Limit market surveillance to just compliance with laws, regulations, mandatory standards and certification schemes.
- Allow commercial organisations that meet accreditation requirements to join market surveillance.

Quality and Safety Services Key Recommendations


- Accelerate the revision of the Regulation on Certification and Accreditation (2016 Amendment) and engage with and collect feedback from enterprises.

2. Further Implement Reforms for a Market-orientated TIC Industry

2.1 Adopt Market-based Mechanisms to Reform Government-affiliated TIC Agencies and Avoid a Second Monopoly Through Administrative Support

- Implement market mechanisms to avoid rent-seeking and monopolistic behaviour during the reform of government-affiliated TIC agencies.
- Reduce excessive and unclear market entry barriers and use international norms for assessment.
- Provide the same treatment to international TIC agencies so that they enjoy the same market status as their domestic peers.

2.2 Allow Non-public Institutions to Qualify to Provide Special Equipment Testing and Inspection Services

- Allow non-public institutions to qualify to provide special equipment testing and inspection services.

Introduction to the Working Group

Standards are “document[s], established by consensus and approved by a recognised body, that provide, for common and repeated use, rules, guidelines or characteristics for activities or their results, aimed at the achievement of the optimum degree of order in a given context”. Standards provide the technical foundation for all major economic activities, as they form the fundamental building blocks for product development by establishing consistent protocols that can be universally understood and adopted. As such, they facilitate business interaction, speed up the introduction of innovative products to the market, and provide interoperability between new and existing products, services and processes. As China opens its door wider to the world, standardisation and conformity assessment will be essential to facilitating cooperation between the European Union and China in investment, trade and production activities.

The Standards and Conformity Assessment (SCA) Working Group was founded in 2008. Its members come from various industry sectors such as automotive, auto components, construction, cosmetics, healthcare equipment, electrical equipment, information and communication technology equipment/services, and machinery. It contains the Quality and Safety Services Sub-Working Group. The working group aims to support the development of China’s SCA systems in order to facilitate China’s integration into the world economy.

Recent Developments

Reform of China’s Standardisation System

On 11th March 2015, the State Council issued the

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Deepening Reform Plan for Standardisation Work (Guofa [2015] No. 13), which aims to reform the overall standards systems and mechanisms for standardisation management. The timeline for reform was divided into three stages. The second stage (2017–2018) focused on transitioning to a modified standards system and encouraged the development of associations that are capable of developing standards and fully implementing the Self-declaration and Disclosure of Enterprise Products and Service Standards initiative, and the third and final stage (2019–2020) will focus on completing the transition to a fully functioning new standards system. The guidelines on the third stage, the Division of the Key Tasks for the Implementation of the Plan for Deepening the Reform of Standardisation Work (2019–2020), were published on 19th April 2019. Reforms have led to a number of developments in the following areas:

- **Building an effective and authoritative standardisation coordination mechanism**
  During the 2018 sessions of the National People’s Congress and the Chinese People’s Political Consultative Conference (Two Sessions), the Plan on the Institutional Restructuring of the State Council was passed. A new government agency, the State Administration for Market Regulation (SAMR) was established, which incorporated the State Administration of Industry and Commerce, the General Administration of Quality, Supervision, Inspection and Quarantine (AQSIQ), and the China Food and Drug Administration (CFDA). The Certification and Accreditation Administration of China (CNCA) and the Standardisation Administration of China (SAC) have been assigned to it with their brands retained. The SAMR is expected to enhance competence when it comes to formulating and enforcing regulations at all levels. The working group welcomes the spirit of this restructuring and hopes to see positive developments in terms of improved coordination and efficiency.

- **Consolidating and streamlining mandatory standards, and optimising recommended standards**
The work of streamlining and consolidating mandatory standards has continued to move forward since 2017. On 23rd March 2017, the former AQSIQ and SAC announced that 396 mandatory national standards were to be formally repealed, and 1,077 mandatory national standards were to be transformed into recommended national standards. The SAC took further action in 2018, with the issue of the Three Batch Plans on National Standard Formulation and Amendment, in March, June and September respectively. A total of 780 standards were formulated, and 288 amended. These batches encompassed mandatory and recommended standards, as well as guiding technical documents. Furthermore, in 2018, the SAC also released the Fourth Batch Plan on Recommended National Standards Plans. On 1st April 2019, the SAC released the Notice of the National Standardisation Administration on the Issuance of the First Recommended National Standards Plan, with 294 formulated standards and 213 revised standards.

On 17th October 2018, the SAMR launched a public consultation on its draft Measures for the Administration of Mandatory National Standards. The European Chamber provided feedback throughout the process on a number of concerns shared by members on some of the specific points of the draft regulation. The Standards and Conformity Assessment Working Group hopes that this input will be taken into account when consolidating the final document.

Finally, the Division of the Key Tasks for the Implementation of the Plan for Deepening the Reform of Standardisation Work (2019–2020) also sets out to further improve the mandatory national standards management system through measures like establishing an open and

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7 Notice on Transforming 1,077 Mandatory National Standards into Recommended National Standards, SAC, 23rd March 2017, viewed 15th April 2019, [http://www.sac.gov.cn/gfllggqjs/gjbbgzg/201703/]
• Cultivating and developing social organisation standards

According to Document No. 13, China encourages associations, federations, unions, industrial technology alliances and other social organisations, to develop standards that meet market demands. Following this mandate, social organisation standards were granted legal status in the revised China Standardisation Law. On 17th January 2018, the former AQSIQ and SAC jointly published the Provisions on the Administration of Social Organisation Standards (For Trial Implementation). The scope of the social organisation standards pilot is swiftly expanding. A search through the national social organisation standard information platform in July 2019 showed that by then, the number of registered groups had increased to 2,440, and the standards to 9,120. On 9th January 2019, the Ministry of Civil Affairs of the SAC issued the Provisions on the Administration of Social Organisation Standards. Among other things, the new regulation stipulates that associations are encouraged to internationalise their standardisation activities and to develop standards in line with international standards; the technical requirements for social organisation standards should not be lower than for mandatory standards; and that this type of standards should fill the gaps left by other standards and meet market needs for innovation. Furthermore, if standards formulated by associations meet the stipulated requirements, the association can apply to have their standards converted into national, industry or local standards. Departments and local governments are also encouraged to apply social organisation standards in industrial policy formulation, administrative management, government procurement, and testing and certification, as well as bidding. On 11th June 2019, SAMR published the Guidelines for Random Inspection of Social Organisation Standards and the Guidelines for Random Inspection of Enterprise Standards.

• Easing restrictions to, and allowing more room for, enterprise standards

In order to deepen reform of the enterprise standards management system, Tian Shihong, Chief administrator of the SAC, suggested establishing an enterprise standard ‘top runner’ system in 2018, to encourage enterprises to proactively set and implement advanced standards. This suggestion materialised with the issuing of the Opinions on Implementing the Enterprise Standards ‘Top Runner’ System (Opinions) by the SAMR, the National Development and Reform Commission (NDRC), the Ministry of Science and Technology (MOST), the MIIT and four other regulatory agencies. According to the Opinions, through the self-declaration scheme for enterprise standards, third party institutions would assess the quality of different enterprise standards and rank them. The goal is to release by 2020 1,000 ‘top runner’ standards on consumer products, 500 on equipment manufacturing and 200 on services. On 20th February 2019, the China National Institute of Standardisation (CNIS) issued the Notice on the Issuance of the Enterprise Standard ‘Top Runner’ Implementation Plan (Trial). A top runner list covering 13 product categories in 11 areas had been released on 30th September 2018, comprising 51 companies, 60 enterprises standards and 119 product types. On 28th May 2019, a new list was released comprised of 100 categories. Finally, in June 2019, the SAMR published the Guidelines on random inspections.

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• Boosting the internationalisation of Chinese standards

Enhancing the international influence of Chinese standards is an important task for the Chinese government. After sparking interest in the international community, the English version of the Standardisation Law was officially published on 3rd January 2018. The move also followed a year of efforts by China to further develop international ties: by the end of 2017, the Chinese Government had signed 45 cooperation agreements with 33 countries. In addition, on 22nd December 2017, China unveiled the Action Plan for Harmonisation of Standards for Jointly Building the Belt and Road (2018–2020), to extend its standardisation strategy to countries involved.

In addition, according to the Notice of the State Council on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment (State Council Document (Guofa) [2017] No. 5), foreign-invested enterprises (FIEs) will enjoy the same treatment as Chinese-invested enterprises while doing standardisation work in China. Echoing State Council Document No. 5, the SAC, the NDRC and the Ministry of Commerce issued the Guiding Opinions on Foreign-invested Enterprises Participating in the Standardisation Work of China (Guiding Opinions) on 29th November 2017. The Guiding Opinions stipulate that FIEs can participate in the drafting of national standards and translating of foreign language versions of national standards, and can also provide opinions and suggestions in the standard-setting and implementation processes. The Foreign Investment Law (FIL), which was passed on 15th March 2019, also stipulates that FIEs can participate in standard-setting work on an equal footing. The Division of the Key Tasks for the Implementation of the Plan for Deepening the Reform of Standardisation Work (2019–2020) mentions standards internationalisation as one of the key goals for this period.

China Standardisation Law

The revised China Standardisation Law entered into force on 1st January 2018. During the law’s revision, there were three calls for comments, starting with the March 2016 draft from the State Council, and then in May and September 2017 from the National People’s Congress. In consultation with its members, the European Chamber submitted comments for each version and reinforced its core messages during face-to-face meetings with former AQSIQ and SAC officials, as well as with the Legislative Affairs Commission of the National People’s Congress. The working group was pleased to note that many of the suggested amendments were implemented.

China Standards 2035

On 10th January 2018, the former SAC and AQSIQ announced that, along with high-end think tanks like the Chinese Academy of Engineering (CAE), they were to research and create China’s new standardisation strategy titled ‘China Standards 2035’. The inaugural meeting for the project took place on 14th March 2018. This project supports China’s shift to high-quality development by establishing a sound and forward-looking standardisation strategy. The project aims to tackle the following four topics: the strategic positioning of the standardisation system; methodology and evaluation; support for developing a high-quality standardisation system; and the establishment of a standardisation strategy for fostering civil-military cooperation.

On 28th November 2018, the CNIS, supported by the SAMR and SAC, hosted the ‘International Symposium on Standardisation Strategy and Policy in the Future’ in Beijing. The meeting brought together around 300 stakeholders from the CAE, Chinese and international standardisation expert committees and organisations, research institutes, academia and various industry sectors. The goal was to define the Chinese standardisation strategy and promote China


26 Notice of the State Council on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment, State Council, 12th January 2017, viewed 15th April 2019, <http://www.gov.cn/zhengce/content/2017-01/17/content_5160624.htm>


Standards 2035. A mid-term exchange meeting on China Standards 2035 was held on 28th February 2019, with stock-taking of past actions and developments. SAC Chief Administrator Tian Shihong addressed the meeting and stressed the need for open and concerted research in order to carry on with the designated tasks. Further meetings took place in May and June 2019.

Update of the China Compulsory Certificate (CCC)
On 15th March 2018, the CNCA published the Notice on Issues of the China Compulsory Certificate Product Marks Reform. The notice allowed for cancelling the review and fee for printing/moulding CCC marks. Furthermore, the notice stipulates that starting on 1st May 2018, designated certification bodies must start issuing standard-size CCC marks and that the categories of CCC marks should be simplified. Finally, designated certification bodies are to strengthen the supervision and management of the CCC mark at all levels.

Key Recommendations

1. Implement the Principles of the World Trade Organization Agreement on Technical Barriers to Trade (WTO/TBT) Related to Standards, Technical Regulations and Conformity Assessment Procedures

Concern
China’s practices do not fully comply with the WTO/TBT Agreement principles, and create unnecessary obstacles for foreign enterprises trying to access the Chinese market.

Assessment
a) Proper notification of mandatory standards, technical regulations and conformity assessment procedures—including administrative licensing—required for market access

According to the WTO/TBT Agreement, central government bodies in China are obliged to notify members of the WTO about proposed technical regulations and conformity assessment procedures—together with a brief indication of their objectives and rationale—at an early stage, which enables amendments and comments to be taken into account.

The working group recognises that China has fulfilled its responsibilities to notify the WTO of new mandatory national standards, the CCC scheme and other regulations in a proper manner. However, non-compliance with the WTO/TBT notification rules has been observed in cases of voluntary standards involved in mandatory certification schemes, mandatory sectoral standards, and some regulations that require conformity assessment procedures for market access.

The practice of using voluntary standards to support mandatory certification is commonplace in China. A large number are applied by the CCC schemes of different product areas, including automobiles and automobile components, low voltage devices, safety glass and telecommunications devices. Of those voluntary standards, a considerable proportion are domestic standards and may differ significantly from international standards. Meanwhile, sector-specific mandatory standards still exist in various industries, even though the relevant departments have already started transforming them into mandatory national standards. Examples can be easily found in sectors such as machinery, chemicals, the lighting industry, electronics, medical devices and building materials. Some regulations stipulating conformity assessment procedures for market access are not promptly notified to other WTO members. Such regulations include the Reviewing Requirements for the Access of Road Vehicle Products and the Specifications for the Lithium Ion Battery Industry, among others.

b) Limiting the scope of technical regulations and mandatory standards to issues related to the protection of health, safety and the environment, according to the WTO/TBT Agreement

The WTO/TBT Agreement allows countries to take necessary measures to fulfill legitimate objectives, such as national security requirements, the prevention of deceptive practices, and the protection of health, safety and the environment.

For more information on the usage of voluntary standards to support mandatory certifications in the ICT sector, please see Key Recommendation (KR) 2 of the Information and Communication Technology Working Group Position Paper.
The working group is pleased to note that China intends to limit the scope of mandatory standards to the above-mentioned objectives. This is a positive step towards further carrying out WTO/TBT principles. The working group recommends that China continue its efforts and fulfills its commitments in this regard while implementing ongoing standardisation reforms, especially in sectors—like healthcare equipment—where there is still room for improvement on actions such as reducing administrative requirements that do not necessarily impact standards. Additionally, similar efforts should be made to ensure that technical regulations can fulfill the legitimate objectives defined in the WTO/TBT Agreement.

Recommendations

• Ensure proper notification of all mandatory standards, technical regulations and conformity assessment procedures, including administrative licensing, that may impact market access.
• Limit the scope of technical regulations and mandatory standards to issues related to the protection of environment, health and safety, according to the WTO/TBT Agreement.

2. Review Mandatory Market Access Requirements, Including the Simplification of Testing and Certification Procedures

Concern

Market access barriers are created when certain products have to fulfill multiple market access requirements published by different authorities that are not coordinated with one another, and certain testing and certification procedures that place unnecessary burdens on manufacturers, increase costs and hinder the import of technology and services without increasing product safety.

Assessment

The concurrent existence of mandatory standards, compulsory certification and administrative licensing schemes

According to the Standardisation Law, many products have to comply with mandatory standards. In addition, other regulations require certain products to comply with specific mandatory certification schemes (e.g. the CCC or the Mining Products Safety Approval and Certification) and individual administrative licensing schemes (e.g. the Network Access Licence) (see Table 1). Although the Standardisation Law, and subsequent regulations, provide for the streamlining of standards, some areas like environmental protection, engineering and medical devices are exempted. Furthermore, many of these regulations are still not well coordinated. As a consequence, manufacturers have to manage overlapping testing requirements, which leads to additional costs and can even delay product launches.

Table 1: Market access requirements for selected products

<table>
<thead>
<tr>
<th>Product Name</th>
<th>Market Access Requirements</th>
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</thead>
<tbody>
<tr>
<td>Mining products</td>
<td>• Mining Products Safety Approval and Certification</td>
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<tr>
<td></td>
<td>• Explosion-proof Electrical Product Certification</td>
</tr>
<tr>
<td>Mobile telecom devices</td>
<td>• Radio Type Approval</td>
</tr>
<tr>
<td>Medical devices</td>
<td>• Product registration required by the SAMR</td>
</tr>
<tr>
<td></td>
<td>• China Metrology Approval (not applicable to all medical devices)</td>
</tr>
<tr>
<td>IT equipment with encryption technology</td>
<td>• CCC</td>
</tr>
<tr>
<td></td>
<td>• State Cryptography Administration licence</td>
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</tbody>
</table>

Part of the reason for this lack of cohesion is that these regulations have been formulated by different ministries and government authorities that work independently in most cases. The working group recommends improving coordination between relevant authorities to eliminate any existing overlap and conflict that arises between the various mandatory standards, compulsory certification schemes and administrative licensing systems. Simplifying market access requirements could allow Chinese customers to access the most up-to-date technologies, increase manufacturing efficiency and revitalise the Chinese economy. In many instances, the government restructuring during the 2018 ‘Two Sessions’ resulted in the consolidation of several separate entities into a single one; enhancing efficiency and optimising processes were two of the key rationales.

37 For further information on medical device mandatory standards, please refer to KR 2.2 and 3 of the Healthcare Equipment Working Group Position Paper.
38 For more information please see KR 3 of the Healthcare Equipment Working Group Position Paper.
behind this transformation, and the working group expects to see tangible results in terms of enhanced coordination.

Recognition of test reports at a national level
There are still examples of test reports issued by CCC-designated testing laboratories not being accepted by other testing laboratories for identical tests of the same product. In such a situation, manufacturers have to retest their products as a pre-requisite for being approved, even though an identical test has already been performed. Such practices not only affect international manufacturers that are active in China, but also Chinese companies wishing to place their products on the domestic market.

Duplicative testing neither increases product safety nor benefits the Chinese authorities and customers. Instead, it wastes company resources, ultimately resulting in delayed product launches, increased costs and reduced efficiency. The working group recommends ensuring nationwide recognition of test reports for the same technical qualifications in all laboratories to avoid product test repetition. This requires that certain testing requirements be defined in order to ensure testing equivalence across China. The working group recommends that China use the procedures already established for existing certification bodies as a model to follow. Part of these efforts could be managed by the China National Accreditation Service for Conformity Assessment. This would allow the use of test reports documenting manufacturers’ in-house testing or third-party type testing for medical device product registration.

Recommended standards used as market access requirements
Recommended standards need to remain voluntary. Unfortunately, some became mandatory as they were chosen to be the basis for mandatory certification and administrative licensing schemes, or directly included some mandatory terms, particularly in the mobile phone and mining industries. For example, regarding the safety approval and certification of mining products, recommended standards based on terminology, testing methods and packaging requirements are already being used for mandatory approval and certification. Consequently, updates and modifications to officially recommended standards were never communicated to the WTO, despite being mandatory for market access under domestic administrative licensing schemes. This lack of transparency causes problems for enterprises that must comply with mandatory market access schemes, including CCC and other industry-specific mandatory certification schemes.

Recommendations
- Optimise the synchronisation of mandatory standards, compulsory certification schemes and administrative licensing schemes.
- Support the recognition of test reports at the national level.
- Allow more manufacturers to use their own testing laboratories, provided they meet all necessary accreditation requirements.
- Ensure all mandatory-type approval schemes for market access are based only on national mandatory standards and are supervised by one standardisation committee in China to avoid breaching China’s WTO obligations.
- Simplify the designation processes for CCC testing laboratories and certification bodies to allow more international laboratories or certification bodies to join the system.

3. Ensure that all Relevant Stakeholders Enjoy Equal Access and Participation Rights in Standardisation Work

Concern
Even though it has been stipulated in numerous pieces of Chinese legislation—including the FIL—that all relevant stakeholders shall be granted equal access and participation rights in standardisation work, there is still a substantial gap in implementation.

Assessment
Equal participation in standardisation work in China is a long-standing concern for FIEs in China. Although this principle has been enshrined in key pieces of legislation such as the FIL, more often than not, the reality does not match what has been put on paper. At the macro level, major strategies for the development of standardisation work, such as China Standards 2035, remain at best opaque to international players. The working group firmly believes that its members could provide valuable contributions to the development

39 For more information on industry concerns regarding to other aspects of testing (e.g. third-party testing reports), please see KR 2.1. of the Healthcare Equipment Working Group Position Paper.
of this strategy if they were granted a degree of involvement in the process.

Access to technical committees (TCs) is also one area where there is room for improvement. Although there have been some positive developments in the past few years, the principle of granting equal access to TCs to all stakeholders—which has been strengthened in the China Standardisation Law and further detailed in the Guidelines on FIEs’ Participation in China’s Standardisation Work—has not been fully implemented. In some cases, FIEs will only be granted observer status or even be excluded altogether from participation in TCs. For instance, some standardisation projects are managed by individual companies and organisations instead of formal TCs and working groups. Their non-transparent development processes prevent many interested stakeholders from contributing and submitting comments. The management of public comments often lacks transparency as well. Furthermore, when it comes to granting access to the TCs, most existing members are domestic competitors who often oppose the entry of FIEs in order to protect their own interests. Examples include TCs under the National Healthcare Commission, including the committee in charge of food contact materials. These issues are common in areas such as environmental protection, engineering and construction, medicine and hygiene.

However, when it comes to the information and communication technology (ICT) industry, the European Chamber has recently noted a number of positive developments, such as the National Information Security Standardisation Technical Committee (TC260) in charge of cybersecurity standardisation accepting wholly foreign-owned enterprises as TC and working group members. The working group welcomes these developments, and hopes that efforts to improve access to working groups under this TC for non-domestic companies will continue.

Recommendations

- Grant fair access to all TCs for interested stakeholders.
- Grant equal rights to all organisations/companies participating in TCs.

4. Continue the Current Reform of the Chinese Standardisation System

Concern

Although the new Standardisation Law has been in force for more than a year, the law has not yet been completely implemented in all technical fields, and the transparency and fairness of existing standard-setting procedures still need to be improved.

Assessment

Although the revised Standardisation Law came into force on 1 January 2018, changes to the law will require all parties to collaborate and cannot be achieved overnight. The new standards management mechanism introduced in the law has not yet been implemented in areas such as environmental protection, engineering and construction, medicine and hygiene. The working group recommends that standardisation reform be expanded to include these areas so far exempted. The working group would also like to propose the following suggestions to ensure the success of the reform process:

Mandatory national standards

The working group has observed that progress has been made in streamlining and consolidating mandatory national standards over the past few years. The number of existing and new mandatory national standards has been progressively decreasing. However, the draft Measures for the Administration of Mandatory National Standards has raised concerns over the transition periods provided for the implementation of new standards. The working group would like to highlight two aspects of the current transition period system for mandatory national standards:

- Some standards are published with extremely short transition periods, particularly in the telecommunications industry. The working group recommends that transition periods be carefully defined and that adequate time be allowed for the integration of new


41 For more information please see KR 2 of the Information and Communication Technologies Working Group Position Paper.

42 For more information on the implementation of the standards management system in the medical sector, please see KR 3 of the Healthcare Equipment Working Group Position Paper.
standards into products.

- The Chinese understanding of transition periods does not always take the reality of the situation into account. In many cases during the transition period—considered as the time between publication of the new edition of a standard and its implementation date—only the old standard is accepted. After the implementation date, only the new edition is accepted. Such a sharp transition makes product manufacturing extremely difficult. In this regard, the European concept of transition periods is much fairer and more realistic – during the transition period, European Union law allows both editions of a standard to be used for regulatory purposes. While the working group acknowledges that the latest draft of the Measures for the Administration of Mandatory National Standards provides for the usage of both the old and new standards during the transition period, it believes that allowing products designed under the old standards to sell out after the implementation period would greatly reduce the burden of companies.

**Social organisation standards**

Moving away from the model where the government is the only entity that can set standards, social organisation standards satisfy the needs of the market and innovation, and stimulate market vitality. They allow product standards and service standards to be formulated independently by market entities, and to be voluntarily used. Social organisation standards are managed according to the Social Organisation Standards (for Trial Implementation) and by the GB/T 20004 Good Practice on Social Organisation Standardisation series of standards. It is prohibited by the Social Organisation Standards (For Trial Implementation) to use such standards to prevent or restrict market competition and/or the free circulation of goods and services. However, the rules also encourage government departments and local governments at all levels to adopt social organisation standards in industrial policy formulation, administrative management, government procurement, social management, inspection, certification and accreditation and bidding, among others. The working group understands that this involvement of administrative measures in social organisation standards goes against the policy of independent development and free use, and that it will lead to unfair position of players in the market. Thus, the working group recommends that authorities stick to the policy of independent development and free use of social organisation standards and strictly avoid the inclusion of administrative measures in such standards. Some associations favour their own interests through the formulation of social organisation standards by means of requiring membership fees, or charging for the formulation of standards. The working group believes that FIEs should have equal access to all social organisations.

**Enterprise standards**

The Chinese Government is reducing control over enterprise standards and is gradually withdrawing the need for their registration. An enterprise standards online service platform has been set up (the Information Public Service Platform of Enterprise Standards: [http://www.cpbz.gov.cn/](http://www.cpbz.gov.cn/)), and manufacturers are encouraged to make an online disclosure and sign the self-declaration of conformity (SDoC). A corresponding supervision system will be established as well.

Meanwhile, the Chinese Government aims to fully implement the self-declaration and disclosure mechanism of enterprise product and service standards, and the SAC is currently formulating a guideline on the management of enterprise standards. The new self-declaration and disclosure mechanism attempts to cover not only personal health, life and property safety, national security and ecological and environmental safety, but also product function and performance, which deviates from the WTO/TBT Agreement. In fact, any new market access mechanisms introduced by the Chinese Government should abide with relevant WTO agreements signed by China. Furthermore, the self-declaration and disclosure mechanism heavily overlaps with compulsory certification schemes, such as CCC and the Product Quality Law, in the sense that products bearing CCC marks have already indicated to the public and authorities the standards and requirements they are in compliance with. Moreover, the Product Quality Law also requires manufacturers to indicate the standards applied on the product’s labelling. Therefore, the working group does not see any additional value brought by the self-declaration mechanism. This mechanism will also lead to significant complexities for manufacturers and consequently increase both industry and consumer costs. Therefore, the working

group suggests limiting the scope of the self-declaration mechanism to mandatory national standards adopted by enterprises. The working group is concerned about the possible need to disclose a company’s intellectual property to the public. Such a requirement should be avoided by all means in order to boost the industry’s acceptance of enterprise standards.

Finally, new schemes such as the ‘top runner’ system have raised concerns among the business community, partly because of questions regarding the scientific nature of the assessment method, and partly because of the involvement of the government in a system that—according to the standardisation reform’s spirit—should be based on market competition and encourage market-led processes.

Recommendations

**Mandatory national standards**
- Expand standardisation reform to include exempted areas.
- Introduce reasonable transition periods for mandatory standards and implement the European concept of transition periods to more industries.

**Social organisation standards**
- Stick to the policy of independent development and free use of social organisation standards and strictly avoid the inclusion of administrative measures in social organisation standards.

**Enterprise standards**
- Ensure that the self-declaration of enterprise standards is limited to adopted mandatory national standards.
- Protect the IPR of enterprise standards.

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5. Ensure Fair and Transparent Market Surveillance

**Concern**

The current market surveillance process for many products has been intentionally extended to voluntary requirements, e.g. recommended national standards, industry standards, local standards, social organisation standards and enterprise standards, which are not related to mandatory market access requirements.

**Assessment**

The working group realises that product quality surveillance and inspection in China is becoming more standardised and systematic. However, the working group would like to highlight that some technical market surveillance requirements are not in line with mandatory market entry requirements.

Market surveillance has been intentionally extended to recommended and voluntary items. This has already resulted in the punishment of manufacturers whose products do not meet the requirements of voluntary standards, which leads to workload increases for both manufacturers and authorities and prevents the latter from focusing on the original task of protecting the environment, improving health and safety, and preventing deceptive practices. This situation has been described in Key Recommendation (KR) 1 of the Fashion and Leather Working Group Position Paper, and KR 1 of the Information Communication Technology Working Group Position Paper. Therefore, the working group recommends aligning market surveillance and market entry requirements, and limiting market surveillance to compliance with national laws, regulations and mandatory standards, which aim to ensure that products do not affect the ability to protect the environment, improve health and safety, and prevent deceptive practices. On 15th April, the SAMR launched a public consultation on the *Administrative Provisions on Product Quality Supervision and Spot Inspections*, and the European Chamber submitted its comments on the draft regulation. The working group hopes this feedback will be taken into account by the relevant authorities.

**Recommendations**

- Align market surveillance and market access requirements with each other.
- Limit market surveillance to just compliance with laws, regulations, mandatory standards and certification schemes.
- Allow commercial organisations that meet accreditation requirements to join market surveillance.

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## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</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>CAE</td>
<td>Chinese Academy of Engineering</td>
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<td>CCC</td>
<td>China Compulsory Certification</td>
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<td>CFDA</td>
<td>China Food and Drug Administration</td>
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<td>CNCA</td>
<td>Certification and Accreditation Administration of China</td>
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<td>CNIS</td>
<td>China National Institute of Standardisation</td>
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<td>FIE</td>
<td>Foreign-invested Enterprise</td>
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<td>FIL</td>
<td>Foreign Investment Law</td>
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<tr>
<td>ICT</td>
<td>Information and Communication Technology</td>
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<td>IP</td>
<td>Intellectual Property</td>
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<tr>
<td>KR</td>
<td>Key Recommendation</td>
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<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
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<td>MOST</td>
<td>Ministry of Science and Technology</td>
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<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<td>SAC</td>
<td>Standardisation Administration of China</td>
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<td>SAMR</td>
<td>State Administration for Market Regulation</td>
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<td>SCA</td>
<td>Standards and Conformity Assessment</td>
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<tr>
<td>SDoC</td>
<td>Self-declaration of Conformity</td>
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<tr>
<td>TC</td>
<td>Technical Committee</td>
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<tr>
<td>TC260</td>
<td>National Information Security Standardisation Technical Committee</td>
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<tr>
<td>WTO/TBT</td>
<td>Technical Barriers to Trade of the World Trade Organization</td>
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Introduction to the Sub-working Group

The Quality and Safety Services Sub-working Group (QSS Sub-working Group) is a sub-working group of the Standards and Conformity Assessment (SCA) Working Group. It was established in 2012 to provide a platform for members to exchange experiences on recent developments in the regulatory environment in their sector. The QSS sector is defined as independent, third-party agencies that provide manufacturers and end users with testing, inspection, and certification (TIC) services and other conformity assessment-related services in relation to their products and management systems, with the aim of improving the safety and quality of products on the market.

The QSS Sub-working Group identifies concerns and makes constructive recommendations for creating a QSS system that is more transparent, better coordinated and improves market access for all players. The SCA Working Group is comprised of manufacturers that are affected by standardisation and conformity assessment issues, and works closely with the QSS Sub-working Group with the mutual aim of supporting the development of China’s SCA systems.

Recent Developments

In comparison to other major economies, China has a heavily regulated central certification system. Once operated by the former General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), and the Certification and Accreditation Administration of China (CNCA). The sub-working group would like China to further open its TIC market and provide opportunities for cooperation between China and Europe in the area of quality and safety management.

The sub-working group’s members are primarily European QSS industry leaders who have operated in China for over two decades, providing tailor-made, high-end services for Chinese manufacturers. These member companies have contributed significantly to China’s market-based reforms, and the CM2025 initiative, by sharing their expertise and advanced management experience with the former General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), and the Certification and Accreditation Administration of China (CNCA). The sub-working group would like China to further open its TIC market and provide opportunities for cooperation between China and Europe in the area of quality and safety management.

The sub-working group provides members with a platform to exchange their experiences on recent developments in the regulatory environment in their sector. The QSS sector is defined as independent, third-party agencies that provide manufacturers and end users with TIC services and other conformity assessment-related services in relation to their products and management systems, with the aim of improving the safety and quality of products on the market.

The QSS Sub-working Group identifies concerns and makes constructive recommendations for creating a QSS system that is more transparent, better coordinated and improves market access for all players. The SCA Working Group is comprised of manufacturers that are affected by standardisation and conformity assessment issues, and works closely with the QSS Sub-working Group with the mutual aim of supporting the development of China’s SCA systems.

Recent Developments

In comparison to other major economies, China has a heavily regulated central certification system. Once operated by the former AQSIQ, this certification system has a tremendous amount of influence on quality and safety—as well as standards development and enforcement—by having extensive control over mandatory TIC processes. This situation enables state-owned enterprises (SOEs) and government-affiliated enterprises to monopolise a huge share of China’s QSS sector, while well-known and highly qualified international TIC agencies make up only a small portion of the market.

A string of quality and safety scandals have highlighted the shortcomings of such a semi-closed market. The lack of transparent regulatory processes and inadequate communication and coordination among different regulatory bodies contribute to low quality production and the poor safety performance of the country as a whole. Despite this, government-affiliated and state-owned TIC agencies remain dominant in the creation and enforcement of national and industrial standards, the receiving of science and research projects in their industry, and in being appointed or recommended as designated laboratories. This leaves international QSS firms at a competitive disadvantage in areas that are crucial to the government.

However, there is a positive signal, as the TIC industry has been listed in the Catalogue of Encouraged Industries for Foreign Investment (Revision 2019). This indicates that China is opening up its TIC market and providing opportunities for cooperation with international partners.

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1 The functions of the now defunct AQSIQ have been incorporated into the State Administration for Market Regulation (SAMR).

Market Developments in the TIC Industry
The TIC industry continued to grow steadily throughout 2018. According to information collected by the State Administration for Market Regulation (SAMR), by the end of 2018, there were a total of 39,472 TIC agencies in China, with year-on-year growth of 8.66 per cent. The same year, the total turnover of TIC agencies in China reached Chinese yuan (CNY) 281.05 billion, with year-on-year growth of 18.21 per cent. In terms of employment, TIC agencies provided 1,174,300 job opportunities in 2018, with year-on-year growth of almost five per cent.3

Developments in the Regulatory Environment
On 17th January 2017, the State Council issued the Notice on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment (State Council Document, Guofa [2017] No. 5). According to the notice, CM2025 is expected to apply equally to domestic and international enterprises alike. The government encourages international enterprises’ involvement in high-end manufacturing, smart manufacturing, green manufacturing and other manufacturing-related service industries, such as industrial design and innovation, project consulting, modern logistics and testing and certification, to reform and improve traditional industries.4

The QSS Sub-working Group welcomes this intended reform, which, although it has been on the table for years, has seen little tangible progress so far. For quite some time, the State Council’s stated intention has been to break the SOE monopoly and create a fairer playing field for all market players, but the reform has encountered unequal treatment and significant obstacles in different sectors.

In December 2016, the former AQSIQ, the CNCA and 32 other ministerial-level Chinese government departments jointly released the 13FYP for China’s Testing, Inspection-Certification and Accreditation Development.5 The aim of the plan is to provide guidance for the development of China’s TIC industry and accreditation system from 2016 to 2020. The plan recognises the importance of the TIC industry in safeguarding people’s safety, and supporting the country’s economic development. It calls for: cross-ministerial cooperation to facilitate industry growth; classifying state-owned TIC agencies as either public service or commercial service providers; separating business and commercial service providers from government administrative work so they can operate as companies; encouraging and adopting TIC results from third parties; avoiding duplicative TIC work to reduce enterprises’ burdens; promoting national treatment for foreign-invested TIC agencies; allowing the inflow of capital and advanced TIC technologies; and the improvement of risk prevention mechanisms. As stated in the Notice on the 2019 Key Assignments of Certification, Accreditation, Testing, and Inspection, issued by the CNCA in April 2019, the institutional reform will be driven further and pilot programme will be implemented.6

The QSS Sub-working Group looks forward to seeing the government’s reform promises being translated into concrete action.

Key Recommendations

Concern
Although a series of documents on revising the Regulations on Certification and Accreditation (2016 Amendment) (Regulations) were formulated by the SAMR and the CNCA, the revision may take a long time to be completed.

Assessment
The Regulations was amended in accordance with the State Council’s decision in February 2016 to amend certain administrative regulations. The 2019 Legislative Work Plan of the SAMR (Work Plan) listed the revision of the Regulations as a secondary programme.7 However, as opposed to the primary programmes listed by the Work Plan, no expected completion dates were provided for secondary programmes. Some progress was made in May 2019, when the CNCA called for comments on the amendments to the Regulations.

In other developments, in March 2019, Premier Li

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4 Notice on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment, State Council, 17th January 2017, viewed 20th May 2019, <http://www.gov.cn/zhengce/content/2017-01/17/content_5160624.htm>
Keqiang stated at the China Development Forum that “all foreign investment will be treated equally and fairly in accordance with the principle of competitive neutrality, adopting national treatment and the negative list approach.”

The following month, in April 2019, the CNCA issued the Notice on the 2019 Key Assignments of Certification, Accreditation, Testing, and Inspection, which stipulates not only that the extra administrative measures placed on foreign-invested certification agencies be completely abolished, but also that national treatment will be granted.

While the QSS Sub-working Group welcomes these efforts, it is also aware that market access restrictions still exist for foreign-invested certification agencies. Article 11 of the Regulations stipulates that, in order to qualify as a certification body, foreign-invested agencies must have three or more years’ experience in certification activities and be accredited by the accreditation body in the country or region where it is located. These requirements come in addition to conditions prescribed for domestic investors. Certification services are not listed as a prohibited or restricted foreign access areas in the Special Management Measures for Foreign Investment Access (2019 Edition). Therefore, these special measures placed only on foreign-invested enterprises are not in line with the “pre-market access national treatment plus negative list administrative system” conditions stated in Article 4 of the Foreign Investment Law, and hinder market opening and fair competition. The QSS Sub-working Group suggests the Chinese Government accelerate the revision of the Regulation and engage with and collect feedback from enterprises in the future.

**Recommendation**

- Accelerate the revision of the Regulation on Certification

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2. Furthering Reforms for a Market-orientated TIC Industry

**2.1 Adopt Market-based Mechanisms to Reform Government-affiliated TIC Agencies and Avoid a Second Monopoly Through Administrative Support**

**Concern**

The current reforms being carried out in the TIC sector, along with excessive administrative interference, are likely to result in market fragmentation and industry monopolies.

**Assessment**

The TIC industry is the basis of high-quality economic and social development and also an important part of the modern services industry. It plays a vital role in strengthening the quality and security of the market, promoting industrial development, safeguarding the rights and interests of consumers, and protecting the environment. TIC agencies are entrusted by product manufacturers and users to adopt a scientific approach and remain professional when inspecting the quality, safety, performance and environmental friendliness of products. After inspecting the products, they should then provide an independent third-party report to evaluate whether the product meets the quality, safety, performance and legal standards required by the government, industry and end users. Through third-party TIC services, enterprises, employees, products and services are able to receive comprehensive, 360-degree assessments of their quality, security, performance and legal compliance.

By introducing and developing world-leading TIC services, the quality, safety and performance of China’s products may be more clearly demonstrated to end users or consumers. TIC services also provide support for industrial upgrading and transformation, as well as an effective and objective basis for evaluation for government and industry management personnel, and ultimately protect the rights and interests of consumers and users.

The Chinese Government—in line with President Xi Jinping’s vision for the Belt and Road Initiative (BRI)—has continued to enhance international cooperation and
increase production capacity. The TIC industry plays an indispensable role in this process. Through their global influence, knowledge and resource base, international third-party TIC agencies can support the quality and service capabilities of products manufactured under the CM2025 initiative, helping these products meet the legal standards of their destination countries and ease users’ concerns regarding quality and safety.

According to the CNCA’s Research Report on the Share of the Contribution Made by the Certification and Accreditation Industry to National Economic and Social Development, in 2015 and 2016, the certification and accreditation industry contributed more than one per cent to China’s total gross domestic product. This demonstrates the importance of the TIC services industry development to China’s overall economic growth.

Ensuring that the TIC industry shifts to using a market-orientated approach to development will have a significant impact on the Chinese economy. This process is also in line with the main aims of the CM2025 initiative – the overall upgrading of China’s economic and industrial capacity.

On 21st February 2014, the State Council released the Notice on the Opinions on Implementing the Integration of TIC Agencies (Notice).13 Guided by the State Council’s Institutional and Administrative Reform Plan,14 the Notice is a positive step towards reforming government-affiliated TIC agencies. Based on the Notice, the former AQSIQ issued the Guiding Opinions on the Integration of TIC Agencies Under the Nationwide Administration System of Quality Supervision Inspection and Quarantine on 6th March 2015.15 This explicitly states that over 3,500 TIC agencies under the former AQSIQ system will be classified into two categories—commercial and public welfare organisations. By 2020, administrative and supervisory functions will be separated from service functions, and the system’s restructuring shall essentially be complete. Additionally, branded, comprehensive TIC corporations should also take shape by then.

The Guiding Opinions on Deepening the Reform of SOEs were released by the Central Committee of the Communist Party of China and the State Council in September 2015. It states that SOEs will be either categorised as commercial or public welfare enterprises. The categorisation is based on the strategic positioning and development objectives of state-owned capital, and the roles, status and development needs for economic and social development of different types of SOEs. Furthermore, it states that SOEs are reformed, developed, regulated, assigned responsibilities and evaluated based on their categorisation, so as to promote in-depth integration between them and the market economy, and between the enterprises’ economic and social profits.

The sub-working group feels justified in its worries, that if the government—based on the current situation where administrative and public institutions and government-affiliated SOEs account for 27.88 per cent of the TIC agencies in China—decides to categorise the SOEs in this sector as public welfare enterprises, then government-dominance and market isolation will become more severe. Although there is a clear annual downward trend in the proportion of SOEs in the sector, the absolute number has not decreased significantly – remaining around 11,000.16 Based on its previous experience, the QSS Sub-working Group believes the current market-orientated reforms in the TIC sector are just the beginning. When implementing regulations, it is essential to prevent government-affiliated agencies from abusing their power to ensure the success of institutional and market-orientated reform.

The sub-working group is greatly concerned about the risk of an administratively-supported monopoly driven by state-owned TIC service companies absorbing the ‘reform vacuum’ during ongoing administrative reforms, which would constitute a breach of the Anti-monopoly Law and further hinder the development of a competitive market environment. A concentration of SOEs in the TIC industry or market fragmentation, both of which deviate from the mandate of market-orientated reform, could jeopardise the reform process and would hinder any efforts at solving China’s pressing quality and safety issues.

During the reform process, the sub-working group has noted that the Chinese Government has been paying close attention to the macro management of the whole service sector. European enterprises have advanced management concepts and market experience, as well as positive experiences that assisted the European Union (EU) and its Member States to reform their own TIC sectors in the past. The sub-working group would like to offer industry suggestions on administrative reform in order to improve the quality and safety environment in China, to increase the competitiveness of ‘Made in China’, to enhance the international influence of the ‘China brand’ and to achieve win-win situations for EU-China trade and investment. This experience sharing would be mutually beneficial for the negotiations on the EU-China Comprehensive Agreement on Investment. It would also help reduce EU-China trade conflicts while upgrading the level of quality and safety of Chinese products and services.

Recommendations

• Implement market mechanisms to avoid rent-seeking and monopolistic behaviour during the reform of government-affiliated TIC agencies.
• Reduce excessive and unclear market entry barriers and use international norms for assessment.
• Provide the same treatment to international TIC agencies so that they enjoy the same market status as their domestic peers.

2.2 Allow Non-public Institutions to Qualify to Provide Special Equipment Testing and Inspection Services

Concern

Only public institutions can currently qualify to provide special equipment testing and inspection services, which is a market access barrier for independent third-party TIC agencies.

Assessment

Special equipment consists of items such as boilers, pressure vessels, pressure pipes, elevators, lifting machinery, passenger ropeways, large amusement facilities and special purpose motor vehicles, which constitute key infrastructure and are vital to the economy and society as a whole. China has gradually established a safety monitoring system for special equipment, which is a dual-track model of safety monitoring and technical inspection agencies. These technical inspection agencies have been a significant force in ensuring products’ safety and quality, promoting industrial development, protecting consumers’ rights and public security, and accelerating energy conservation, emission reductions and environmental protection. With the joint effort of the government and various stakeholders, the rate of accidents related to special equipment has steadily decreased, although certain safety concerns remain.

As the economy develops rapidly, so has the use of special equipment, especially elevators. By the end of 2018, there were around 13,943,500 units of special equipment across the country. This included 403,900 boilers, 3,946,000 pressure vessels, 6,278,300 elevators, 2,347,900 units of heavy lifting machinery, 1,036 passenger ropeways, 25,100 large amusement facilities and 941,200 special purpose motor vehicles. If such a large number of special equipment was not subject to adequate inspection, the potential risk would be immeasurable.

With the development of economies, technology and societies, special equipment has become larger and more complex, bearing higher risk and creating ever-increasing requirements for safety management. This results in increasing demands for the testing and inspection services of such equipment. At the same time, the development of qualified inspection personnel has struggled to keep pace. For example, the growth of inspection personnel for elevator inspections is far behind the increase in numbers of elevators. Some personnel have to complete up to 1,000 elevator inspections per year, whereas experts suggest that the ideal workload is approximately 400 units per year. This raises considerable concern about the quality of inspections and potential safety issues that may arise due to such a heavy workload.

The Constantly Increasing Demand for Quality and Safety is Unmet

Currently, due to the restriction on qualifications, only the China Special Equipment Inspection and Research Institute (CSEI), and a very small number of companies, 17 Notice on the National Safety Situation of Special Equipment in 2018, SAMR, 4th April 2019, viewed 11th April 2019, <http://www.samr.gov.cn/tszsbj/gzdt/201904/020190404_292592.html>
18 Qi, Lan, Reform research on converting institutions to non-profit organisations from the perspective of policy tool selection: An example with special equipment inspection institutions, Zhongguo Jigou Gaige Yu Guanli (Reform and Management of Organisations in China), 2016, No.10, 5th December 2016.
are qualified to provide testing and inspection services for special equipment. As of the end of 2018, there were only 472 comprehensive testing agencies for special equipment in China, of which 282 are in the administrative system, and the remainder industry or in-house testing agencies.  There is still a long way to go to achieving the target of having comprehensive coverage for testing and assessment services.

**Insufficient Market Competition**

Many qualified third-party TIC agencies are not able to participate in the market due to certain barriers. The resulting lack of competition means that qualified agencies with access are not motivated to drive technological innovation and further invest in personnel training. In addition, their capabilities and equipment are often inadequate, particularly with respect to any special equipment involving new technology or materials. This inability to perform comprehensive, systematic and scientific testing and inspections services means that some hazards may not be identified accurately or in a timely manner. As the currently installed special equipment ages, the potential for serious incidents will inevitably pose greater challenges for the government’s risk prevention and control capacity.

**Lack of Specifications, Standards and Risk Assessment**

The standards related to safety technologies in China are not in line with international practice, which restricts the competitiveness of China’s special equipment. Some technical measures and regulations are very general and lack quantitative indicators, resulting in challenges for implementation. Meanwhile, there is a lack of such standards for risk assessment, lifespan estimation and malfunction warnings.

The participation of third-party TIC agencies can relieve pressure on the government’s safety and quality monitoring responsibilities, and improve the supply of testing and inspection services for special equipment. Their advanced testing and inspection technologies, as well as their comprehensive assessment systems, operating mechanisms, management models, methodologies and qualified personnel, would effectively serve the needs of the current mandatory testing system. Participation of third-party TIC agencies would also help mandatory testing agencies to grow quickly, enhance their innovation capabilities and improve internationalisation, thereby boosting the industry overall.

**Recommendation**

- Allow non-public institutions to qualify to provide special equipment testing and inspection services.

**Abbreviations**

13FYP 13th Five-Year Plan
AQSIQ General Administration of Quality Supervision, Inspection and Quarantine
BRI Belt and Road Initiative
CM2025 China Manufacturing 2025
CNY Chinese Yuan
CNCA Certification and Accreditation Administration of China
CSEI China Special Equipment Inspection and Research Institute
EU European Union
QSS Quality and Safety Services
SAMR State Administration for Market Regulation
SCA Standards and Conformity Assessment
SOE State-owned Enterprise
TIC Testing, Inspection and Certification

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Section Three
Goods
The Goods section of the Position Paper encompasses 10 European Chamber working groups and four sub-working groups:

- Agriculture, Food and Beverage (AFB)
  - Cheese
  - Paediatric Nutrition and Food for Special Medical Purpose
- Automotive
- Automotive Components
- Cosmetics
- Energy
  - Carbon Market
- Fashion and Leather
- Healthcare Equipment
- Petrochemicals, Chemicals and Refining (PCR)
- Pharmaceutical
- Shipbuilding

The global trading system sustained major damage over the past year. In September 2018, the United States (US) imposed a 10 per cent tax on United States dollars (USD) 200 billion worth of Chinese goods.\(^1\) China responded with taxes on 5,207 American imports worth USD 60 billion.\(^2\) Despite seemingly making progress in trade talks at the end of 2018, and again at the beginning of 2019, the situation deteriorated further when the US announced it would raise tariffs on the same group of Chinese goods to 25 per cent, and threatened 25 per cent tariffs on an additional USD 325 billion worth of Chinese imports. As of August 2019, China had imposed tariffs on a total of USD 110 billion worth of US goods.\(^3\)

The very nature of global supply chains means that tariffs on such a wide range of goods leaves very few industries unaffected, and a great many companies that manufacture goods for export have suffered. In January 2019, a quarter of European Chamber members reported that they have exports to the US that were impacted by US tariffs; and the same number of members reported that imported supplies from the US were hit by Chinese tariffs. Many affected member companies ate into their margins to remain cost-competitive, but this strategy is likely no longer feasible due to the subsequent raising of tariff rates to 25 per cent for most affected goods.\(^4\)

Despite these seriously unwelcome developments, European companies involved in the manufacture of goods remain committed to the China market. At the same time, they are expecting more positive reforms to China’s business environment, particularly in areas where China is officially focussing its policy efforts, such as the upgrading of its industries, institutional restructuring and improving regulation in general. For example, European Chamber members involved in the food and beverage industries have long suffered from uneven enforcement of regulations across different regions, which has resulted in operational complexity and compliance issues. With the formation of the State Administration of Market Regulation (SAMR), the Agriculture, Food and Beverage Working Group is now looking for increased oversight on

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food chain traceability, and strengthened capacity among enforcement authorities.

Poor regulation of China’s e-commerce industry has long resulted in a proliferation of inferior, fake automotive components entering the market. This has a clear effect on the brand reputation of companies whose goods are being counterfeited, but given the crucial function of many automotive components, it can also negatively impact health and safety. With the release of the E-commerce Law on 1st January 2019, online vendors are under increased pressure to take responsibility for eliminating fake products from their platforms, and members of the Automotive Components Working Group hope that this will substantially reduce the number of counterfeit goods in China.

In June 2018, the Ministry of Justice initiated a second round of public consultations on the Amendment of the Provisions on Medical Device Supervision (Order 680). Promulgation of the amended version is expected in the second half of 2019, and when it comes into force the Healthcare Equipment Working Group anticipates that it will pave the way for a series of reforms aimed at accelerating market access for new and innovative medical devices.

Another strong influence on the present and future operations of European companies is China’s increasing focus on environmental reforms. In 2018 and the first half of 2019, a large number of regulations have been rolled out in the automotive industry, related not only to investment and tariffs, but also to emissions and fuel efficiency. And although the overall automotive industry experienced its first slump in 28 years, China’s new-energy vehicle (NEV) market saw rapid production and sales growth at 59.9 per cent and 61.7 per cent respectively. The Automotive Working Group is now advocating for a more stable and predictable legislative environment in the interests of sustainable development of the NEV industry, including equal access to incentives for all market participants.

More EU-China cooperation is still required to solve a great many challenges related to environmental concerns, however. For example, China’s ambitions to rely more heavily on natural gas have been hampered by insufficient production, storage and transportation facilities. Recent relocations and closing of chemical facilities also remain a concern. While the State Council’s issuance of Circular No. 77 on the Relocation of Hazardous Chemicals Production Enterprises from Urban Populated Areas (Circular 77) seems like a positive step towards making relocation criteria more transparent, it still requires proper follow-up up at the provincial level. Although the Petrochemicals, Chemicals and Refining Working Group welcomes the increased emphasis on safety, excessive shutdown measures may disrupt chemical supply chains, with the effects then negatively impacting many other parts of the economy.

China has recently turned its focus to becoming a leader in the manufacturing of high-tech maritime vessels and related equipment. It hopes to realise this ambition through the setting of global market share targets and promoting such industrial policies as the China Manufacturing 2025 initiative and the Ministry of Industry and Information Technology’s Action Plan for Promoting Transformation to Intelligent Berth-assembling and Shipbuilding (2019–2020) and Intelligent Ship Development Action Plan (2019–2020), as well as the use of such tools as industrial subsidies. With China already dominating
in the three traditional categories of shipbuilding, this determined push to do the same in the high-tech segment—where European companies currently hold an advantage—poses a real threat to the European shipbuilding industry. The likely strategic merger between China State Shipbuilding Corp (CSSC) and China Shipbuilding Industry Corp (CSIC) further piles pressure on European shipbuilders – the merged mega-entity would have a 20 per cent global market share. To address these significant challenges, the European Chamber formed a Shipbuilding Working Group in 2019. The working group is focussed on WTO reform—particularly dealing with the issue of subsidies and other market-distorting practices—advocating for national treatment and increased market access, increasing channels for financing and gaining equal access to R&D funds in China.

9 Bulkers, tankers and container ships.

This icon represents the number of years the working group has been making this recommendation.
Agriculture, Food and Beverage Working Group

Agriculture, Food and Beverage Key Recommendations

1. Establish a Unified System for Compliance Evaluation and Law Enforcement to Ensure the Consistent Enforcement of Rules and Regulations by Law Enforcement Officers at all Levels in China
   - Develop a job performance appraisal system to regulate the practices of law enforcement personnel.
   - Improve, through systematic legal training and the promotion of case studies, law enforcement officers’ legal capacity and their ability to enforce the rule of law.

2. Establish an Effective Food Safety Traceability System Across Administrative Departments, Distribute Responsibilities Proportionately Across the Supply Chain and Strengthen Communication on Food Safety Risks
   2.1 Establish a Food Traceability System that can Effectively Communicate Food Safety Risks, to Create a Reliable Supply Chain
      - Publish a unified standard or policy document to guide and encourage companies in the establishment of a time-efficient and cost-effective food chain traceability information system.
      - Further improve extant laws and regulations, issue guidance documents for mandatory standards and formulate documents for different product categories where necessary.
   2.2 Distribute Responsibilities Proportionately Across the Whole Supply Chain and Strengthen Communication on Food Safety Risks
      - Introduce comprehensive, reasonable and fair rules to clarify the corresponding responsibilities of all suppliers and participants in the food supply chain.
      - Create a database of crucial data exchange between key users, including producers, processors and distributors.
      - Establish a rapid alert mechanism, like the EU’s Rapid Alert System for Feed and Food (RASFF), to evaluate and report food supply chain risks.

3. Release an Official Document Detailing the Approval Procedures and Timetable for the Use of New Food Ingredients and Additives Derived from Genetically Modified (GM) Technology
   - Conduct call for comments on and publish the Guidance on Safety Evaluation of the Genetically Modified Microorganisms (and Products) for Food Use as soon as possible, and ensure that the data requirement is science-based and reasonable.
   - Publish clear approval procedures for all new food ingredients and food additives derived from GM technology and streamline the number of ministries involved in the approval process.

4. Strengthen Communication with the Organisation for Economic Co-operation and Development (OECD) to Support the Advancement of China’s Accession to the OECD Framework Agreement on the Pesticide Field
   - Strengthen communication with the OECD and its members to support the advancement of China’s accession to the OECD framework agreement in the pesticide field to facilitate compatibility between Chinese and international pesticide registration test systems.
5. **Optimise the Implementation of the National Nutrition Plan 2017–2030 to be Based on Strong Scientific Evidence**
   - Define a timetable and science-based approach for the implementation of the National Nutrition Plan 2017–2030 and promulgation of relevant action plans.
   - Encourage the advocacy of traditional and diversified diets based on ‘Positive Nutrition’.
   - Promote education programmes on the role of diet, portion sizes and the frequency of consumption.

6. **Optimise the Food Contact Materials and Articles (FCMs) Regulatory Framework**
   6.1 **Speed up the Approval for Registering New Food-related Products and Include all Commonly-used Additives for FCMs on the Approved List in an Efficient Manner**
   - Include all commonly used additives for FCMs in the approved list in an efficient manner.
   - Speed up the registration and approval process for new food-related products.
   6.2 **Update the Technical Requirements for FCMs Stipulating Limitations of Used Ingredients and Additives in Food-related Products**
   - Update the technical requirements for FCMs to stipulate limitations of used ingredients and additives in food-related products.

**Cheese Industry Key Recommendations**

1. **Optimise the Regulation of Cultures Applied in Cheese Production from Two Aspects: the Legality of the Usage of Cheese Strains and the Cheese Culture Claim**
   - Revise the labelling requirement in the relevant national food safety standard so that the general name of the ‘food culture’ can be listed on the label instead of all individual cultures, in order to align with international regulations.
   - Exempt the cultures that have a history of safe use in cheese production from the current China food culture positive list, or expand the current Chinese list to include certain cultures based on the historical safe use of their application in cheese, and classify them as permitted ingredients in the production of cheese as soon as possible.

**Food for Special Medical Purpose and Paediatric Nutrition**

1. **Optimise the Registration System for Special Food**
   - Improve the regulations related to the change of Food for Special Medical Purpose (FSMP) registration and infant formula recipe registration, as soon as possible, relevant detailed guidelines.
   - Specify the department conducting the verification and assessing standards during on-site inspections of clinical trials.
   - Improve the on-site inspection system, clarify the requirement of “actual needs”, and accelerate the on-site inspection of overseas factories.
   - Coordinate the registration and change of registration of infant formula among local and provincial-level supervisory records, and specify the process.

2. **Continue the Revision of the National Food Safety Standards**
   - Improve coordination among regulatory authorities in the management of special food avoiding conflicts caused by dual-track management, and reducing repeated supervision.
• Postpone the release and formal implementation of the national food safety standards for infant formula and FSMP until 2023, and ensure that the SAMR and the NHC coordinate their efforts to forge an effective connection between the registration and the national food safety standards, and then supervise the two processes.

• Revise national food safety standards so they are more aligned with the latest international standards.

• Add additional product categories in the national food safety standards for FSMP to promote industry development and fulfil people’s increasing product needs, while putting in place technical indicators for relevant products.

• Verify differences among existing testing methods, clarify what the scope is for each testing method and develop food safety national testing methods for FSMP.

• Refrain from conducting national or local supervision and inspection on FSMP products in the absence of national testing standards for the sector.

3. Publish New Administrative Measures on the Sale of Breast Milk Substitutes

• Develop new Administrative Measures on the Sale of Breast Milk Substitutes and clarify the definition and scope of breast milk substitutes as soon as possible.

• Allow FSMP manufacturers to communicate with healthcare professionals regarding scientific feeding, under the prerequisite that the companies do not interfere with breastfeeding practices.

• Allow breast milk substitute manufacturers and operators to conduct scientific research, consultation and health education activities with medical and health institutes and their staff.

4. Reduce Resource Wastage Caused by Certain Administrative Requirements

• Combine several pre-approval on-site inspections to avoid repetition and the accompanying waste of resources.

• Enforce dynamic production only during the initial on-site inspection, and do not enforce it for any subsequent inspections.

5. Enhance Public Education on FSMP

• Increase educational opportunities for consumers and caregivers on the importance of good nutrition during the first 1,000 days from the mother’s pregnancy to the infant’s second birthday.

• Publish educational materials for customers and encourage local-level governments to educate the public on basic nutrition, to help people understand and recognise FSMP and its correct usage.

• Develop a reasonable administrative measurement for the examination and release of advertisements for FSMP, allowing proper promotion and accurate communication with consumers with respect to infant FSMP, including rigorous academic exchanges and scientific popularisation in the form of academic journals and conferences.

6. Optimise the Requirements for Clinical Trials of FSMP

6.1 Rationalise the Requirements Placed on Trial Participants

• Establish a method for businesses to be exempted from conducting clinical trials, or allow a reduction in the use of clinical trial cases for populations under the age of 10, and populations with rare diseases, so as to ensure the proper use of clinical trial resources and satisfy the needs of special groups.

• Accept the normal diet as a control group in a single-arm study, and the ‘before and after’
Agriculture, Food and Beverage Working Group

Section Three: Goods

Introduction to the Working Group

The agriculture, food and beverage (AFB) industries have a significant impact on people’s daily lives. At the global level, they are continuously innovating, with more attention being paid to food safety and the sustainable sourcing of food, pushing them to achieve new breakthroughs and employ new technology. For China, in addition to furthering agricultural development and modernising food production processes, improving the safety and security of food are essential to ensure the continuous and sustainable development of the economy and people’s livelihoods.

The Agriculture, Food and Beverage Working Group helps connect members with the Chinese authorities, in order for the government to better understand what needs to be done to promote food safety and improve market access for European food and beverage companies operating in China. The working group represents a wide range of companies that include importers and exporters, manufacturers, distributors, retailers, catering service providers, specialised testing laboratories and consultancies. Currently, the working group has over 150 member companies.

7. Promote Capacity Building for Law Enforcement Personnel

- Improve information disclosure, clarify the review requirements as soon as possible, release the review requirements to the public and provide training to local law enforcement personnel accordingly.
- Enhance scientific supervision and improve the capabilities of registration reviewers by providing relevant training.

8. Improve the Openness and Transparency of Law Enforcement

- Improve the openness and transparency of major decisions that will affect the development of the industry, and actively communicate with the industry and provide guidance.
- Publicise the annual plan for on-site inspections of overseas factories (FSMP and infant formula) so that enterprises can prepare raw materials and production in advance.

Recent Developments

China’s institutional restructuring plan—submitted by the State Council to the National People’s Congress (NPC) in March 2018,¹ and fully implemented by the beginning

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¹ Explanation on the State Council’s Institutional Reform Programme, NPC, 14th March 2018, viewed 26th April 2019, <http://wwwnpc.gov.cn/npc/dbdhyy13_1/2018-03/14/content_2048552.htm>
of 2019—brought significant changes to the Chinese regulators responsible for the AFB sectors. The working group welcomes institutional reform at all levels, since the lack of cross-departmental coordination on food-related standard setting and implementation has been a long-standing issue. Nevertheless, to ensure that the reorganisation helps facilitate trade and increase work efficiency in customs clearance and other food safety law enforcement domains, the working group recommends that the Chinese central government provides further guidance to promote harmonisation among policies, regulations and standards in the food safety regulatory system as soon as possible. The industry looks forward to more clarity on food safety and non-food safety standards, and the roles of relevant regulatory departments.

The AFB Working Group is closely following developments related to the draft Measures for the Administration of Certificates Attached to Foods Imported to China (Measures), which are to be implemented on 30th September 2019. The draft requires the food importer to attach a certificate issued by the competent authority of the exporting country/region to every batch of food to prove they have been approved by exporting country/region authorities and are eligible for human consumption. While the working group supports efforts on the government side to guarantee the safety of food and protect Chinese consumers, the industry nevertheless is concerned that such measures risk disrupting trade, as authorities from certain countries may not dispose of the necessary legal framework to provide such certificates. The working group also welcomes and looks forward to the fulfilment of the commitments outlined in the recent EU-China Summit Joint Statement. These include: seeking the guidance of international standard setting bodies on low-risk food products’ official certification; formally concluding the EU-China Agreement on the Cooperation on, and Protection of, Geographical Indications (GI) negotiations; promoting quick approval times, increasing operational complexity for companies and leads to potential non-compliance risks. The working group looks forward to the fulfilment of the commitments outlined in the recent EU-China Summit Joint Statement.

A lack of appropriate coordination across relevant regulatory authorities at central and local levels also creates operational challenges. The AFB Working Group hopes that the newly established State Administration of Market Regulation (SAMR) will facilitate improved coordination among supervisory authorities and internal responsibility among regulatory bodies of the former State Administration for Industry and Commerce (SAIC), China Food and Drug Administration (CFDA), and Quality and Technology Supervision Bureau, so that the government reshuffle ultimately results in improved regulatory efficiency and supervision of food safety.

The revised Standardisation Law of the People’s Republic of China came into effect on 1st January 2018, and provides a clear legal hierarchy of different standards. In order to avoid compromising the effect of these standards, the working group recommends providing more training and guidance for both enforcement authorities and companies, in order to avoid confusion or misinterpretation at the local level.
Recommendations

- Develop a job performance appraisal system to regulate the practices of law enforcement personnel.
- Improve, through systematic legal training and the promotion of case studies, law enforcement officers’ legal capacity and their ability to enforce the rule of law.

2. Establish an Effective Food Safety Traceability System Across Administrative Departments, Distribute Responsibilities Proportionately Across the Supply Chain and Strengthen Communication on Food Safety Risks

2.1 Establish a Food Traceability System that can Effectively Communicate Food Safety Risks, to Create a Reliable Supply Chain

Concern

There is no unified standard or guideline to help businesses establish food safety traceability systems; and any monitoring that does exist is not robust enough to communicate all food safety risks, meaning the resulting information can easily be changed or falsified.

Assessment

Primary agricultural workers, processors, packers, wholesalers, distributors, retailers and warehouses in the supply chain each have a different understanding of risk communication and food safety traceability. At the same time, there is no uniform food safety traceability system at the national level across administrative departments in China, despite a number of documents concerning food safety traceability systems being issued, such as: the General Principles and Basic Requirements for the Design and Implementation of Traceability Systems for Feed and Food Chains (GB/T 22005-2009) issued by the Standardisation Administration of China (SAC) in 2009;5 the Administrative Measures for Food Recalls6 and Several Provisions on Establishing a Food Safety Traceability System by Food Production and Operation Enterprises7 issued by the former CFDA in 2015 and 2017 respectively; and the Suggestions on Accelerating the Construction of a Traceability System for Agricultural Product Quality and Safety8 issued by the then Ministry of Agriculture (MOA) in 2016. Consequently, when businesses across the supply chain establish their own traceability systems, out of necessity, the systems can only meet the companies’ internal needs. They cannot efficiently communicate all potential external food risks.

The establishment of a traceability system is an important factor when it comes to ensuring food safety, and the working group supports the Chinese Government's commitment to do so. In order to achieve this goal, regulatory coordination among different authorities is crucial for enforcing relevant policies. The working group hopes that the government restructuring will help address this issue, promote the consolidation of food and agricultural product traceability systems, and strengthen existing policy documents and technical standards by issuing guidance documents for mandatory standards and formulating documents for different product categories where necessary, to ensure consistency in food safety. Many local government departments tend to manage food traceability by actively promoting the establishment of a local traceability platform. However, it is costly for companies to follow and comply with multiple traceability systems. Therefore, because food safety responsibility lies primarily with enterprises under the current system, the decision about which traceability service to adopt should be a commercial one. Finally, the working group recommends that the Chinese Government adopts measures to secure the information that is uploaded to the traceability platform, to ensure it is unfalsifiable and immutable.

Recommendations

- Publish a unified standard or policy document to guide and encourage companies in the establishment of a time-efficient and cost-effective food chain traceability information system.
- Further improve extant laws and regulations, issue guidance documents for mandatory standards and formulate documents for different product categories where necessary.

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2.2 Distribute Responsibilities Proportionately Across the Whole Supply Chain and Strengthen Communication on Food Safety Risks

Concern
The lack of a rapid response system and information exchange channel, as well as responsibility among relevant stakeholders, poses a great risk to food safety.

Assessment
Sometimes, even when a food manufacturer makes every effort to prevent food safety risks, negligence can still occur in other parts of the supply chain. This can lead to an outbreak of food safety incidents, and the accompanying public outcry. At present, there is an overall lack of responsibility among relevant stakeholders, which increases the risks to food safety. Although relevant information from stakeholders is retrievable, it is scattered, decentralised and fragmented.

In order to respond more quickly to sudden food safety incidents, the working group recommends the Chinese Government adopt best practices developed in the European Union (EU). For instance, in order to strengthen food safety management measures in the supply chain, the European Commission (EC) has clearly defined responsibilities for each participant, outlined in its White Paper on Food Safety. This has completely transformed food safety in the European supply chain. In addition, the launch of the Rapid Alert System for Feed and Food (RASFF) by the EC has delivered a communication and assessment system for responding to potential threats caused by food or feed issues: the RASFF provides transparency and results in action being taken much more quickly in order to protect consumers and others along the supply chain. Afterwards, a decision is made based on a comprehensive analysis of all relevant information to prevent the continued distribution of compromised food products.

Recommendations
• Introduce comprehensive, reasonable and fair rules to clarify the corresponding responsibilities of all suppliers and participants in the food supply chain.
• Create a database of crucial data exchange between key users, including producers, processors and distributors.
• Establish a rapid alert mechanism, like the EU’s RASFF, to evaluate and report food supply chain risks.

3. Release an Official Document Detailing the Approval Procedures and Timetable for the Use of New Food Ingredients and Additives Derived from Genetically Modified (GM) Technology

Concern
The temporary joint-approval process for new food ingredients and additives derived from GM technology by the National Health Commission (NHC) and the Ministry of Agriculture and Rural Affairs (MARA) has not yet been officially clarified, which results in relatively low regulatory efficiency, while the lack of an official document regarding the application dossiers’ requirements creates uncertainty for new submissions.

Assessment
In China, no new raw food materials or food additives derived from GM technologies have been approved for nine years. This regulatory stop prevents a large number of advanced products from entering the Chinese market. Consequently, the competitiveness of the corresponding derivatives or downstream products in the industrial chain is limited and weakened in the global market.

In 2010, the former Ministry of Health (MOH) stopped approving food ingredients and additives derived from GM technology, and requested that applicants obtain biosafety certificates from the former MOA. These two former ministries did not reach a consensus on the issuance of biosafety certificates until June 2017, when the State Council’s Food Safety Committee put forward a solution in the form of a joint approval by the two ministries. In mid-June 2018, the NHC started accepting dossiers on food additives derived from GM technology again, but only those submitted for MARA review. By the end of 2018, MARA had passed 14 enzyme products derived from GM technology. The NHC started its food additive review procedure for the same products in February 2019.


While great progress has been made in the approvals process for those 14 products, no official regulatory document has been released for such a joint approval procedure and application dossiers requirement, thus, the unpredictability and uncertainty remain of great concern to the industry. The government has drafted a Guidance on Safety Evaluation of the Genetically Modified Microorganisms (and Products) for Food Use, but its content and potential publication date have as yet not been disclosed.

Another aspect to this regulatory hurdle is the fact that the current approval procedure does not apply to all kinds of food ingredients and additives derived from GM technology. For example, since 2016, the application dossiers of oligosaccharides produced by genetically modified microorganisms (GMMs) have been rejected for submission.

**Recommendations**
- Conduct call for comments on and publish the Guidance on Safety Evaluation of the Genetically Modified Microorganisms (and Products) for Food Use as soon as possible, and ensure that the data requirement is science-based and reasonable.
- Publish clear approval procedures for all new food ingredients and food additives derived from GM technology, and streamline the number of ministries involved in the approval process.

**4. Strengthen Communication with the Organisation for Economic Co-operation and Development (OECD) to Support the Advancement of China’s Accession to the OECD Framework Agreement on the Pesticide Field**

**Assessment**
On 1\textsuperscript{st} June 2017, China’s newly revised Pesticide Management Regulations\textsuperscript{12} were officially implemented. This and supporting regulations have introduced clear provisions on strengthening pesticide management, simplifying and strengthening pesticide production licensing procedures, improving evaluation standards and strict market supervision, encouraging pesticide innovation, and further improving pesticide management levels and ensuring the quality and safety of the product in China.

The industry is concerned, however, that the provisions related to the approval of overseas test data in Article 16 of the Pesticide Registration Administration Measures\textsuperscript{13} are difficult to implement in practice. The measures require that “the registration test report should be issued by registration test institutions recognised by MARA, or by an overseas relevant laboratory that has signed a mutual recognition agreement with the relevant authorities of the Chinese Government; but the efficacy, residue, environmental impact and other tests closely related to environmental conditions and the registration test of China’s endemic biological species should be completed in China.” Up to now, China has not signed a mutual recognition agreement with any country or international organisation, such as the OECD framework agreement (or the OECD pesticides programme). In fact, China is the only country in the world that requires all pesticide registration tests to be carried out in its own country.

Based on the specificity of pesticide registration and industry in China, and after joint efforts and discussions between the Ministry of Commerce (MOFCOM), MARA, industry associations and OECD institutions in China, the OECD in China hopes to invite China to firstly join the Mutual Acceptance of Data (MAD) framework agreement in the pesticide field in order to solve the shortage of new products due to the extended registration period, which the Chinese Government fully supports. At the moment, the industry awaits the results of OECD members’ vote on the implementation of this proposal.


\textsuperscript{12} Pesticide Management Regulations, MOA, 5\textsuperscript{th} April 2017, viewed 2\textsuperscript{nd} July 2019, [http://www.moa.gov.cn/gk/zcfg/xzfg/201704/t20170405_5549362.htm](http://www.moa.gov.cn/gk/zcfg/xzfg/201704/t20170405_5549362.htm)

\textsuperscript{13} Pesticide Registration Administration Measures, State Council, 21\textsuperscript{st} June 2017, viewed 2\textsuperscript{nd} July 2019, [http://www.gov.cn/gongbao/content/2017/content_5234531.htm](http://www.gov.cn/gongbao/content/2017/content_5234531.htm)
Recommendations

• Strengthen communication with the OECD and its members to support the advancement of China’s accession to the OECD framework agreement in the pesticide field to facilitate compatibility between Chinese and international pesticide registration test systems.

5. Optimise the Implementation of the National Nutrition Plan 2017–2030 to be Based on Strong Scientific Evidence

Concern

As an important participant in the implementation of the National Nutrition Plan 2017–2030, the food and beverage industries require clearer guidance on the execution of the plan, so as to be able to fully engage in improving the overall provision of nutrition in China.

Assessment

Currently, food and beverage industry players in China are looking to receive clearer guidance from authorities on the implementation of the National Nutrition Plan 2017–2030.

Industry contributions are crucial for defining proper and validated techniques and methodologies (e.g. implementing cohort studies to be compared to internationally recognised benchmarks of healthy diets) for monitoring and evaluating of food and the nutritional status of the population, including the quality and safety of raw materials. The traditional approach towards food preparation and preservation should be integrated with modern industrial food processing practices. Food and health-related scientific knowledge should be communicated to the food and beverage industry in a clear and practical manner, and be aligned with available up-to-date nutritional scientific knowledge.

According to recent data, a dietary pattern characterised by the consumption of foods rich in protective compounds (i.e. plant foods and their components, such as fibre, polyphenols and polyunsaturated fatty acids)—which are key components of traditional diets—is likely to be of more benefit than limiting consumption of nutrients considered less favourable (i.e. essentially, saturated fat and sugar). Based on these assumptions, it can be inferred that the adoption of coercive legislative interventions—which have been introduced in some western countries to improve diet quality—may not be an optimal strategy.

Recent literature suggests that the diet–disease relationship is complex, and that overall health may be improved through a diet rich in specific nutrients that have a protective effect against common modern diseases, rather than by restrictive diets based on outdated nutritional, epidemiological and experimental approaches. Certain dietary compounds are effective in antagonising or neutralising diet-disease relationship phenomena, together with ensuring a balanced physical and mental state. The most potentially favourable and promising strategy to ensure a healthy diet appears to be ‘Positive Nutrition’ – a participative rather than coercive approach. Encouraging ‘healthier’ food choices via prescriptive and normative measures may not be the best tool to reach expected outcomes, especially in a domestic environment.

In 2014, the World Health Organization (WHO) suggested that limiting portion sizes to reduce overall energy intake would therefore also reduce the risk of unhealthy weight gain. Research focusing on nutrition education, together with the promotion of healthier eating within large scale government healthcare programs could generate substantial health gains, as well as prevent obesity and related diseases.

Recommendations

• Define a timetable and science-based approach for the implementation of the National Nutrition Plan 2017–2030 and promulgation of relevant action plans.

• Encourage the advocacy of traditional and diversified diets based on ‘Positive Nutrition’.

• Promote education programmes on the role of diet, portion sizes and the frequency of consumption.

6. Optimise the Food Contact Materials and Articles (FCMs) Regulatory Framework

6.1 Speed up the Approval for Registering New Food-related Products and Include all Commonly-used Additives for FCMs in the Approved List in an Efficient Manner

**Concern**

A high number of state of the art substances are not included in the *National Food Safety Standard on Hygienic Standards for Uses of Additives in Food Containers and Packaging Materials (GB 9685-2016)*, which results in the disruption of imports of packaging materials, equipment, machinery, pipes, fittings and other materials used in the food and feed production sector, thus damaging the Chinese food and feed industry.

**Assessment**

*GB 9685-2016* specifies principles for the use of additives in food containers and packaging materials: the types of permitted additives; scope of use; maximum levels; specific migration limits or maximum permitted quantities; as well as other restrictive requirements. The standard also includes some monomers and initiators during the production of food contact materials and products.

*GB 9685-2016* became effective on 19th October 2017. The standard introduced a clearer management model for raw and auxiliary materials – positive lists are now used to manage them. For each category of food contact material, including plastic, coating, rubber and silica gel, a permitted additives list is provided. Products with additives not included in the positive lists are illegal in China. The NHC has since approved new additives and food contact materials to satisfy the demands of the FCM industry.

However, in comparison to the white list of substances that are legally eligible in the EU as additives in materials that may come into contact with food, in China many essential substances—which are commonly used by European industries and have been proven safe for use in food contact materials—are not compliant with domestic regulations. For instance, in the *National Food Safety Standard on Rubber Food Contact Materials and Articles (GB 4806.11-2016)*, the reference to *GB 9685-2016* and other relevant regulations is insufficient, since a lot of substances for rubber and silicon rubber listed there are missing. However, these substances are important and/or indispensable for the production of sealing materials for machinery or components. That these additives are not yet included in *GB 9685-2016* is highly problematic with respect to the import of packaging materials, equipment, machinery, pipes, fittings and other material that may be used anywhere in the food and feed production sector in China. The disruption of such imports may damage the Chinese food and feed industry.

In addition, the registration of new food-related products usually takes a very long time, which may lead to a significant reduction in inbound trade in terms of both volume and value.

**Recommendations**

- Include all commonly used additives for FCMs in the approved list in an efficient manner.
- Speed up the registration and approval process for new food-related products.

6.2 Update the Technical Requirements for FCMs Stipulating Limitations of Used Ingredients and Additives in Food-related Products

**Concern**

Without access to information on raw and auxiliary materials of food contact materials, especially with regard to restricted substances and conditions of use, FCM traders cannot accurately assess their compliance and safety.

**Assessment**

Chemical substance manufacturers need to produce products in accordance with the *National Standard for Food Safety General Hygienic Practice for Production of Food Contact Materials and Articles (GB 31603)*, and provide a declaration of compliance for chemicals that specifies authorisation of use in FCMs, as well as usage restrictions. Moreover, according to the *National Standard for Food Safety – General Safety Requirements for Food Contact Materials and Articles (GB 4806.1-2016)*, all operators in the supply chain must bear responsibilities with regard to the compliance and safety of the final products. However, most importers of FCMs buy products from overseas traders instead of overseas manufacturers. In general, FCMs traders lack knowledge about product composition...
in terms of ingredients or additives, and this is often compounded by manufacturers actively protecting proprietary information related to product development, manufacturing and processing. Nevertheless, technical requirements laws and regulations for FCMs are not simply indices; they also stipulate limits for ingredients and additives used during manufacturing. Only with access to information on raw and auxiliary materials, especially restricted substances and conditions of use for FCMs, can the industry accurately assess the compliance and safety of the materials. However, this information is usually considered a trade secret, which further adds to difficulties in analysing risks and complying.

**Recommendations**

- Update the technical requirements for FCMs to stipulate limitations of used ingredients and additives in food-related products

**Abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>AFB</td>
<td>Agriculture, Food and Beverage</td>
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<td>CFDA</td>
<td>China Food and Drug Administration</td>
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<td>EU</td>
<td>European Union</td>
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<td>EC</td>
<td>European Commission</td>
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<td>FCM</td>
<td>Food Contact Material and Article</td>
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<td>GI</td>
<td>Geographical Indication</td>
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<td>GLP</td>
<td>Good Laboratory Practice</td>
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<td>GM</td>
<td>Genetically Modified</td>
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<td>GMM</td>
<td>Genetically Modified Microorganisms</td>
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<td>MAD</td>
<td>Mutual Acceptance of Data</td>
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<td>MARA</td>
<td>Ministry of Agriculture and Rural Affairs</td>
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<td>MNC</td>
<td>Multinational Corporation</td>
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<td>National People’s Congress</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>RASFF</td>
<td>Rapid Alert System for Feed and Food</td>
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<td>SAC</td>
<td>Standardisation Administration of China</td>
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<td>State Administration for Industry and Commerce</td>
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<td>SAMR</td>
<td>State Administration of Market Regulation</td>
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<td>WHO</td>
<td>World Health Organization</td>
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Cheese Industry Sub-working Group

Introduction to the Sub-working Group

Cheese making dates back several thousand years. The use of different microbes, amounts of salt and lengths of storage have over the years given rise to a huge variety of different cheeses all over the world, and it is widely considered a nutritional food in European diets. Chinese consumers are also now beginning to recognise cheese as a valuable source of nutrition. The European Chamber’s Cheese Industry Sub-working Group was established in 2014, and has eight prominent European cheese producers and industry associations that are committed to bringing the best cheese products to China’s market to meet Chinese consumers’ demands.

The Cheese Industry Sub-working Group represents members’ interests and promotes constructive dialogue and communication between relevant stakeholders, including industry associations and regulators, to ensure a level playing field for all players.

Recent Developments

In recent years, there has been an increase in popularity of cheese products among Chinese consumers. The past five years has seen double-digit growth of the sales value of China’s cheese market, which has benefitted both domestic producers and importers of cheese products. The import volume has grown from 28,600 metric tonnes in 2011 to 108,300 tonnes in 2018, and it is predicted that the total value of sales of cheese in China will reach Chinese yuan (CNY) 8.3 billion by 2020.

In 2016, the former National Health and Family Planning Committee (NHFPC) announced the revision of the GB 5420-2010 National Food Safety Standard for Cheese. The China National Centre for Food Safety Risk Assessment (CFSA) coordinated with relevant institutes on the revision of these two standards. On 23rd May 2019, the National Health Committee (NHC) published on its homepage the invitation to public consultation on both draft standards with a deadline of 20th July 2019. According to the latest draft, the limits on yeast and mould were removed, which is very much welcomed by the European cheese industry. It is still too early to tell when these new standards will be effective.

The Cheese Industry Sub-working Group provided comments on both standards and expects them to be revised based on existing scientific evidence. The sub-working group further anticipates that barriers currently preventing both the importation of certain European cheese products and the development of the domestic cheese industry in China will be removed.

In September 2017, the importation of certain types of European cheeses that use particular types of cultures (e.g. geotrichum candidum, penicillium candidum and penicillium camemberti) was impacted by strengthened regulatory measures enacted by China to ensure food safety. The use of cultures in cheese production is an ongoing, longstanding issue that has been raised many times by the Cheese Industry Sub-working Group and has been discussed, in detail, in the past four position papers. After holding extensive discussions with the relevant government authorities, the Codex Alimentarius was used in China as a frame of reference to address the regulations of the use of cultures in cheese production. This action was welcomed by the cheese industry.

It is important for regulatory barriers to be reduced and for the development of the cheese industry to be promoted, in line with the Chinese Government’s position on promoting trade liberalisation and economic globalisation. Also, as cheese is well-recognised as a nutritional food, the development of the industry would

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help to improve the overall health and nutrition status of the Chinese population, an aim that is laid down in the strategic plan Healthy China 2030,7 and the National Nutrition Plan 2017–2030.8 In addition, the development of the cheese industry is one of the key drivers that will facilitate the upgrading of China’s dairy industry.

The Chinese Government intends to enhance its technical competence with respect to cheese industry regulation in order to ensure the safety of cheese products in China. The Cheese Industry Sub-working Group expects that the formulation and revision of the National Food Safety Standards For Cheese and Processed Cheese will be compatible with related international standards and manufacturing conditions, while maintaining a high level of food safety. As market demand for cheese continues to increase in China, sub-working group members continually seek opportunities to enhance communication with the regulatory authorities and present Chinese customers with a greater variety of nutritional products.

**Key Recommendations**

1. Optimise the Regulation of Cultures Applied in Cheese Production from Two Aspects: the Legality of the Usage of Cheese Strains and the Cheese Culture Claim

**Concern**

Many cultures traditionally used in European cheese-making processes are not included in the positive list that China uses to regulate the application of cultures in food production, which acts as a barrier to the Chinese market.

**Assessment**

China’s regulation of food cultures allows a very limited number of microbial cultures to be used. In 2010, the then Ministry of Health (MOH) issued the List of Cultures Applied in Food.9 The notice included a positive list that only recognised a few microorganism types, mainly used for yoghurt manufacturing, with regulated cultures applied in food for infants and young children featuring in another list. This regulation exempts a number of cultures that are traditionally used for food manufacturing and processing. Although exempted cultures listed in the notice are not specified as those used in traditional Chinese cooking, the official interpretation and actual implementation does in fact apply only to cultures used in ‘traditional Chinese food’; this includes vinegar, soy sauce, and Chinese liquor, among others.

After the introduction of seven additional notices, a total of 38 cultures are now listed, expanded from the original 21 listed in 2010. This means that only 17 cultures have been added in nine years. Cultures other than those 38 listed and those used in Chinese traditional foods must not be used in production until they are approved in a safety review conducted by the NHC. The review process is made impossible for producers of cultures used in cheese as it requires information that is very difficult to obtain—such as the toxicological assessment of a certain culture—and so is hindering the growth of the Chinese cheese industry. Furthermore, the review process is labour-intensive, which is an unnecessary cost, as these cultures have a long history of safe usage in a wide variety of European cheeses.

Authoritative lists of microorganisms used by international organisations, or in countries other than China, include cultures that are generally recognised for their history of safe usage, or are manufactured for traditional foods. Such lists include that published as a result of a joint project between the International Dairy Federation (IDF) and the European Food and Feed Cultures Association in 2002, and a Danish list of notified microbial cultures that are used in food production. After being reviewed and updated in 2012 and 2018, the IDF inventory now lists approximately 300 microbial cultures covering a wide range of food matrices.10 The Chinese Government and a number of research institutes are cooperating with the IDF to include the cultures used in manufacturing traditional Chinese food.

The Danish Veterinary and Food Administration (DVFA) has a list of notified microbial cultures used in food. The list is a record of all microbial cultures the DVFA has been notified of, and can be expanded if given...
more information by culture manufacturers. Culture registration does not preclude safety documentation: the DVFA does not approve microbial cultures before they are used. In European countries, cultures are considered ingredients and must satisfy legal safety requirements, with the responsibility for them being safe lying with manufacturers. Related regulations state that manufacturers shall only use cultures that have a history of safe use.

The contribution of certain microbes to cheese has been widely recognised, and pure microbial cultures are commonly used by cheesemakers. In addition to lactic acid bacterial starter cultures, various species of bacteria and fungi can be added to give cheese very specific characteristics. For instance, blue-mould cheeses have always been fermented with *Penicillium roqueforti*. Spores of the filamentous fungus *Penicillium camemberti* are inoculated into milk during the production of bloomy, rind cheeses such as Brie and Camembert. The actinomycete bacterium *Brevibacterium linens* (*B. linens*) contribute to the reddish-orange colour found in the traditional cheese Epoisses. For centuries, cheesemakers have learned how to consistently cultivate specific microbial colonies by manipulating the conditions a cheese is subjected to during the ageing process. Recognising the historical safe use of cultures applied in cheese will help promote the cheese industry in China and allow Chinese customers to enjoy a wider variety of cheeses.

**Recommendations**

- Revise the labelling requirement in the relevant national food safety standard so that the general name of the ‘food culture’ can be listed on the label instead of all individual cultures, in order to align with international regulations.
- Exempt the cultures that have a history of safe use in cheese production from the current China food culture positive list, or expand the current Chinese list to include certain cultures based on the historical safe use of their application in cheese, and classify them as permitted ingredients in the production of cheese as soon as possible.
Introduction to the Sub-working Groups

Food for special medical purpose (FSMP) can provide the best and most economical nutritional support for the treatment and recovery of people with special medical needs. It enhances people’s quality of life by catering to their individual needs, cutting treatment costs and supporting healthier ways of living.

The European Chamber’s FSMP Sub-working Group was established in 2016, and counts four leading international manufacturers as members that specialise in special nutrition. Members of this sub-working group have charted outstanding performance in the domestic FSMP market and are committed to FSMP industry growth in China.

The European Chamber’s Paediatric Nutrition Sub-working Group was established in 2009, and currently has nine international companies as members and four domestic manufacturers as local partners. Members and partners of the sub-working group include major manufacturers of infant and young children milk-based powder formula (infant formula) who are active in China, and their expertise in the infant formula sector is widely recognised by Chinese consumers. They are known for providing high-quality paediatric nutrition products that meet consumer needs. Members have also significantly contributed to the development of the paediatric nutrition industry in China. The sub-working group believes that breast milk is the best food for infants and wants to offer its support in educating both health workers and the general public on the benefits of breast milk.

The Food for Special Medical Purposes Sub-working Group and the Paediatric Nutrition Sub-working Group believe that it is crucial to regulate the special food sector with modern legislation and standards, based on scientific evidence and input from both industry and the public at large. Both sub-working groups strive to promote dialogue and communication among all relevant stakeholders, including with industry associations and regulators. The sub-working groups are both committed to contributing to a better quality of life in China, and to ensuring that the whole special food industry is safe, healthy and sustainable.

Recent Developments

Food safety has always been the top priority in special food regulation, just as with general food products. To further ensure the safety of special foods, the Chinese Government is establishing a registration system, revising corresponding national food safety standards and issuing additional regulations for support. Some recent regulatory and institutional changes are as follows:

- By August 2019, 34 FSMP products and 1,254 infant formulas had been approved for recipe registration and released for sale on the market. 2017 saw 952 infant formulas approved for recipe registration and 3 FSMP products registered. In 2018, 36 recipes for infant formulas and 18 FSMP products were approved. By August 2019, 13 FSMP products and 55 recipes for infant formula were successfully registered. These figures show that the registration rate for FSMP products is slow and the registration rate for infant formula has slowed down significantly.
- On 18th February 2019, the State Administration for Market Regulation (SAMR) released the Detailed Rules for Examination of Production Licences for Food for Special Medical Purposes.¹
- On 20th May 2019, the State Council released the Suggestions of Further Reforms on Food Safety Regulations.²
- On 23rd May 2019, the Action Plan for the Improvement of Domestic Infant and Young Children Formula Milk Powder was jointly released by seven Chinese ministries, led by the National Development and Reform Commission (NDRC).³

Key Recommendations

1. Optimise the Registration System for Special Food

Concern

Improvements are needed in the administrative measures and relative regulations for FSMP and infant formula that specify the requirements for registration, changing registration and subsequent supervision, to ensure that these administrative tasks are coordinated and done in an orderly manner.

Assessment

Changing Registration

The administrative measures and relative regulations for FSMP are ambiguous and unclear with respect to change of registration. According to the Items and Requirements on Application Materials for FSMP Registration (Trial) (Revised Version 2017), “for changes to items that may impact product safety, nutritional sufficiency and special medical purpose clinical effectiveness, such as changes to product formulas and manufacturing techniques, the application for changing registration shall be submitted pursuant to the requirements for new product registration”. This overly simple wording does not serve as practical guidance and requires further clarification. Only small parts of the documents already submitted for product registration are shown on the registration certificates and their appendices. It is therefore not clear whether companies can change the information not shown on registration certificates and appendices themselves. Also, the requirements and the procedure for changing registration certificates and their appendices are neither clear nor practical. For infant formula, the SAMR called for public comments on 24th July 2018 on the Guidelines for Changing Recipe Registration for Infant Formulas (call for comments). However, since the public consultation, no regulation has been released as of August 2019.

On-site Verification of Clinical Trials

According to the existing regulations, nutritionally complete FSMPs for 13 kinds of diseases need to undergo clinical trials, which will be verified once they have been concluded. However, it remains unclear at this stage which agency will conduct the verification. As some enterprises have already conducted clinical trials, specifying the relevant agency and the standards for on-site verification of clinical trials is urgently needed to provide guidance on the process and improve trial quality.

On-site Inspection of Factories

It is stated in Article 13 of the Management Measures on the Registration of Infant and Young Children Milk-based Powder Formula that the Centre for Food and Drug Inspection shall conduct on-site inspections based on “actual needs”. It is also stated in Article 11 of the Administrative Measures for the Registration of Food for Special Medical Purposes that the evaluation institution shall conduct on-site inspections of applicants according to “actual needs”. It remains unclear what “actual needs” means in both these cases. At present, the regulatory authorities have not made nor published any plans for on-site inspections of overseas factories, so manufacturers cannot plan ahead. As a result, the process from the submission of registration to the final launch of a new product will be unpredictable. In addition, registration documents for various FSMP products produced by the same factory may be submitted at different times. If on-site inspections are carried out for each product, it will be a waste of resources.

Filing of Infant Formula

The recipe registration of infant formula should be aligned with the supervisory components of the Food Safety Law (here after referred as the Law). To satisfy supervisory requirements, according to the Law, “the infant formula manufacturer shall notify the provincial- and municipal-level food and drug administration authorities, providing information on raw materials, additives, product formula and labels.” Manufacturers are also required to provide such information for changes to the recipe registration of infant formula. When they apply for a change in registration, detailed procedures are needed to specify how this information is to be recorded at the local and provincial level.

Recommendations

- Improve the regulations related to the change

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4 The 13 kinds of diseases are: diabetes; respiratory diseases; kidney diseases; tumours; liver diseases; sarcopenia; trauma; infection, operations and other stress states; inflammatory bowel diseases (IBD); food protein allergy; intractable epilepsy; gastrointestinal absorption disorder and pancreatitis, fatty acid metabolic disorder; and obesity and fat-reducing operations.

of FSMP registration and infant formula recipe registration, as soon as possible, relevant detailed guidelines.

- Specify the department conducting the verification and assessing standards during on-site inspections of clinical trials.
- Improve the on-site inspection system, clarify the requirement of “actual needs”, and accelerate the on-site inspection of overseas factories.
- Coordinate the registration and change of registration of infant formula among local and provincial-level supervisory records, and specify the process.

4. Continue the Revision of the National Food Safety Standards

Concern
China’s existing national food safety standards are out of date and may hinder trade; while the release of new standards without a sufficient grace period will affect enterprises’ ability to continue operations as normal.

Assessment
Dual-track Management of Special Foods
Since the revised Food Safety Law came into effect in 2015, dual-track management has been applied to infant formula and FSMP products, which involves both registration and compulsory national food safety standards.

In order to keep up with international standards and meet domestic regulatory requirements, the former National Health and Family Planning Commission (NHFPC) started to revise three infant formula standards and one infant FSMP standard. At present, the revision is in progress and some of the standards have been published for consultation. They are expected to be officially released by the end of 2019 or early 2020. According to the published draft, adjustments have been made to the limits on protein, fat and some optional nutrients such as docosahexaenoic acid (DHA). This indicates that enterprises will have to adjust their formulas accordingly and complete registration for the amended formulas before formal implementation of the standard. These four standards will affect all registered infant formula and FSMP products on the market (around 1,300).

Based on the current regulations and nearly two years of practical experience, the working group estimates that the material review and approval alone will take 10 to 12 months. Before that, companies are expected to make adjustments to formulas, conduct stability research on samples, complete examinations and prepare registration materials, all of which will take around 20 to 24 months for each recipe. Taking the on-site inspection of factories into consideration, if the transition following the standard revision is not smooth and coordinated with registration requirements, it will be impossible for enterprises to complete registration in time once the updated standard is released. This will hinder enterprises’ ability to continue operations as normal, particularly with plans for on-site inspections of overseas factories by the SAMR currently missing. The entire industry will be faced with the situation where products that have been registered and approved according to old standards will not meet the new standards, and those that do meet the new standards will not have enough time to register.

FSMP
Released in 2010, the National Food Safety Standard Guideline for Formulas for Special Medical Purposes Intended for Infants (GB 25596-2010)\(^6\) only covers six categories of products.\(^7\) The National Food Safety Standard General Principles for Food for Special Medical Purposes (GB 29922-2013),\(^8\) which were released in 2013, divided the products into nutrient-complete FSMP, disease-specific FSMP and nutrient-incomplete FSMP. Disease-specific FSMP only encompasses 13 product categories, and the nutrient-incomplete FSMP contains just five, which is insufficient to meet ever-increasing clinical needs due to the overwhelming number of diseases diagnosed in China.

Furthermore, there are no product technical indicators for the 13 products contained in disease-specific FSMP, which causes unnecessary challenges during the registration process.

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7 The six barriers are: no/low lactose formula, Lactoprotein partly hydrolysed formula, Lactoprotein deeply hydrolysed formula/amino acid formula, premature/low birth weight infant formula, breast milk supplements, and amino acid metabolism disorder formula.

Infant Complementary Foods

At present, Chinese complementary food products for infants follow the National Food Safety Standard of Cereal-based Complementary Foods for Infant and Young Children (GB 10769-2010)\(^9\) and the National Food Safety Standard of Canned Complementary Foods for Infant and Young Children (GB 10770-2010).\(^10\) Both standards were issued in 2010, and revisions to both started in March 2018.

In the revised version of GB 10769-2010, it states that some products that contain nutrients such as iron and vitamin A should take into consideration international standards and production. Iron is the most needed nutrient for weaning infants. According to the Chinese Dietary Reference Intakes (DRIs) Handbook (2013), it is recommended that infants over six months are given 10 milligrams (mg) of iron per day,\(^11\) whereas the recommended intake is 10–12.5mg/day according to the World Health Organization (WHO),\(^12\) and 11mg/day according to the American Academy of Paediatrics.\(^13\)

Iron intake according to international standards is generally higher than what is currently advised by the national standards – for example, the standard found in the Codex has no limitation on the amount of iron to consume. The iron content from two cereal-based meals per day can barely reach the level of the average daily iron intake recommended by the current Chinese national standard. Therefore, the sub-working group recommends that the upper limit of iron be increased accordingly.

Vitamin A is easily attenuated by oxidation. In the drum drying process of infant cereal, the attenuation of vitamin A is aggravated by heat. These factors lead to difficulties in controlling vitamin A content in the finished product. Therefore, the sub-working group recommends that the upper limit of vitamin A also be increased.

Optional nutrients have not been included in GB 10770-2010. This is detrimental to the nutritional supplementation of infants. Based on sufficient scientific demonstration, certain optional nutrients should be added. In canned complementary foods for infant and young children, dietary fibre comes from natural raw materials and its amount may be very low or fluctuate largely with the season/planting conditions. The introduction of ‘dietary fibre’ in the nutrition label is either technically unfeasible or meaningless in practice. Enterprises should therefore be allowed to indicate on the label the ‘total carbohydrates’ or ‘usable carbohydrates’, and to make their own decision whether to include ‘dietary fibre’ on the label. Although GB 10770-2010 prohibits the use of spices, exceptions should be made for certain vegetables that have been categorised as spices, such as onions, celery and mangoes. The sense of taste of young children one year and above would benefit from the appropriate use of these flavours.

At present, many mature foreign complementary foods for infant and young children, such as soluble bean yogurt, fruit and vegetable crisps and potato products, as well as ultra-high-pressure sterilised fruit and vegetable paste, have not been included in the existing standards, which is not conducive to industry development.

Testing Method Standards for Special Foods

Since 2015, the former NHFPC (now the National Health Committee (NHC)) has reviewed and consolidated hundreds of testing method standards. It is very common for these standards to contain several different testing methods; however, it is often unclear which food category each testing method is applicable to. Using different methods to test a given product sometimes leads to relatively significant differences in results, which will directly affect the results of random inspections, possibly creating erroneous judgements. The variation in results from using different testing methods with the same standard, and the problems that arise from selecting the wrong testing and inspection methods, remain issues that should be addressed.

FSMP is included in the State Supervision and Inspection Plan issued by SAMR in 2019.\(^14\) This category of products contains different substrates for meeting

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the needs of different patients. Compared with infant formula, the substrate of these products has been changed from protein to polypeptide or amino acids. In developing and verifying the newly-issued GB 5009 Series of Standards, no testing or researching on products with FSMP substrates was conducted, hence the incompatibility of the testing methods with many existing products. Consequently, the amount of nutrients tested with methods provided in relevant national standards turns out to be quite different from the actual amount, which results in erroneous judgements. The problems with the applicability of FSMP testing must therefore be urgently solved.

Recommendations

- Improve coordination among regulatory authorities in the management of special food avoiding conflicts caused by dual-track management, and reducing repeated supervision.
- Postpone the release and formal implementation of the national food safety standards for infant formula and FSMP until 2023, and ensure that the SAMR and the NHC coordinate their efforts to forge an effective connection between the registration and the national food safety standards, and then supervise the two processes.
- Revise national food safety standards so they are more aligned with the latest international standards.
- Add additional product categories in the national food safety standards for FSMP to promote industry development and fulfill people’s increasing product needs, while putting in place technical indicators for relevant products.
- Verify differences among existing testing methods, clarify what the scope is for each testing method and develop food safety national testing methods for FSMP.
- Refrain from conducting national or local supervision and inspection on FSMP products in the absence of national testing standards for the sector.

3. Publish New Administrative Measures on the Sale of Breast Milk Substitutes

Concern

The repeal of the Administrative Measures on the Sale of Breast Milk Substitutes\(^{15}\) by the former NHFPC leads to misleading and aggressive advertising by some brands, which might have a negative impact on encouraging breastfeeding and spreading awareness of nutritional issues.

Assessment

Formulated and released in 1995 by the former Ministry of Health (MOH), the Administrative Measures on the Sale of Breast Milk Substitutes was subsequently abolished in December 2017 by the former NHFPC. At present, there is no new administrative regulation concerning the sale of breast milk substitutes. This lack of regulation has led to misleading and aggressive infant formula advertising. At the same time, relevant policies have prevented, to a certain extent, mothers and caregivers from accessing the most scientific information on nursing and, as a result, from choosing the most appropriate products.

Developing infant and young children formula recipes, especially for special medical purposes, usually relies on extensive scientific research and clinical evidence. Production also requires advanced technology. In practice, different infant and young children formula products, especially those for special medical purposes, need to have their recipes adjusted according to an infant’s actual condition. Thus, medical and health specialists need to fully understand a specific product’s information to communicate with manufacturers about issues that arise when in use. This not only helps breast milk substitute manufacturers improve their formulas, but also helps medical and healthcare specialists instruct on infants’ feeding activities in a scientific way. Therefore, communications aimed at enhancing scientific research between breast milk substitute manufacturers and medical and health specialists will contribute to improving product quality and use. In addition, in line with the principle of not promoting breast milk substitutes, cooperation between manufacturers and medical and health institutes should be permitted in order to promote breastfeeding and communicate knowledge related to nutritional issues to consumers and the public. These activities should also be permitted in medical institutions based on actual needs.

Recommendations

- Develop new Administrative Measures on the Sale of Breast Milk Substitutes and clarify the definition and scope of breast milk substitutes as soon as possible.

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4. Reduce Resource Wastage Caused by Certain Administrative Requirements

Concern
Some administrative requirements, such as repeated inspections and the need for dynamic production, are both a burden to enterprises and a waste of administrative and social resources.

Assessment
According to existing laws and regulations, different Chinese government authorities are at liberty to launch various on-site inspections of overseas or domestic infant formula and FSMP production plants before administrative approvals are granted. An on-site inspection of the production site’s quality management system is conducted to verify the authenticity and correctness of companies’ application documents. Carrying out such inspections, especially overseas factory inspections, requires a large number of inspectors (three to four officers on average), significant travel expenses and high management fees.

From a regulatory perspective, according to the requirements found in the Administrative Measures for the Registration of Infant Formula and FSMP, conducting an on-site inspection of the applicant is dependent upon whether the authorities believe it is necessary after having inspected a company’s application materials. For imported products, the former Certification and Accreditation Administration of China (CNCA) also conducted on-site inspections of factories when carrying out overseas-manufacturer registration, as per the provisions of the Food Safety Law. For domestic factories, provincial regulatory authorities conduct on-site inspections when reviewing production permissions, according to the administrative regulations on production permissions. As the regulatory authorities have now been integrated under SAMR, it should now be possible to merge various on-site inspections.

Although different on-site inspections have slightly different focuses, the main content and requirements are almost the same. In addition, all on-site inspections require dynamic production—where an entire production run using actual ingredients must take place—though the products from dynamic production cannot be sold, only disposed of. Furthermore, it is common for the same inspectors to perform different on-site inspections at different times. This is highly wasteful of resources for both manufacturers and inspectors, particularly if multiple inspections are carried out that all require dynamic production.

Recommendations
• Combine several pre-approval on-site inspections to avoid repetition and the accompanying waste of resources.
• Enforce dynamic production only during the initial on-site inspection, and do not enforce it for any subsequent inspections.

5. Enhance Public Education of Food for Special Medical Purpose (FSMP)

Concern
As a new food category in China, public education on FSMP is needed to promote the significant amount of nutritional support it provides for specific sections of the population, in order to increase its clinical use and raise consumer awareness.

Assessment
FSMP for Infants Under One Year
FSMP for infants under one year came onto the market in 2012 when the relevant national food safety standard was published. The six product categories specified under that standard target infants with special medical needs or under medical condition. Over the past few years, these kinds of products have been widely used and are recognised by parents and caregivers. However, clinical medical personnel and the public at large still have little knowledge about these products, and only professional doctors in specific nutrition departments use this type of FSMP when diagnosing and prescribing medication for patients. This is not conducive to the healthy growth and development of infants and young children in China.

As stated in the Chinese Nutritional Development
paediatric nutrition within the first 1,000 days from the mother becoming pregnant to the infant turning two years old tends to impact the person’s health throughout his/her entire lifecycle. Malnutrition within this timeframe can not only stunt the infant’s physical and intellectual development, resulting in poor cognition and intelligence, but can also weaken the infant’s immune system, affect his/her capacity to work as an adult and reduce his/her lifespan. The damage caused during this period is irreversible. An unhealthy diet, or even excessive nutrition, can result in frequent occurrences of chronic diseases during adulthood, thus impacting their quality of life and increasing medical costs. Infants with medical conditions sometimes need special nutrition support to ensure that they can catch up with the growth. Or in a worse scenario, tailor-made formula is their sole source of nutrition. For example, newborns with phenylketonuria (PKU) have to use formula designed to limit the build-up of the amino acid phenylalanine in their bodies. Without adequate nutrition intervention, PKU infants will suffer from irreversible intellectual disability and other complications. Therefore, educating consumers on the importance of nutrient intake during the first 1,000 day period is crucial to ensuring they understand which products provide the necessary nutrition for a healthy infant’s physical and intellectual development. And it is even more important to educate consumers to understand the importance of nutrition to support the growth of a baby with a medical condition.

However, accurate information on nutrition—particularly regarding the importance of diet within the first 1,000 days—is still not sufficiently publicised in China. Moreover, while the Internet, and the media in general, help to increase consumers’ access to information, they also facilitate the dissemination of information that is both unreliable and unscientific. This makes it extremely difficult for consumers to discern fact from fiction. Consumers from different educational and economic backgrounds vary significantly in terms of nutritional knowledge. Given that the target consumers of infant formulas have specific needs, it is crucial for them to correctly identify which products to use.

FSMP for Infants Above One Year Old
FSMP for infants above one year old was registered as ‘enteral nutrition pharmaceuticals’ in the late 1990s in China. At present, parenteral nutrition (also known as intravenous nutrition) remains the major source for clinical nutritional support in China, which runs contrary to conditions in developed countries. After 40 years’ development, in Europe and the United States enteral nutrition is the main method used, with the ratio of enteral nutrition to parenteral nutrition being 10:1. Nutritional therapy should rely primarily on enteral nutrition and secondarily on parenteral nutrition. Since the supply of enteral nutrition products is not sufficient in China, the inappropriate nutritional therapy has been used, which primarily consists of parenteral nutrition and is supplemented by intestinal nutrition. China’s current model for clinical nutritional support not only leads to parenteral nutrition abuse but also increases the risk of complications developing from nutritional therapy use. Parenteral nutrition in China costs Chinese yuan (CNY) 20 to 30 billion every year, which results in wasted medical expenses between CNY 12 to 18 billion when compared to enteral nutrition.

Recommendations
• Increase educational opportunities for consumers and caregivers on the importance of good nutrition during the first 1,000 days from the mother’s pregnancy to the infant’s second birthday.
• Publish educational materials for customers and encourage local-level governments to educate the public on basic nutrition, to help people understand and recognise FSMP and its correct usage.
• Develop a reasonable administrative measurement for the examination and release of advertisements for FSMP, allowing proper promotion and accurate communication with consumers with respect to infant FSMP, including rigorous academic exchanges and scientific popularisation in the form of academic journals and conferences.

6. Optimise the Requirements for Clinical Trials of FSMP

6.1 Rationalise the Requirements Placed on Trial Participants

Unified clinical trial requirements are not suitable for diversified FSMP products, and therefore need to be reassessed and revised.
Assessment
Due to ethical reasons stemming from their age and selection criteria, certain difficulties may arise when clinical trials are launched in paediatric patients, especially large-scale trials. The Announcement on the Technical Guiding Principles for Paediatric Populations in Drug Clinical Trials (No. 48 of 2016) clearly stipulates that in designing clinical trials for drugs that are used in paediatric populations, the principle of “smallest sample size, fewest specimens and least pain” shall be observed, while ensuring that the evaluation needs are met.17 Based on these guiding principles, application channels need to be provided for exemption of clinical trials or reduction of the number of cases for clinical trials in a paediatric population.

Besides paediatric populations, in order to obtain the necessary sample size for clinical trials, a relatively long clinical trial cycle is needed when it comes to rare diseases, due to low morbidity, the difficulties for patients to join such trials and the relatively high dropout rate. Furthermore, these kinds of disease-specific FSMP are always in demand by clinical patients and cannot be replaced by normal FSMP.

There is currently an insufficient number of approved FSMP or enteral nutrition pharmaceuticals, as a result of which, when it comes to clinical application, it is impossible to choose appropriate enteral nutrition products for control groups with certain diseases.

Recommendations
• Establish a method for businesses to be exempted from conducting clinical trials, or allow a reduction in the use of clinical trial cases for populations under the age of 10, and populations with rare diseases, so as to ensure the proper use of clinical trial resources and satisfy the needs of special groups.
• Accept the normal diet as a control group in a single-arm study,18 and the ‘before and after’ comparison of one patient or the comparison with standard normal growth, instead of mandating parallel controlled clinical trials.
• Specify the FSMPs that apply to single-arm studies clearly.

6.2 Optimise Clinical Observation Indicators

Concern
The currently drafted clinical observation indicators and judgement criteria are impractical, which will hinder the development of the FSMP industry.

Assessment
Some of the guidelines for conducting clinical trials of disease-specific FSMP are under development and in public consultation. According to existing requirements, a product can be branded as disease-specific FSMP only when its safety, nutritional sufficiency and clinical effectiveness are proven to be no worse than the nutrient-complete FSMP control group. The observation indicators that have to be met when conducting disease-specific FSMP clinical trials are too broad in scope, and a statistical analysis may indicate discrepancies in one or more of the secondary observations but no clinical significance.

Recommendation
• Appraise the effectiveness of disease-specific FSMP in a scientific way instead of simply requiring all indicators to be no worse than the control group, allowing an in-depth assessment to explain the possible reasons for underperformance in certain indicators.

7. Promote Capacity Building for Law Enforcement Personnel

Concern
The recent government restructuring has resulted in big changes in law enforcement personnel, with some who are not very familiar with infant formula and FSMP nor the relevant regulations and standards.

Assessment
Infant formula and FSMP are both high-risk foods. They contain a variety of nutrients, adopt specialised production techniques and are subject to complex requirements through various regulations and standards. These circumstances incur high entry barriers for manufacturers and necessitate high-quality regulatory personnel.

At present, during FSMP registration, reviewers are often not completely clear about the documents


18 Single-arm trials involve a sample of individuals with the targeted medical condition who are given the experimental therapy and then followed over time to observe their response.
that enterprises are required to submit. It occurs quite frequently that even though the enterprise has submitted the documents an opinion panel has specified as necessary, the reviewer continuously demands additional supporting materials. Multiple rounds of dialogue result in a slow and inefficient administrative process.

In addition, some reviewers do not seem to understand the original meaning of the stipulations of the law, and rigidly require the submission of registration and other supporting documents. This has indirectly resulted in unnecessary testing and explanation, and thus slows the review process. For some indicators, the testing method outlined in international standards is different from national food safety standards, despite the effect being the same. Different testing methods are sometimes used for the same indicator, which receive the same result but demonstrated in different ways. In these cases, if one insists on submitting a test report which uses exactly the same method as the national food safety standard, it not only increases the burden on enterprises but prolongs registration times.

During the registration process for the recipe of infant formula and FSMP, enterprises must submit all kinds of technical documents involving production capacity, research capacity and testing capacity, which will be reviewed in multiple rounds by the Centre for Health Food Evaluation and a team of experts from universities and hospitals, before registration approval is issued. However, the information requested when applying for registration approval does not cover all the technical information; only certain details, such as the formulation dosage. In the registration approval process, the formulation dosage is a specific target value, however in reality, individual batches of raw materials contain different amounts of nutrients due to varying factors, for example, the season they are produced in. Therefore, during actual production, the dosage of nutrients fluctuates above or below the target value. Rigid enforcement of the regulation, according to the information shown on the registration approval, will lead to erroneous judgements.

Recommendations
• Improve information disclosure, clarify the review requirements as soon as possible, release the review requirements to the public and provide training to local law enforcement personnel accordingly.
• Enhance scientific supervision and improve the capabilities of registration reviewers by providing relevant training.

8. Improve the Openness and Transparency of Law Enforcement

Concern
In recent years, insufficient disclosure and transparency from the authorities in charge of the supervision of special foods has hindered companies’ preparations and compliance, which is an obstacle to the development of and may affect consumers’ trust in the industry.

Assessment
Since the implementation of the registration system in 2015, China’s regulatory authorities have attached great significance to FSMP products and kept them under strict supervision. However, as the registration system was created from scratch, the regulatory authorities have an obligation to continually improve it during implementation. While new requirements on the application materials have been continuously put forward by the authorities, the relevant laws and regulations have not been kept updated, and communication with the industry has been ineffective. As a result, the industry has been passively informed of some requirements and has not received a positive response to many of their demands for more information. For some important issues, such as the requirements and plans for on-site inspections, there was no opportunity for industry representatives to communicate with the regulatory authorities, which may indirectly create a breeding ground for rumours in the industry. This will not only hinder the sound development of the industry in the long run, but also gradually erode consumers’ confidence in the FSMP industry and its regulation.

Recommendations
• Improve the openness and transparency of major decisions that will affect the development of the industry, and actively communicate with the industry and provide guidance.
• Publicise the annual plan for on-site inspections of overseas factories (FSMP and infant formula) so that enterprises can prepare raw materials and production in advance.
**Abbreviations**

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<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>CFDA</td>
<td>China Food and Drug Administration</td>
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<td>CNCA</td>
<td>Certification and Accreditation Administration of China</td>
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<td>CNY</td>
<td>Chinese Yuan</td>
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<td>DHA</td>
<td>Docosahexaenoic Acid</td>
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<td>DRI</td>
<td>Dietary Reference Intake</td>
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<td>FSMP</td>
<td>Food for Special Medical Purpose</td>
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<td>mg</td>
<td>milligrams</td>
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<td>MOH</td>
<td>Ministry of Health</td>
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<td>NDC</td>
<td>National Dairy Engineering and Technology Research Centre</td>
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<td>NHC</td>
<td>National Health Commission</td>
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<td>NHFPC</td>
<td>National Health and Family Planning Commission</td>
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<td>PKU</td>
<td>Phenylketonuria</td>
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<td>SAMR</td>
<td>State Administration for Market Regulation</td>
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<td>WHO</td>
<td>World Health Organization</td>
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Key Recommendations

1. Create a Stable and Predictable Legislative Environment that is Conducive to the Sustainable Development of New Energy Vehicles (NEVs)
   - Involve all stakeholders in the discussion of NEV policies, to improve transparency and predictability.
   - Release the NEV 2020 subsidy policy as early as possible, and refrain from producing further technical requirement enhancements, as there is not enough lead time for original equipment manufacturers (OEMs) to plan and react.
   - Consider and incorporate industry input for NEV credit policy to ensure that realistic targets are set.
   - Provide equal access to incentives (e.g. free licence plates, purchase/replacement subsidies, absence of traffic restrictions and exemptions to low-emission zone charges) for all homologated NEVs, imported and locally produced alike, and abolish any preferential treatment for local producers.

2. Adopt Comprehensive Policies for Intelligent Connected Vehicles (ICVs) that Promote Both a Level Playing Field for Business Operations and Technological Development
   - Provide foreign companies with equal access to China’s national initiatives for ICV development and promote advanced technologies and products in China.
   - Adopt a market-orientated and technologically-neutral policy approach to allow diversified choices for businesses to choose partners and for customers to choose products.
   - Encourage local authorities’ cooperation with on-road vehicle testing applications and test licences.
   - Expand and deepen cooperation on ICVs between China and Europe.

3. Allow Flexibility for Corporate Average Fuel Consumption (CAFC) Compliance and Provide Reasonable Lead Time for Original Equipment Manufacturers (OEMs) to Adapt
   - Retain NEV incentives to the greatest extent in recognition of NEVs’ contribution to CAFC compliance.
   - Allow negative NEV credits to be carried forward and redefine the concept of ‘affiliated company’ to facilitate CAFC credit transfers
   - Ensure flexibility for compliance by allowing off-cycle technology (OCT) credit.
   - Publish the next phase of CAFC rules early, allowing at least two years of lead time for the industry to adapt.

4. Improve Coordination among Different Government Agencies that Regulate the Automotive Industry
   - Improve coordination among relevant government agencies and streamline administrative red tape, especially for repetitive tests and approvals.
   - Centralise authority within one governmental agency for homologation/type approval.
   - Avoid overlapping responsibilities of different government agencies and clarify the government agency which takes the lead.
   - Consult industry stakeholders when introducing new rules and regulations, and allow the automotive industry ample time to adjust to new rules.
Introduction to the Working Group

The automotive industry is a crucial driver of economic growth by itself, and an industry that has close linkages with a wide array of upstream and downstream industries. For decades, it has been contributing to China’s development by generating employment opportunities and expertise, and by providing mobility for people and goods, without which modern societies could not function. Today, as China strives towards industrial transformation and upgrading, the automotive industry is committed to developing sustainable mobility solutions, while maintaining its crucial role in both the economy and society.

The Automotive Working Group is composed of European manufacturers and importers of passenger vehicles, commercial vehicles, automotive components (including tyres), special vehicles and automated systems. The Automotive Working Group works closely with the Auto Components Working Group, which consists of more than 120 European companies involved in the manufacture of auto-components, machine tools for production of auto-components and automotive assembly lines. The core members of the Automotive Working Group are also members of automotive associations at both the European Union (EU) and Member States level.

Recent Developments

Market Development

In 2018, China’s automotive market—the largest in the world for 10 consecutive years—recorded a decline of nearly three percent per year-on-year, the first decline in 28 years. At the same time, the country’s new energy vehicle (NEV) market continued its rapid growth.¹

The production and sales volumes of automobiles reached 27.81 million and 28.08 million units in 2018, down 4.16 per cent and 2.76 per cent year-on-year, respectively. For passenger cars, production and sales registered at 23.53 million and 23.71 million units, a drop of 5.15 per cent and 4.08 per cent respectively; and for commercial vehicles, the figures stood at 4.28 million and 4.37 million, up 1.69 per cent and 5.05 per cent respectively. A series of factors, including the end of the preferential policy on vehicle purchase tax, slowing economic growth and a lack of consumer confidence, may have contributed to sales missing expectations.²

Sales growth of luxury cars, however, far outstripped the average level for passenger cars and reached 3.04 million in 2018, up 11.6 per cent. This trend of car consumption upgrade is linked to factors including increases in household income, the constant decline of luxury cars’ prices, and younger buyers with stronger desires for luxuries.³

As previously mentioned, NEV production and sales in China maintained rapid growth in 2018, with a growth rate of 59.92 per cent and 61.74 per cent year-on-year, to 1.27 million and 1.26 million units respectively.⁴ Specifically, the production and sales of battery electric vehicles (BEVs) were 986,000 and 984,000 units respectively, up 47.9 per cent and 50.8 per cent year-on-year; for plug-in hybrid electric vehicles (PHEVs), the figures stood at 283,000 and 271,000, an increase of 122 per cent and 118 per cent respectively over the same period the previous year; and fuel cell electric vehicles (FCEVs) saw 1,527 units in both production and sales.⁵

China’s automotive market continued to fall in the first half of 2019, with total vehicle sales standing at 12.3 million units, a decrease of 12.4 per cent compared with the first half of 2018. However, NEV sales are cruising at high speed, with BEVs and PHEVs selling a cumulative total of 617,000 units from January to June 2019, up 49.6 per cent compared with the same period in 2018.⁶

Despite the positive figures for NEVs, the overall market decline necessitates the automotive industry, and the Chinese Government, to reassess the ambitious sales forecasts that were made based on previous records of rapid growth. In the meantime, the cooling-down of the market also provides an opportunity for industry restructuring and policy reforms.

² Ibid.
⁵ Ibid.
In order to boost the economy, and the automotive industry in particular, China in March 2019 passed measures to decrease the value-added tax rate for the manufacturing industries from 16 per cent to 13 per cent, and for the transportation and construction industries from 10 per cent to nine per cent. Electricity costs for enterprises were also reduced, as were social insurance fees payable by employers.\(^7\)

**Policy and Regulatory Development**

Over the course of 2018 and 2019, many new policies and regulations have been unveiled that either concern or directly affect the automotive industry, covering areas ranging from investment and tariffs, to emissions and fuel efficiency. While the majority of them contain positive elements in line with China’s frequent calls for reform and opening-up, the industry is awaiting crucial implementing details.

On 30\(^{th}\) June 2019, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) released the *Catalogue of Industries Encouraging Foreign Investment (2019)*.\(^8\)

This document includes a catalogue of industries encouraging foreign investment nationwide and a catalogue of advantageous industries in central, western and northeastern regions. On-board battery chargers and ICVs are being encouraged for the first time.

On 24\(^{th}\) June 2019, the Ministry of Industry and Information Technology (MIIT) annulled the list of recommended battery suppliers,\(^9\) a decision the working group believes will open up the world’s biggest market for electric-vehicle batteries.

On 6\(^{th}\) June 2019, the NDRC announced a series of measures to revive slumping automobile sales,\(^10\) but failed to meet market expectations as there was no plan to relax controls over the issuance of new licences for internal combustion engine (ICE) vehicles in major cities. According to the NDRC, these measures would serve to stop local governments from imposing new restrictions on vehicle purchases and cancelling existing restrictions that apply to NEVs.

On 6\(^{th}\) May 2019, the State Council released the revised *Administrative Measures on Recycling of End-of-life Vehicles*.\(^11\) The new version removes control over the number of market players, allowing qualified companies to access the end-of-life vehicle recycling market upon government approval. It also allows end-of-life vehicles’ ‘Five General Assemblies’—engine, steering system, transmission, and front and rear axles—to be sold to remanufacturing companies.

On 15\(^{th}\) March 2019, the National People’s Congress (NPC) promulgated the Foreign Investment Law, a fundamental law governing foreign investment.\(^12\) The law stipulates a strengthening of intellectual property protection and a prohibition of forced technology transfers. Although the European Chamber is advocating a higher level of specificity in the law when it finally comes into force,\(^13\) these are generally positive signals in response to long-held concerns of the international business community. Detailed implementing regulations are expected to be finalised by the end of 2019.\(^14\) For more details, please refer to the Investment Working Group Position Paper.

China cancelled the ratio restriction of foreign shares for manufacturers of special-purpose vehicles and NEVs in 2018, and will cancel the restriction for commercial vehicles in 2020 and passenger cars in 2022. Meanwhile, the rule that foreign original equipment manufacturers (OEMs) can only have a maximum of two joint venture partners when they enter the Chinese market was revised on 30\(^{th}\) June 2019, allowing each of the two joint venture partners to have at least 50 per cent ownership.

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\(^7\) Government Work Report, State Council, 5\(^{th}\) March 2019, viewed 4\(^{th}\) May 2019, [http://www.gov.cn/zhengce/content/2019-05/content_499960.htm](http://www.gov.cn/zhengce/content/2019-05/content_499960.htm)


\(^12\) *Foreign Investment Law*, NPC, 15\(^{th}\) March 2019, viewed 4\(^{th}\) May 2019, [http://www.chinalaw.gov.cn/Department/content/2019-03/18/592_230773.html](http://www.chinalaw.gov.cn/Department/content/2019-03/18/592_230773.html)

\(^13\) Article 22 of the Foreign Investment Law explicitly prohibits administrative organs and their staff from using administrative means to force the transfer of technology, which echoes the language used in other high-profile policies that have been released in recent years, most notably State Council Document No. 19 (2018). However, this leaves open the possibility for any non-administrative body to use any other means to compel technology transfers. Instead, the European Chamber believes that the Foreign Investment Law should simply prohibit forced technology transfer by any means; European Chamber’s Stance on the (Draft) Foreign Investment Law, European Union Chamber of Commerce in China, 25\(^{th}\) February 2019, viewed 22\(^{nd}\) May 2019, [https://www.europeanchamber.com.cn/en/press-releases/2920/european_chamber_s_stance_on_the_draft_foreign_investment_law](https://www.europeanchamber.com.cn/en/press-releases/2920/european_chamber_s_stance_on_the_draft_foreign_investment_law)

\(^14\) Keynote of Chinese Premier Li Keqiang to the Opening of the 2019 Bo’ao Forum for Asia, CRI.cn, 29\(^{th}\) March 2019, viewed 4\(^{th}\) May 2019, [http://news.cri.cn20190329/63d428f-9051-e429-e00-85c263c7f0.html](http://news.cri.cn20190329/63d428f-9051-e429-e00-85c263c7f0.html)
market is also expected to be removed by 2022. The working group sees this as a significant and important development in the history of China’s opening-up, and hopes that China can maintain such positive momentum by lifting restrictions for future technologies in a timely manner, so that lifting does not always happen for historical topics.

On 18th December 2018, the NDRC released the Administrative Provisions on Investment in the Automotive Industry, allowing the approval regime for automotive investment projects to be replaced with a simpler process of filing projects with local governments, starting from 10th January 2019. However, the overall investment climate still grows more difficult. As a result of the strict control over capacity expansion of ICE vehicles, manufacturers of new ICE vehicles—including conventional hybrids and plug-in hybrids—struggle to obtain relevant licences, unless the vehicles to be produced are for export only. The requirements for manufacturers to obtain licences for new BEVs—including range-extended electric vehicles and FCEVs—have also been tightened and, furthermore, additional implementing details are necessary. For example, currently, a new capacity expansion project needs to meet a series of stringent requirements before it can be launched. These include requiring the annual utilisation rate of automobile production capacity of the province in which the project is based to be higher than the industry average for the same product category for the past two years, yet the utilisation rates of provinces are currently not published. This makes it extraordinarily difficult for OEMs to make informed capacity expansion decisions.

On 6th December 2018, the MIIT released the Administrative Measures on Road Motor Vehicle Manufacturer and Product Admission (Administrative Measures). These are aimed at streamlining the administration of manufacturers of road motor vehicles and associated products in order to provide a more efficient and flexible regulatory environment, as part of efforts to further modernise the industry and accommodate new development trends including electrification, connectivity and shared mobility. The Administrative Measures contain several specific positive elements that would provide OEMs with greater flexibility—including vehicle family management, corporate group management and conditional contract manufacturing—but the corresponding implementing details have yet to be provided and foreign OEMs may face more restrictions. The Automotive Working Group hopes that foreign OEMs will be treated equally and be allowed to benefit from all of the aforementioned improvements introduced by the Administrative Measures.

Early enforcement of the China 6 emission standard caused much anxiety among automotive industry players in 2018, with local governments initially announcing different implementation timelines and technical requirements (for China 6a and China 6b). Fortunately, the majority of local governments decided to start implementation on 1st July 2019, while Beijing will require light-duty vehicles to comply with China 6b requirements as of 1st January 2020. Local governments offered transition periods ranging from zero to three months for registration of China V vehicles after 30th June 2019. The Automotive Working Group advocates for the harmonisation of the legislative intent with current business realities, in order to alleviate industry concerns and improve the business environment overall.

On 9th July 2019, the MIIT published a draft amendment to the Paralleled Management Measures on Corporate Average Fuel Consumption (CAFC) and NEV Credits, covering the period 2021-2023. The amendment considers alcohol/ether-fuelled passenger cars as traditional passenger cars, and sets the annual mandatory requirements on NEV credits as 14 per cent, 16 per cent and 18 per cent for 2021, 2022 and 2023 respectively. The methods for determining the per-vehicle NEV credit have been designed in such a way to decrease the importance of electric range, increase the importance of energy consumption, and enhance alignment with other policies such as financial subsidies and vehicle purchase tax exemption. For traditional OEMs, the amendment allows NEV credits to be carried
forward with a 50 per cent ratio, provided that fuel consumption meets the prescribed threshold.\(^{19}\)

On 22\(^{nd}\) May 2018, the Customs Tariff Commission of the State Council made an official announcement that it would trim tariffs on imported cars to 15 per cent of their wholesale value. It also announced a cut on tariffs for imported car parts, reducing them to a standard six per cent.\(^{20}\) Chinese tariffs on parts previously ranged from six to 25 per cent, depending on the category, and averaged approximately 10 per cent. While this tariff reduction is certainly encouraging for the passenger vehicle industry, the working group advocates for reducing tariffs on the commercial vehicles industry as well. China is introducing high capacity transport vehicles to improve the efficiency and safety of the road transport system; vehicles which require the use of rigid chassis. However, the heavy-duty vehicle chassis has an import tariff level of 15 per cent, which is high when compared to the tariffs on road tractors. To promote the development of sustainable transport in China, the working group recommends the tariff level for heavy duty vehicles and road tractors should both be the standard six per cent.

Amid mounting Sino-US trade frictions, European OEMs suffer greatly from the additional tariffs imposed on vehicles imported from the US, as many have set up factories in the country, which account for a large part of the car imports from the US to China. Starting from 1\(^{st}\) January 2019, China suspended the additional tariffs on the complete vehicles and automotive parts imported from the US. Nevertheless, frequent tariff changes in 2018, triggered by the trade conflict, negatively impacted consumer expectations and confidence and partially resulted in the automotive sales slump and the weakening of the economy in general. At the time of writing, no trade deal had been reached by the two sides, meaning that uncertainty over automotive tariffs continues. Instead, a new round of mutual tariff hits restarted in May 2019, dimming the prospect of trade negotiations. The Automotive Working Group remains highly concerned about this tariff turbulence.

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**Key Recommendations**

1. Create a Stable and Predictable Legislative Environment that is Conducive to the Sustainable Development of NEVs

**Concern**

Compulsory regulations are becoming more stringent for NEV manufacturers, while policy incentives to motivate customers’ demands remain unclear, adding unpredictability to an already challenging market.

**Assessment**

**Policy Transparency**

As product decisions need to be made several years ahead of the launch of new NEV models, it is important for the government to ensure policy transparency and early industry involvement before introducing new policies. In the absence of a predictable way to determine whether a NEV product will be able to fulfil new regulatory requirements, OEMs will remain cautious about investing in and developing new models.

**Subsidies and Incentives in an Increasingly Uncertain Post-subsidy Era**

On 26\(^{th}\) March 2019, China unveiled its 2019 NEV subsidy policy,\(^{21}\) retaining its focus on supporting only high-quality NEVs that employ high technology. The policy tightens the threshold requirements for obtaining subsidies, reduces the number of central subsidies by more than 50 per cent and removes local vehicle subsidies (excluding new energy buses and FCEVs). Local governments are instead required to incentivise the development of charging/hydrogenation infrastructure and supporting services.

According to this policy, all NEVs that have passed MIIT homologation can be listed in the catalogue of NEVs recommended for wider application, whereas subsidies are only granted to NEVs fulfilling the 2019 requirements. While this demonstrates the determination of the central government to create fair market access conditions, local implementation still needs to be monitored.

The Automotive Working Group notes the apparent trend towards continuous tightening of relevant

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19 The ratio of actual fuel consumption of the traditional passenger car/average fuel consumption of the enterprise ≤ 123 per cent.


21 Notice on Improving the Financial Subsidy Policy for the Promotion and Application of NEVs, Ministry of Finance (MOF), MIIT, Ministry of Science and Technology (MOST) and NDRC, 26\(^{th}\) March 2019, viewed 4\(^{th}\) May 2019, <http://js.mof.gov.cn/zhang/wx/201903/20190326_3204190.html>
technical requirements, which makes it of paramount importance to closely monitor adjustments to the current subsidy policy in 2020. For the post-2021 period, when subsidies will be completely phased out, higher threshold requirements may be introduced for models to be included in the Purchase Tax Exemption Catalogue, which then might serve as a prerequisite for obtaining free licence plates. Besides, as local governments are requested to not provide purchase subsidies, but to offer usage incentives instead—for example, by exempting NEVs from purchase and usage restrictions, and from the charges associated with low emission zones—this may result in a variety of local requirements being created that are not consistent or compatible nationwide.

As for the purchase tax exemption policy, which will come to an end by the end of 2020, there is currently no clear indication if it will be extended or what the technical requirements will look like, giving rise to further uncertainty.

Given that the NEV Industry Development Plan 2021–2035 is under drafting, the Automotive Working Group recommends that the final version incorporates a stable regulatory and policy framework, adhering to the principle of technology neutrality, retaining purchase tax incentives, and providing incentives to all homologated vehicles, be they imported or locally produced, PHEVs/BEVs or FCEVs.

**NEV Credits**

On 9th July 2019, the MIIT published the revised draft Paralleled Management Measures on CAFC and NEV Credits. According to this policy which will remain valid until 2023, NEV credit quotas for OEMs should account for 14 per cent of the production/import volume of traditional vehicles in 2021, 16 per cent in 2022, and 18 per cent in 2023. From an industry perspective, such adjustments will necessitate significant changes to enterprises’ research and development (R&D) and production.

While local producers and importers are faced with the same requirements for NEV credits, unequal treatment makes it extremely difficult for foreign OEMs to reach their targets, as central and local subsidies are currently only given to locally-produced NEVs. Equal treatment for calculating NEV credits should be given, so that all OEMs, be they foreign and domestic, are subject to the same rules.

**Free Licence Plates**

Additionally, lobbying and negotiations are needed city by city for imported NEVs to access free licence plates in regulated cities. Therefore, the working group recommends that the government provides equal access to free licence plates for all qualified NEVs and abolishes preferential treatment for local producers.

**Recommendations**

- Involve all stakeholders in the discussion of NEV polices, to improve transparency and predictability.
- Release the NEV 2020 subsidy policy as early as possible, and refrain from producing further technical requirement enhancements, as there is not enough lead time for OEMs to plan and react.
- Consider and incorporate industry input for NEV credit policy to ensure that realistic targets are set.
- Provide equal access to incentives (e.g. free licence plates, purchase/replacement subsidies, absence of traffic restrictions and exemptions to low-emission zone charges) for all homologated NEVs, imported and locally produced alike, and abolish any preferential treatment for local producers.

2. **Adopt Comprehensive Policies for Intelligent Connected Vehicles (ICVs) that Promote Both a Level Playing Field for Business Operations and Technological Development**

**Concern**

The Chinese Government has been producing overarching guidelines on ICVs for the past two years, focusing on setting goals rather than solving implementation barriers resulting from multi-ministerial management, and has intervened in technological development by prescribing technological pathways for companies.

**Assessment**

Today, a new generation of information and communication technology (ICT) is transforming urban transportation and individual mobility at an unprecedented pace. The development of ICVs has drawn the world’s attention...
and become a new driver for the next round of the Industrial Revolution.

In recent years, China has accelerated its efforts to create a world-leading ICV industry, by setting ambitious goals and formulating overarching guidelines. Significant developments were witnessed in 2018 after the release of the Medium- and Long-term Development Plan of the Automotive Industry,24 and an ICV technology roadmap in 2017.25 In January 2018, the NDRC released the Intelligent Vehicle (IV) Innovation and Development Strategy,26 setting specific goals for IV development in China. According to the strategy, by 2020, China should achieve an IV penetration rate of 50 per cent, a Long-Term Evolution (LTE)-Vehicle to Everything (V2X) coverage of 90 per cent in megacities and on highways, and full nationwide coverage of BeiDou navigation satellite services; by 2025, an IV penetration rate of 100 per cent should be achieved. In addition, Chinese IV standards are expected to take a leading global role by 2035. The NDRC also proposes the establishment of a platform to promote domestic, indigenous innovation. The Automotive Working Group would like to encourage the NDRC to allow both domestic and foreign companies to have equal access to the innovation platform and any other similar national initiatives.

In December 2018, the MIIT issued the Internet of Vehicles (IoV) Industrial Development Action Plan,27 to further promote the sound growth of the IoV industry. The plan underlines that the IoV is an innovative and comprehensive technology model that requires synergies between various sectors, such as automotive, electronics and transportation, as well as ICT. It proposes a set of specific targets, including achieving breakthroughs in key technologies of Level Three,28 and beyond by 2020; deploying LTE-V2X and 5G-V2X; finalising IoV/ICV technical standards, scenario database and assessment programmes; and carrying out a feasibility study for issuing LTE-V2X and IoV operation licences. The Automotive Working Group hopes the government can adopt a market-orientated and technologically-neutral policy approach to allow diversified choices for businesses to choose partners, and for customers to choose products. Taking V2X as an example, the deployment of both the dedicated short-range communications service and the cellular V2X technology should be encouraged in China, with consumers then left to make a choice.

In addition to advanced technology, data on customer behaviours and local traffic environments are two other factors that are indispensable to ICV development. Given the complex traffic conditions in China, public road tests are critical for autonomous driving development and promotion. In April 2018, the MIIT, the Ministry of Transport (MOT) and the Ministry of Public Security (MPS) jointly released the Administrative Provisions on ICV Testing on Public Roads (Trial),29 allowing local government authorities to issue ICV testing licences. By June 2019, 22 provinces, cities and regions had issued specific rules for ICV road testing, while over 140 testing licences had been issued by 11 cities to more than 20 entities for ICV testing on assigned public roads. This kind of decentralisation brings greater policy flexibility, but also geographical inconsistency. Meanwhile, under existing local guidelines, a third party is tasked with reviewing and approving the applications, resulting in a lack of transparency with regard to both the qualifications of the third party and the review process. The Automotive Working Group therefore encourages local government authorities to expedite the issuance of test licences, allowing companies to conduct relevant R&D activities; to take a coordinated approach in determining the rules of on-road vehicle testing applications and test licences; and, furthermore, to ensure harmonisation with global standards so as to accelerate the development of ICVs in China.

At the same time, China has been deepening international cooperation and building close partnerships in the field of ICVs, and has signed several Memorandums of

28 Level Three refers to conditional automation, i.e. the driving mode-specific performance by an automated driving system of all aspects of the dynamic driving task with the expectation that the human driver will respond appropriately to a request to intervene. For more details please refer to: SAE Levels of Driving Automation, The Center for Internet and Society, 18th December 2013, viewed 4th May 2019, <http://cyberlaw.stanford.edu/blog/2013/12/sae-levels-driving-automation>
Understanding on standards and other ICV-related subjects with Europe in particular. The working group believes such moves are in the right direction and will be beneficial to both domestic and foreign industry stakeholders. It hence recommends further coordination between China and Europe to ensure the concrete implementation of the cooperation frameworks.

**Recommendations**
- Provide foreign companies with equal access to national initiatives for ICV development and promote advanced technologies and products in China.
- Adopt a market-orientated and technologically-neutral policy approach to allow diversified choices for businesses to choose partners and for customers to choose products.
- Encourage local authorities’ cooperation with on-road vehicle testing applications and test licences.
- Expand and deepen cooperation on ICVs between China and Europe.

### 3. Allow Flexibility for Corporate Average Fuel Consumption (CAFC) Compliance and Provide Reasonable Lead Time for Original Equipment Manufacturers (OEMs) to Adapt

**Concern**
China sets quite challenging CAFC targets but is slow in creating the CAFC administrative rules for 2021–2025, making it difficult for the industry to adjust.

**Assessment**
The CAFC targets set by the government are four litres (l) per 100 kilometres (km) in 2025, and 3.2l/100 km in 2030. The targets are quite ambitious, and it is impossible for traditional vehicles to meet the target alone. In fact, the targets are based on an assumption that NEVs will comprise 20 per cent of the entire automotive market by 2025 and 40 to 50 per cent by 2030.

Given that China has only drafted CAFC administrative rules for 2021–2023, and that rules for 2024–2025 have not yet been discussed, the Automotive Working Group believes the government should consider the following points:

1. **First**, the estimation of the improvement of fuel consumption for traditional vehicles needs to be realistic. While it is technically feasible for OEMs to improve traditional vehicle fuel consumption by reducing overall vehicle weight or using transmission technologies, cost-effectiveness goals cannot be met, making fuel consumption improvements of traditional vehicles increasingly difficult. Over the past five years, China’s industry CAFC reduced by four per cent annually, whereas traditional vehicle CAFC only reduced by two per cent annually. Without the tremendous contribution from NEVs, the industry could not have met its 2018 CAFC target.

2. Second, while fuel consumption reduction heavily relies on the development of NEVs, China’s NEV market will face great uncertainties with the complete phase-out of subsidies in 2021. Therefore, NEV incentives, such as super credit multipliers (two for 2020), should be preserved to the greatest extent to recognise NEVs’ overall contribution to the final CAFC and NEV credit compliance.

3. Third, the draft rules for 2021–2023 allow positive NEV credits to be carried forward. The working group would like to propose that negative NEV credits be allowed to be carried forward as well, to avoid potential NEV credit supply shortages and price fluctuations as a result of the carry-forward of positive NEV credits.

4. Fourth, the government should allow flexibility for compliance. For example, off-cycle technology (OCT) can help reduce fuel consumption and improve CAFC performance. However, OCT credits are currently not recognised, although they are planned in the Phase IV (2015–2020) CAFC policy. The working group suggests that OCT credits be included and recognised in the CAFC policy for 2021–2025. In the meantime, more energy-saving technologies should be included in the OCT list.

5. Furthermore, while the current rules allow CAFC credit transfers among affiliated OEMs, these rules are complicated and difficult for OEMs to comprehend. In practice, it is easy for locally-affiliated OEMs to transfer...
the credits, but nearly impossible for foreign-affiliated OEMs to do the same. The working group therefore recommends simplifying existing rules so that OEMs, both local and foreign, can benefit from such flexibility.

Finally, enough lead time should be given to the industry when CAFC administrative rules for 2021–2025 are implemented. The automotive industry needs the next phase of CAFC rules, so market players can urgently make business plans and investment decisions. It is therefore critical for the government to introduce the updated rules as early as possible and to give the industry at least two years of lead time to adjust. In particular, discussions on the rules for 2024–2025 should be initiated immediately instead of waiting for the rules for 2021–2023 to be implemented.

Recommendations
- Retain NEV incentives to the greatest extent in recognition of NEVs’ contribution to CAFC compliance.
- Allow negative NEV credits to be carried forward and redefine the concept of ‘affiliated company’ to facilitate CAFC credit transfers.
- Ensure flexibility for compliance by allowing OCT credit.
- Publish the next phase of CAFC rules early, allowing at least two years of lead time for the industry to adapt.

4. Improve Coordination among Different Government Agencies that Regulate the Automotive Industry

Concern
Multiple government agencies regulate the automotive industry in an uncoordinated manner, which leads to inconsistent interpretation of policy and results in unnecessary costs, as well as barriers to technical innovation, for enterprises.

Assessment
Automotive products in China are subject to more than one type of approval/homologation system. Taking the example of heavy-duty trucks, a new model is first required to be type-approved by the MIIT, which ensures the model’s conformity to a set of technical standards, including fuel consumption. Meanwhile, the model also needs to be approved for entering the marketplace by the China Compulsory Certification System, which is run by the Certification and Accreditation Administration of China (CNCA) under the State Administration for Market Regulation.

In fact, almost all of the technical requirements for these two approvals are the same. However, OEMs have to submit test reports and technical data in different formats for approval by the two authorities.

In addition to these two repetitive approval processes—which both include requirements on fuel emission standards—OEMs still have to comply with the current national emission standards set by the Ministry of Ecology and Environment before they can put the vehicle into use. If the model is to be sold in Beijing, approval from the Beijing Environmental Protection Bureau is also mandatory. This is still not enough, as further approval by the MOT must be received before the truck manufacturer can receive a Commercial Transportation Permit for the truck model.

This lack of coordination among different government agencies not only doubles their own administrative burdens but also results in unnecessary costs for OEMs. In some cases, individual agencies have a different understanding of the same test results, creating further problems for OEMs. These administrative hurdles greatly interrupt product development and affect customer satisfaction.

Recommendations
- Improve coordination among relevant government agencies and streamline administrative red tape, especially for repetitive tests and approvals.
- Centralise authority within one governmental agency for homologation/type approval.
- Avoid overlapping responsibilities of different government agencies and clarify the government agency which takes the lead.
- Consult industry stakeholders when introducing new rules and regulations, and allow the automotive industry ample time to adjust to new rules.
Abbreviations

BEV  Battery Electric Vehicle
CAFC  Corporate Average Fuel Consumption
EU  European Union
FCEV  Fuel Cell Electric Vehicle
ICE  Internal Combustion Engine
ICT  Information and Communication Technology
ICV  Intelligent and Connected Vehicle
IoV  Internet of Vehicles
IV  Intelligent Vehicle
km  Kilometre
l  Litres
LTE  Long Term Evolution
MIIT  Ministry of Industry and Information Technology
MOF  Ministry of Finance
MOFCOM  Ministry of Commerce
MOST  Ministry of Science and Technology
MOT  Ministry of Transport
NDRC  National Development and Reform Commission
NEV  New Energy Vehicle
NPC  National People’s Congress
OCT  Off-cycle Technology
OEM  Original Equipment Manufacturer
PHEV  Plug-in Hybrid Electric Vehicle
R&D  Research and Development
V2X  Vehicle to Everything
1. Accelerate Promulgation of the Anti-monopoly Guideline in the Automotive Industry and Strengthen Policy Enforcement in the Independent Automotive Aftermarket (IAM)
   - Accelerate promulgation of the Anti-monopoly Guideline in the Automotive Industry (AML Guideline) and align its enforcement nationally.
   - Introduce a ‘repair clause’ in the Patent Law that excludes design patent rights for visible spare parts intended to restore the initial appearance of the vehicle.
   - Create a statutory obligation against discriminatory payments for original equipment manufacturers (OEMs) in order to allow auto component suppliers (ACSs) to use production tools owned by OEMs when manufacturing products for the IAM.
   - Declare as invalid agreements that restrict the rights of an ACS to use OEM-owned tools when manufacturing products for the IAM.

2. Improve the Legislative Framework of Anti-counterfeiting Laws and Regulations, and Strengthen Relevant Enforcement to Protect the Legitimate Interests of Intellectual Property Right (IPR) Owners
   - Lower the threshold for filing automotive component criminal cases and enforce the right to claim punitive damages for problems with counterfeit parts that have an impact on safety.
   - Accelerate the amendment of the Patent Law.
   - Establish an annual automotive parts safety inspection for eliminating fake parts circulated in the market.
   - Publish regulations for handling confiscated counterfeits to ensure they do not re-enter the market.
   - Promulgate supporting regulations at both the national and provincial level to implement the E-commerce Law, so as to further improve the legal environment for IPR owners to pursue civil or criminal remedies for online infringement.

3. Promote the Development of the Remanufacturing Industry and Strengthen Relevant Policy Enforcement
   - Accelerate the formation and promulgation of the Interim Measures for the Administration of Remanufacturing of Auto Parts, to effectively protect the rights of qualified remanufacturing enterprises, regulate the market and promote healthy development.
   - Establish a review and supervisory mechanism to prevent unqualified enterprises entering the remanufacturing industry, and develop a platform for information exchanges between relevant government departments to ensure this mechanism is applied uniformly.
   - Accelerate the implementation of Measures for Administration of Recycling Scrapped Motor Vehicles, and formulate relevant implementation rules to promote the development of the domestic scrapped auto parts recycling market, and reduce the burden of enterprises in importing raw materials for remanufacturing.
   - Accelerate the formation and improvement of tax policies to support the development of a remanufacturing and recycling system, and to reduce the cost of remanufacturing for qualified enterprises.
   - Formulate subsidies and preferential policies for qualified remanufacturing enterprises to promote the development of the overall industry.
Introduction to the Working Group

The auto components industry complements the automotive industry in helping to provide mobility for people and goods, which is essential in today’s interconnected world. The heavy reliance on road-freight transportation and light vehicles for trade and travel naturally creates a demand for both original equipment (OE) parts and aftermarket parts. As such, the industry has become extremely important, both to the economy in general and as a significant driving force for scientific and technological transformation.

The industry’s societal benefits fit perfectly with China’s development goals, and with the Chinese Government labelling the automotive sector (including auto components) a pillar industry. The auto components working group urges the government to consistently launch and commit to its economic development plans. These plans devote particular attention to areas that help the industry thrive, such as technological innovation and industrial cooperation in new energy vehicles (NEVs), autonomous driving, and electric vehicle (EV) battery recycling and remanufacturing.

The Auto Components Working Group was created in 2000. It consists of around 80 international companies involved in the manufacturing of auto components, machine tools for producing auto components and automotive assembly lines. Members also import and distribute auto components and provide after-sales services in China. An independent automotive aftermarket (IAM) Desk was established in October 2014 by the Auto Components Working Group, to explore the possibilities associated with applying a European Union (EU)-type Motor Vehicle Block Exemption Regulation (MVBER) in China to improve the accessibility of the automotive aftermarket for suppliers. This also includes advocating for improvements to existing laws and regulations, such as the revision of the Access to Vehicle Repair and Maintenance Information Methods, and the Administrative Measures for Automobile Sales, as well as enforcement of the promulgation of the Anti-monopoly Law (AML) Guideline. This working group has fostered ties with various organisations and governmental bodies in Europe and China.

Recent Developments

Market Development

In 2018, as the global auto market cooled down, the automotive industry in China was under pressure. Annual production and sales were lower than estimated at the beginning of the year, at 27.8 million and 28.1 million units, respectively, down 4.2 and 2.8 per cent from 2017. However, the NEV market maintained rapid growth. In 2018, the production and sales of NEVs reached 1.27 million and 1.26 million units, respectively, a year-on-year increase of 59.9 and 61.7 per cent. Of these totals, plug-in hybrid models production and sales reached 0.28 million and 0.27 million units, respectively, a year-on-year increase of 143.3 and 139.6 per cent. According to the China Automotive Parts Industry Development Research report, released in May 2018 by the China Automotive Technology and Research Centre, the total output value of China’s auto components industry is about Chinese yuan (CNY) 4 trillion. Domestic enterprises account for CNY 2.88 trillion, with profits of CNY 170 billion; the profits made by foreign-owned enterprises and joint ventures reached CNY 150 billion during the same period.

With China’s promotion of NEVs, the EV battery business is growing rapidly. In 2018, the annual production capacity of traction batteries was 57.35 gigawatt hours (GWh), a year-on-year increase of 57 per cent. The production capacity of passenger NEVs reached 32.86GWh, a year-on-year increase of 137 per cent.

6 Ibid.
7 ‘China’s Auto Parts Industry Development Research’: The First Thorough Investigation; China’s Auto Components Industry Needs A Key Breakthrough, China Automotive News, 14th June 2018, viewed 2nd April 2019, <http://www.cnautonews.com/w/201806/20/180014_5899099.html>
cent, and the sector’s main growth driver. Under market pressure, and despite the implementation of measures for encouraging consumption and the introduction of a series of tax reduction policies, automobile production and sales are expecting flat growth rates in 2019.

On 29th January 2019, the National Development and Reform Commission (NDRC), together with another nine ministries, including the Ministry of Industry and Information Technology (MIIT) and the Ministry of Commerce (MOFCOM), jointly issued the Implementation Plan for Further Optimising Supply, Promoting Steady Consumption Growth and Promoting the Formation of a Strong Domestic Market (2019). The plan aims to implement policies of consumption promotion, e.g. by promoting the orderly disposal and recycling of scrapped cars, continuously implementing NEV purchase policies, and accelerating the commercial deployment of fifth generation (5G) wireless systems. To further improve consumption, the Chinese Government plans to intensify the construction of the manufacturer credit system and the quality traceability system for important commodities, and increase efforts on IPR enforcement with respect to counterfeiting. The plan is also aimed at improving existing infrastructure, and accelerating the construction of roads, car parks and NEV charging facilities, among others.

To ensure rapid, high-quality development of the automobile industry, an integrated collaboration and coordination mechanism is required for auto manufacturing and auto component businesses. The working group therefore advocates upgrading the automotive industry by promoting efficient and collaborative development between auto manufacturing and auto component enterprises. This could be accomplished by designing new policies, including a call to develop a new ‘vehicle components’ partnership in order to streamline R&D between the two industries and improve cooperation on auto components procurement, in order to establish a safe and controllable key components support system. The government should also consider supporting legislation that accelerates the development of the automotive aftermarket and overall automotive industry transformation, from being product-orientated to customer-orientated. Finally, new legislation encouraging the development of automotive finance, used cars, maintenance, car rental and other aftermarket services, as well as third-party logistics and e-commerce groups, would also be beneficial to the whole industry.

1. Accelerate Promulgation of the Anti-monopoly Guideline in the Automotive Industry and Strengthen Policy Enforcement in the Independent Automotive Aftermarket (IAM)

Concern
Automotive component suppliers (ACS) are still prevented by OEMs in China from selling in the IAM the same authorised auto components supplied by ACSs to OEMs for the first vehicle installation, due to various restrictions such as contractual arrangements, dual branding limitations, intellectual property claims and tooling ownership.

Assessment
Technically, direct or indirect restrictions, often imposed by OEMs on ACSs, constitute a ‘monopoly agreement/arrangement’, that inhibits free competition and restricts customers’ choices for preferred maintenance providers and replacement parts. Such limitations should be prohibited under the current AML. The draft AML Guideline is a milestone for ACSs when it comes to opening up the IAM in China, especially in relation to the following two issues:

Definition of ‘Relevant Market’ Regarding the IAM
Aligning with similar regulations in Europe, Article 1.2 of the draft AML Guideline confirms that maintaining the integrity of car brands is essential for the automotive aftermarket. Therefore, OEMs may have a dominant position in the aftermarket (which could potentially consist of only one brand) even if they have no dominant position in the new vehicle market.

The definition of ‘relevant market’ is helpful in recognising that OEMs do have market power when conducting business with ACSs. In particular, OEMs use this as leverage when participating in tenders and bidding, as well as during contract negotiations.
with ACSs, and the results of these discussions are often predicated on this aftermarket advantage. Once the AML Guideline comes into effect, ACSs should have legal grounds to claim OEM abuse for having unfair access limitations imposed on customers, and excessive restrictions on IP ownership.

**Territorial and Customer Restrictions**

Article 2.3.4 of the draft AML Guideline outlines four ‘hard-core’ restrictions, where exemptions will not be made even if the aforementioned relevant market shares fall under 25–30 per cent. These situations include the following: (1) the restriction of passive sales; (2) the restriction of cross-supplies between distributors; (3) the prohibition of distributors and repairers from selling parts to end users; and (4) the restriction of auto components suppliers, repair tools, testing equipment or other types of equipment from selling products they manufacture for distributors, repairers or end users, except in situations where a subcontracting agreement exists.

With regard to subcontracting agreements, under the MVBER, the following restriction imposed on ACSs regarding access to the automotive aftermarket violates EU competition law and are automatically void:

**Article 5(b): “The restriction, agreed between a supplier of spare parts, repair tools or diagnostic or other equipment and a manufacturer of motor vehicles, of the supplier’s ability to sell those goods to authorised or independent distributors or to authorised or independent repairers or end users.”**

In practice, OEMs prohibit ACSs from producing and selling dual-branded parts in the IAM by using OEM-owned tooling and IPR. OEMs usually use these conditions to claim the supply agreement is a subcontracting agreement between OEMs and ACSs.

Article 6.1 of the draft AML Guideline states that a subcontracting agreement requires an OEM to provide necessary/essential IPR, equipment/tooling and know-how for a manufacturer to produce car parts based on their requirements. However, in all other cases, the auto components are developed by researchers and designed by engineers trained by and working for the ACSs, and manufactured using equipment, tooling and IP owned by the ACSs. The development and tooling costs are normally paid by the OEM to the ACS, however these costs only cover the work related to adapting the research results for the specific products requested, protecting the IP, and the labour of designers and engineers in the production of specific parts. They do not cover the entire investment cost undertaken by the ACS for inventing, engineering and developing necessary technology and expertise.

Regarding tooling, the European Commission’s (EC’s) Notice on the Supplementary Guidelines on Vertical Restraints in Agreements for the Sale and Repair of Motor Vehicles and for the Distribution of Spare Parts for Motor Vehicles (Supplementary Guidelines) can serve as a reference point for Chinese legislators as it explains the EC’s interpretation of existing automotive rules.13

**Paragraph 23:** “Article 5(b) of the Motor Vehicle Block Exemption concerns any direct or indirect restriction agreed between a supplier of spare parts, repair tools or diagnostic or other equipment … if a motor vehicle manufacturer obliges a component supplier to transfer its ownership of such a tool, intellectual property rights, or know-how, the agreement at issue will not be considered to be a genuine sub-contracting arrangement.”

As illustrated by the provisions quoted above, the purchasing terms should take OEM obligations into consideration (under the MVBER and the Supplementary Guidelines) and allow ACSs to use OEM-owned tools in the IAM.

Regarding IPR, OEMs being able to allegedly restrict original ACS sales to the IAM appears to be groundless.

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14 When the motor vehicle manufacturer provides a tool, IPR and/or know-how to a component supplier, this arrangement will not benefit from the subcontracting notice if the component supplier already has the tool, IPR or know-how at its disposal, or could, under reasonable conditions, obtain them.
in light of ACSs’ significant contributions to the design, development and innovation of such products. Numerous countries, in and outside the EU, have adopted regulations whereby an OEM cannot use its patent design rights to restrict spare parts being used in the repairing or restoration of a complex product (the so-called ‘repair clause’). With the cooperation of European OEMs, European vehicle manufacturers rely on the IAM as a reliable source for parts that can be used in repair and maintenance. This results in job creation in the IAM, the promotion of healthy competition between authorised networks, a wide range of consumer choices for service and repair and a market-driven price point for such services. For Chinese legislators wishing to see these benefits in China, the Supplementary Guidelines could serve as a reference point.

Under the Supplementary Guidelines:

Paragraph 24: “Article 5(c) of the Motor Vehicle Block Exemption relates to the restriction agreed between a manufacturer of motor vehicles that uses components for the initial assembly of motor vehicles and the supplier of such components, which limits the supplier’s ability to place its trademark or logo effectively and in an easily visible manner…By not allowing this, motor vehicle manufacturers can restrict the marketing of OE parts and limit consumers’ choice in a manner that runs counter to the provisions of Article 101 of the treaty.”

Without any official legislation in place, ACSs must follow binding agreements that are usually favourable to OEMs in China.

Recommendations

• Accelerate promulgation of the AML Guideline and align its enforcement nationally.
• Introduce a ‘repair clause’ in the Patent Law that excludes design patent rights for visible spare parts intended to restore the initial appearance of the vehicle.
• Create a statutory obligation against discriminatory payments for OEMs in order to allow ACSs to use production tools owned by OEMs when manufacturing products for the IAM.
• Declare as invalid agreements that restrict the rights of an ACS to use OEM-owned tools when manufacturing products for the IAM.

2. Improve the Legislative Framework of Anti-counterfeiting Laws and Regulations, and Strengthen Relevant Enforcement to Protect the Legitimate Interests of Intellectual Property Rights (IPR) Owners

Concern

China’s automotive IAM has been heavily disrupted by the widespread distribution of counterfeits, resulting in increased consumer preference for authorised networks for repair, service and maintenance.

Assessments

The current legal framework allows rightful owners to fight producers of counterfeit goods by utilising several different methods—administrative, civil and criminal proceedings—based on the quantity and value of the illegal produce. Although much work has been done, according to members’ experiences, the existing framework has not yet thoroughly solved the counterfeiting problems brand owners are facing.

As new technologies rapidly evolve, more platforms are being developed to facilitate online transactions, including private and public social media accounts and dedicated e-commerce stores. The circulation of counterfeits is also well established on these platforms. When ACSs file lawsuits, the burden of proof falls on them—including evidence acquisition, providing data and information to authorities, and counterfeit identification—making it difficult for ACSs to prosecute counterfeiters. Previously, because of the ‘safe harbour’ rule for online service providers, ACSs had difficulty locating genuine data on counterfeiters’ identities, business locations and illegal transaction histories. In addition, ACSs face high costs when fighting counterfeiters operating in the traditional offline market. The high costs of investigating the locations of stored counterfeit goods often leads to ACSs abandoning the process of formally lodging a complaint. Furthermore, there is a lack of effective regulations to prevent the circulation of confiscated items. If the ACS does not pay for storage or destruction, confiscated items are likely to re-enter the market.

Because administrative regulations currently differentiate counterfeiting activities based on the quantity and value of fake items, counterfeiters have adopted methods of

15 Safe-harbour rule: In normal cases, online platforms do not disclose their clients’ information until being placed as a case on file.
evading detection by manufacturing and distributing small quantities of low-quality fake goods. This means that if they are caught by a local market regulator, the punishment is usually a minor fine and simple confiscation. Considering that the unit price of spare parts is generally relatively inexpensive, this level of punishment for such crimes may not be severe enough to disincentivise counterfeiters. The working group welcomes the government’s work on amending the Patent Law in 2019 to substantially increase the cost of patent infringement. It is expected that the amended Patent Law will help fix these kinds of regulatory loopholes and stem the proliferation of counterfeiters and fake products.

In addition, regarding auto components, safety must be the top consideration. Counterfeit auto parts often raise concerns regarding their ability to meet safety requirements imposed by authorities. With the potential of counterfeit parts to cause serious injuries to users, the impact on safety should be taken into consideration when lodging a complaint against counterfeit auto component producers, as it may also have an impact on brand perception. The intangible value of a brand is the most important asset a company possesses, and it must be secure if the market is to be open to fair competition. Counterfeiters not only pose a safety risk but steal revenue from ACSs as well.

Finally, as legal entities, ACSs are responsible corporations. They employ a growing number of local employees, train them, invest in an increasing number of R&D centres in China, develop talent and technologies—which in most cases are firstly deployed locally—and generate notable tax revenues. As such, ACSs should not be burdened with having to provide proof of, and pay the associated costs related to, counterfeiters in the market.

In recent years, the Chinese Government has put increasing efforts into anti-counterfeiting and IP protection. China’s Supreme People’s Court (SPC) launched a specialised court on 1st January 2019 to hear IPR appeals. This IPR court is expected to help prevent inconsistency in legal application and improve the quality and efficiency of trials. With the implementation of the E-commerce Law also coming into effect on 1st January 2019, the auto components industry expects the new legal framework to be more effective in regulating the online market environment, especially in regards to anti-counterfeit and IP protection. According to the notice for the Work Plan of Rectification over Counterfeiting in Key Areas (2019-2020) (Work Plan 2019), released on 10th January 2019 by the State Administration for Market Regulation (SAMR), the business environment will be further optimised by 2021, with noticeable improvements in overall law enforcement capabilities and modernised market regulation. The Work Plan 2019 also shows the government’s determination to further improve the e-commerce environment, through the launch of special e-commerce platform regulations and the promotion of comprehensive online supervision and governance.

The working group hopes the government can continue to narrow the gap between the current market situation and the regulatory environment, to create a more efficient regulatory environment for ACSs to fight counterfeiters and act as a deterrent to those planning to engage in the production, trade, sales and export of counterfeits.

Recommendations

- Lower the threshold for filing automotive component criminal cases and enforce the right to claim punitive damages for problems with counterfeit parts that have an impact on safety.
- Accelerate the amendment of the Patent Law.
- Establish an annual automotive parts safety inspection for eliminating fake parts circulated in the market.
- Publish regulations for handling confiscated counterfeiters to ensure they do not re-enter the market.
- Promulgate supporting regulations at both the national and provincial level to implement the E-commerce Law, so as to further improve the legal environment for IPR owners to pursue civil or criminal remedies for online infringement.

17 For more analysis on the IPR legal system, enforcement and other IP protection related issues see the Intellectual Property Rights Working Group Position Paper.
20 Ibid.
3. **Promote the Development of the Remanufacturing Industry and Strengthen Relevant Policy Enforcement**

**Concern**
As the number of scrapped vehicles increases, the existing laws and regulations cannot effectively regulate the remanufacturing industry.

**Assessment**
In recent years, the remanufacturing industry has developed rapidly in China. In 2018, China remanufactured 23,000 engines, 46,000 transmissions and 40,000 generators. The whole industry saw a total turnover of CNY 1.17 billion.21

As an advanced form of circular economy, remanufacturing plays an important role throughout the supply chain of the automotive and related parts industries. Inspection and analysis of the raw materials (used parts) can help improve product design, and optimise component configuration. At present, the quality and performance of remanufactured products can often match that of the original prototype, and the industry has realised factory- and large-scale production.

Remanufacturing also has a significant effect on energy conservation and emissions reduction, which are key to green development. Compared with original prototypes, producing remanufactured parts can reduce energy use by 60 per cent, raw materials by 70 per cent and costs by 50 per cent, with almost zero solid waste, while air pollutant emissions are reduced by more than 80 per cent. This means the cost of producing remanufactured engines, for example, is only a quarter of that for the original prototype.22 Through remanufacturing auto parts, it is therefore possible to maximise the potential value of products and reduce energy waste to close to zero, which is of great significance to the sustainable development of both China’s economy and its society.

To promote and regulate the development of the remanufacturing industry, the Chinese Government has made a series of plans and policies. In March 2008, the NDRC promulgated the *Notice on Organising and Carrying Out the Pilot Remanufacturing of Auto Parts*.23 By the time the Pilot Plan came to an end in October 2018, the NDRC had announced two lists of qualified pilot companies. At the same time, to optimise resource allocation, the NDRC approved the setting up of five remanufacturing industry demonstration bases to encourage the establishment of industrial clusters. They are located in Shanghai (Lingang), Zhangjiagang, Hejian, Changsha (Liuyang, Ningxiang), and Wuzhou.

In order to standardise remanufacturing production and guarantee quality, on 29th January 2013, the NDRC, the Ministry of Finance (MOF), the MIIT, and the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) promulgated the *Remanufacturing Unit Quality and Technical Control Regulations (Trial) (Trial Specifications).*24 Based on feedback from and development of the industry, on 27th December 2017, the NDRC issued Decree No. 12, abolishing the *Trial Specifications.*25 The *Interim Provisions on the Traceability Management of Recycling of New Energy Vehicle Power Batteries*, formulated by the MIIT on 1st August 2018, requires traceability management for the recycling of NEV power batteries. It also requires information to be collected throughout the whole process, on production, sales, use and scrapping, recycling, utilisation and so forth. The performance of stakeholders in each link of the recycling process will be monitored.

In addition, the *Measures for Administration of Recycling Scrapped Motor Vehicles (Revised Draft) (Measures)*, which were reviewed and approved at the State Council’s executive meeting on 30th January 2019, made major policy adjustments to the recycling management of scrapped motor vehicles.26 This revision liberalises remanufacturing restrictions on the ‘five key assemblies’ (engines, steering gears, transmissions, front and rear axles, frames). It also eliminates the limitation on the number of remanufacturing enterprises, with the aim of waiting for the outbreak. China Automotive News, 11<sup>th</sup> April 2019, viewed 15<sup>th</sup> April 2019. <http://www.cnautonews.com/tj/lbj/201903/t20190323_608990.html>

22 Ibid.


of promoting competition in and development of the scrap recycling industry. From 1st April 2019, the first remanufacturing group standard issued by the China Association of Automobile Manufacturers (CAAM), Requirements for the Management System of Auto Parts Remanufacturing Enterprises (Group Standard) was officially implemented. This group standard will be used to structure the overall auto components remanufacturing management system, and as the basis for the government to regulate and manage the industry. At present, the Interim Measures for the Administration of Remanufacturing of Automotive Parts (Interim Measures for Administration) are being formulated. This will be the main policy basis for the management of the automotive parts remanufacturing industry now that the Pilot Plan has come to an end. With the revision of the original Measures, the promulgation of the Requirements for the Management System of Automotive Parts Remanufacturing Enterprises, and the Interim Measures for Administration, the automotive parts remanufacturing industry environment is expected to improve. At present, the main problems restricting industry development are as follows:

- The level of recognition and understanding of remanufacturing is low in China, resulting in insufficient raw materials and low demands for remanufactured products in the domestic market.
- When the Pilot Plan came to an end, no structured management system for industry regulation and administration was established in its place, resulting in a lack of a clear regulatory authority and consequently the coexistence of qualified and unqualified remanufacturing enterprises in the market.
- There is a lack of specific policies supporting the remanufacturing industry, in terms of used parts circulation, fiscal and tax incentives, and subsidies, which is hampering the development of qualified remanufacturing companies.

Unformed Administration System

The Trial Specification for the remanufacturing of auto parts has been abolished, and the new Interim Measures for Administration is yet to be issued, leading to uncertainty over management regulations and market policies. One example is whether remanufactured parts can be used during warranty periods. In the Trial Specifications, the fifth chapter of Section 24 covering the sales system—the sales network and product traceability—clearly states that “pilot” enterprises may not use remanufactured products in the production of original prototypes, nor for repair and replacement within the warranty period required by the authority or company.” There is currently no limitation on the use of remanufactured products during the warranty period. However, due to the uncertainty of policy norms, no company has been able to successfully apply remanufactured products to the business during the warranty period in accordance with the government remanufacturing plan.

In addition, currently, there is no clear access standard and qualification certificate for entrance to the automotive parts remanufacturing industry. The NDRC abolished the Pilot Plan, hoping more remanufacturing companies would form and get entry access through local authority supervision and service optimisation rather than through central policy supervision. However, for passenger vehicle companies, as the NDRC is no longer in charge of market access, and the remanufacturing of parts for passenger vehicles is not within the jurisdiction of the MIIT, a vacuum has resulted with respect to supervision of market access. The lack of a supervisory system has also led to unqualified companies engaging in auto components remanufacturing, which has affected the quality of products entering the market, and hindered the development of qualified companies.

The lack of market norms has become a major concern for foreign companies when developing their remanufacturing strategies in China. The absence of a policy preventing unqualified products from entering the market has resulted in the coexistence in the aftermarket of unqualified products without the mark identifying them as remanufactured automotive products (‘mark’) and qualified products with the ‘mark’. Market chaos has ensued, which damages the credibility of the

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overall industry, and makes it difficult for consumers to recognise high-quality remanufactured products.

The Lack of Supporting Policies for Remanufacturing

In the context of economic globalisation, remanufacturing often requires global cooperation between ACSs and automobile manufacturers. The raw materials used in remanufactured products are mostly imported. Due to the nature of the trade in parts for remanufacturing, companies cannot enjoy export tax rebate incentives during the raw material procurement process. Moreover, as a considerable number of used parts recycling companies in the domestic market are unable to provide value-added tax (VAT) invoices, it is also not possible for remanufacturing companies to enjoy the tax incentives for green industries.

Although several government announcements have emphasised the importance of the circular economy, there are no specific preferential policies for the remanufacturing industry. Compared with other projects encouraged by the government, there are neither subsidies for remanufacturing and R&D processes, nor income tax deductions for R&D investment, nor special corporate income tax incentives for remanufacturing enterprises. This increases the costs of high-quality remanufactured products, making it difficult for manufacturers to compete with those that produce unqualified products.

Recommendations

- Accelerate the formation and promulgation of the *Interim Measures for the Administration of Remanufacturing of Auto Parts*, to effectively protect the rights of qualified remanufacturing enterprises, regulate the market and promote healthy development.
- Establish a review and supervisory mechanism to prevent unqualified enterprises entering the remanufacturing industry, and develop a platform for information exchanges between relevant government departments to ensure this mechanism is applied uniformly.
- Accelerate the implementation of *Measures for Administration of Recycling Scrapped Motor Vehicles*, and formulate relevant implementation rules to promote the development of the domestic scrapped auto parts recycling market, and reduce the burden of enterprises in importing raw materials for remanufacturing.
- Accelerate the formation and improvement of tax policies to support the development of a remanufacturing and recycling system, and to reduce the cost of remanufacturing for qualified enterprises.
- Formulate subsidies and preferential policies for qualified remanufacturing enterprises to promote the development of the overall industry.

Abbreviations

5G  Fifth Generation  
ACS  Auto Component Supplier  
AML  Anti-monopoly Law  
AQSIOQ  General Administration of Quality Supervision, Inspection and Quarantine  
CAAM  China Association of Automobile Manufacturers  
CNY  Chinese Yuan  
EC  European Commission  
EU  European Union  
EV  Electric Vehicle  
IAM  Independent Automotive Aftermarket  
IP  Intellectual Property  
IPR  Intellectual Property Rights  
MIIT  Ministry of Industry and Information Technology  
MOF  Ministry of Finance  
MOFCOM  Ministry of Commerce  
MVBER  Motor Vehicle Block Exemption Regulation  
NDRC  National Development and Reform Commission  
NEV  New Energy Vehicle  
OE  Original Equipment  
OEM  Original Equipment Manufacturer  
R&D  Research and Development  
SAMR  State Administration for Market Regulation  
SPC  Supreme People’s Court  
VAT  Value-added Tax
Key Recommendations

1. **Implement Reforms from the Forthcoming Cosmetics Supervision and Administration Regulations (CSAR) in Secondary Legislation, and Ensure the Smooth Transition of the Industry**
   - Fully implement streamlining and delegation in secondary legislation to establish an efficient supervision system based on risk management, mainly in relation to in-market and post-market supervision, with companies bearing the responsibility for product quality and safety.
   - Provide sufficient transition periods and policies for major changes that affect the industry in order to ensure a smooth and stable transition.

2. **Promote the Establishment of a Comprehensive and Scientific Management System for Cosmetics Ingredients and Ensure its Full Implementation**
   - **2.1 Management of New Ingredients**
     - Widely refer to and accept data from different sources in the evaluation of new ingredients and put forth reasonable and appropriate information requirements based on the principles of safety and risk assessment.
     - Implement an administration model that combines pre-market notification based on safety risk assessments and post-market monitoring of adverse effects, for the management of the notification of non-high-risk ingredients, in order to set up a system where the main responsibility lies with the companies.
   - **2.2 Management of Listed Cosmetics Ingredients**
     - Standardise and improve the administration scheme for ingredients in positive, negative and restricted cosmetics ingredients lists in the *Cosmetics Safety and Technical Standards*; and for ingredients assessed and permitted for use by foreign authorities, apply relatively simplified assessment procedures and acceptance mechanisms.
     - Set up and implement a regularly updated management mechanism for the *Used Cosmetics Ingredients Catalogue* that regulates the supplementation and assessment process and criteria, and, for the sake of the objectivity of the catalogue, differentiate the ingredients in question by providing notes instead of deleting the items.

3. **Establish a Modern Risk Management System Based on Product Safety Assessments and Gradually Rescind the Mandatory Requirement for Animal Testing**
   - Establish a scientific product safety risk assessment system, accelerate the validation and acceptance processes for alternative experiment methods, accept data obtained from these methods in administrative permits/notifications, and gradually cease the mandatory requirement to test on animals.
   - Allow qualified companies, in reference to the notification requirements for domestic non-special cosmetics, to submit safety assessment reports in place of testing the finished products on animals for the notification of imported non-special cosmetics.
4. Improve Registration and Notification Processes for Cosmetics Products

4.1 Administrative Approval Time Limit and Review Standard
- Further specify the administrative licensing review time limit, especially for extensions, changes of hygiene permits, and data supplementation situations.
- Improve and optimise the review processes in accordance with the safety risk level of registration review opinions, provide quick and convenient reviews of data supplementation that are not related to product safety and enhance reporting efficiency.
- Establish detailed and transparent guidelines for review, adopt unified expert review standards, conduct investigations, and publicly announce new review requirements ahead of their implementation.
- Give due consideration to changes from old to new regulations, strictly implement the time periods stated in the new regulations and allow enterprises sufficient time for transition.

4.2 Notification Management of Cosmetics Imported for Non-special Use
- Further simplify the requirements for content, form review and review of materials after notification for non-special filed materials, so all companies can benefit fully from the change to notification for information only.
- Optimise the notification system to facilitate notification and ease the application process.
- Further improve local governments’ supporting administration system for supervision both during and after notification, and standardise the criteria so that companies have a clear guideline on risk control and management.

5. Improve the Management of Efficacy Claims and Labelling

5.1 Administration of Efficacy Claims
- Formulate efficacy management provisions, clarify efficacy claims per enterprise self-discipline, and exempt efficacy claims from product notifications and registration.
- Remove the requirement stipulating a minimum number of cases for human trials and consumer surveys and other unnecessary requirements from the Guidelines for Cosmetics Efficacy Claims Evaluation (Draft for Comments).
- Accept efficacy validation data and reports issued by overseas agencies within reason.
- Prohibit the use of animal test data in cosmetic efficacy claim evaluations.

5.2 Administration of Labelling
- Ensure that new labelling rules are compatible with existing requirements and global practices, and only require that mandatory content in Chinese labels be consistent with those labelled in the original packaging.
- Provide the industry with adequate transition periods when formulating/revising the laws and regulations on labelling.

6. Establish a Well-organised Post-marketing Surveillance System

6.1 Random Inspection and Result Publishing
- Improve the procedures for validation of product test results and postpone releasing test results until proper verification or re-examination has been carried out.
- Publish the inspection and spot-check results with due caution, along with a scientific explanation of the test results in order to avoid false media reports that can mislead consumers.
- Establish a national network of sampling systems that will avoid duplicate sampling and repeated penalties and allow companies to access this data.
- Give full play to market supervision, establish social collaboration mechanism and standardise the items for sampling and publicity process.
6.2 Social Supervision
• Formulate relevant laws and regulations to standardise activities related to ‘social supervision’.
• Punish organisations or individuals that invent or disseminate false information in order to give full play to the role of social co-governance.

6.3 Supervision of Adverse Effect
• Define and scope serious adverse effects of cosmetics in reference to the definition of serious adverse effects/accidents provided by the World Health Organisation.
• Define clearly the types/categories of adverse effects of cosmetics that need to be reported by the companies producing and marketing the cosmetics, as well as the assessment principles, from the perspective of scientific and efficient supervision.
• Improve and complete specific and clear working guidelines regarding the supervision and reporting of adverse effects in cosmetics including enterprises’ self-monitoring obligations, filing information for potential inspection and reporting if the adverse effects have been diagnosed by medical institutions and the reason is confirmed.

Introduction to the Working Group
As President Xi Jinping said, “People’s yearning for a better life is the goal we strive for”.

Cosmetics are not only used to make one look better, but they also help to improve one’s well-being. Although cosmetics were once thought of as luxury products, they are now considered a daily necessity for most people. Thus, the sustainable development of the cosmetics industry will help to satisfy the population’s desire for a better standard of living.

The Cosmetics Working Group consists of 60 members, including a large number of internationally well-known cosmetics brands, with a diverse range of business models. The majority of members have established research and development and production facilities in China and are industry leaders. Their expertise has been widely recognised by consumers, and they have contributed significantly to cosmetics development in China. The cosmetics industry has also acted as a catalyst for other related industries, such as fine chemicals, packaging, logistics and advertising.

The Cosmetics Working Group aims to:
• represent the interests of European cosmetics companies and facilitate information exchange among members, professional associations and regulatory bodies;
• promote the healthy and sustainable development of China’s cosmetics industry and contribute to the formation of a fair, efficient and transparent regulatory environment; and
• ensure consumer safety.

The new principal contradiction facing Chinese society, as outlined in the report issued after the 19th Party Congress, “is the contradiction between unbalanced and inadequate development and the people’s ever-growing needs for a better life”. European cosmetics companies possess cutting-edge technologies and extensive experience in quality management and safety assessment. A fully-opened market that allows both competition and cooperation between Chinese and European cosmetics companies will not only ensure that the domestic market becomes stronger through exposure to competition, but also enable Chinese consumers to access a variety of new and advanced products.

Recent Developments
According to the National Bureau of Statistics, China’s cosmetics industry continued to maintain steady growth in 2018. Cosmetics retail sales reached Chinese yuan (CNY) 261.9 billion in 2018, an increase of nine per cent. The momentum gained by the industry was driven by the rise of domestic brands and the development of multi-channel marketing.
levels of urbanisation and a growing need for high-end cosmetics in tier-two and tier-three cities has also significantly contributed to this growth.\(^4\) Meanwhile, product innovation throughout the world is speeding up. The rise of beauty care equipment, biotechnology products and personalised products has added new impetus to the industry.

With the reorganisation of the administrative organs of the State Council, the State Administration of Market Regulation (SAMR) was established in 2018. The formerly decentralised market supervision functions have been consolidated, and the cosmetics industry is no longer subjected to monitoring by many administrative bodies. This change is conducite to increased efficiency of government supervision and administration. The quality and safety of cosmetics will continue to be under the control of the National Medical Products Administration (NMPA) and, for the first time, an independent cosmetics regulatory department has been established with full responsibility for market access and compliance. This new function reflects the government’s increased emphasis on management of the cosmetics industry, and provides a good foundation to set laws and regulations over the next five years.

The Cosmetics Working Group has always paid close attention to legal reforms and regulatory changes in the industry, and was therefore pleased to see that the State Council listed the Cosmetics Supervision and Administration Regulations (CSAR) in its 2018 legislative work plan, with substantial advances noted in the legislation’s progress.\(^5\) In August 2018, the Ministry of Justice (MOJ) again sought opinions from the industry on the draft, and in December informed the World Trade Organization (WTO) of the draft. After comprehensive consultation with all parties concerned, the draft regulations now reflect a more advanced administration that takes a scientific approach.\(^6\) Members of the working group anticipate new regulations to be introduced and implemented this year.

On 10\(^{th}\) October 2016, the State Council issued the Notice on Promoting the Reform of ‘Separation of Licenses’ Throughout the Country,\(^7\) which clearly stipulated that the import of non-special cosmetics can now be filed via notification, and that an administrative license is no longer required. A month later, on 9\(^{th}\) November 2018, the NMPA issued the Announcement on Matters Concerning the Expansion of the Pilot Implementation of Imported Non-special Use Cosmetics Notification Throughout the Country (No. 88, 2018).\(^8\) This announcement stated that, effective immediately, the first import of non-special cosmetics would be subject to the current inspection and approval management system, and that the pilot implementation of the notification administration within free trade areas would eventually be converted to a unified, national notification administration system. The NMPA will no longer accept applications for administrative licenses for the import of non-special cosmetics. The working group has long called for a notification administration concerning imports of non-special cosmetics, and therefore welcomes this policy.

The vibrant development of e-commerce has further promoted the consumption of cosmetics. Premier Li Keqiang chaired the executive meeting of the State Council on 2\(^{nd}\) November 2018, in which it was decided to continue and improve relevant policies concerning cross-border e-commerce after 1\(^{st}\) January 2019.\(^9\) Several new policies related to cross-border e-commerce were subsequently introduced. On 28\(^{th}\) November 2018, the Ministry of Commerce, the Ministry of Finance (MOF), the General Administration of Customs (GAC) and six other ministries issued the Notice on Improving the Supervision of Retail Imports in Cross-border E-commerce (No. 486, 2018).\(^10\) On 29\(^{th}\) November, the MOF, the GAC and the State Administration of Taxation issued the Notice on Improving the Policy of Retail Imports in Cross-border E-commerce that clearly

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\(^6\) Cosmetics Supervision and Administration Regulations (Draft), WTO, 18\(^{th}\) December 2018, viewed 26\(^{th}\) April 2019, <https://members.wto.org/cmnattachments/2018/TBT/CHN/18_6501_00_x.pdf>

\(^7\) Notice of the State Council on Promoting the Reform of ‘Separation of Licences’ Throughout the Country, State Council, 10\(^{th}\) October 2018, viewed 16\(^{th}\) April 2019, <http://www.gov.cn/zhengce/content/2018-10/10/content_5329182.htm>


\(^9\) Executive Meeting of the State Council Chaired by Premier Li Keqiang - Decision to Continue and Improve the Cross-border E-commerce Policy for Retail Imports and Expand its Scope of Application, State Council, 2\(^{nd}\) November 2018, viewed 26\(^{th}\) April 2019, <http://www.gov.cn/premier/2018-11/21/content_5342252.htm>

\(^10\) Notice by Six Departments on Improving the Supervision of Retail Imports in Cross-border E-commerce (No. 496, 2018), State Council, 1\(^{st}\) January 2018, viewed 26\(^{th}\) April 2019, <http://www.gov.cn/xinwen/2018-12/01/content_5345041.htm>
E-commerce (Tax No. 49, 2018). On the same day, 13 ministries, including the MOF and the GAC, issued the Announcement on Adjustment of the List of Retail Imports for Cross-border E-Commerce. After the end of a transitional period of two and a half years, China moves into a new era of development in 2019, as it implements the policies and regulations to support cross-border e-commerce business for retail imports.

Local market regulators are gradually unifying and standardising the implementation of the Advertising Law. Cases of improper penalties imposed on companies arising either from deviations in the legal interpretation or abuse of discretionary powers have gradually decreased. The working group welcomes this change.

The Cosmetics Working Group has assisted the Chinese authorities in building a proactive, international legal and regulatory management system. The working group has also contributed to promoting the development of the cosmetics industry in China under the basic principle of ensuring product safety, and the establishment of a well-organised market environment. In 2019, the working group continues to focus on industrial development trends.

Key Recommendations

1. Follow the Reform Direction of the Forthcoming Cosmetics Supervision and Administration Regulations (CSAR) in Secondary Legislation, and Ensure a Smooth Transition of the Industry in Applying the New Regulations and Rules

Concern

Since the CSAR are the most important and influential regulations in the industry and form the basis of other cosmetics policies, inadequate streamlining and delegating of authorities in secondary legislation will hinder reform, while successful implementation of the regulations also requires an adequate transition period.

Assessment

Enacted in 1989, the Cosmetics Hygienic Management Rules (hereafter called the Rules) are quite outdated due to being more concerned with licensing instead of supervising, which cannot meet the new norm of scientific surveillance and hinders industry development. A substantial revision of the Rules took place in 2015, and is now known as the Cosmetics Supervision and Administration Regulation (CSAR). In August 2018, the MOJ solicited public comments on the draft CSAR.

The working group is of the opinion that the draft shows marked progress in administrative streamlining, decentralising authority and improving the risk-based classification management system. For example, the low-risk new ingredients notification system and the general cosmetics notification system fully demonstrate the concept of scientific management based on risk, which is conducive to innovation and upgrading cosmetics research and development. However, secondary legislation and implementation details are required to create an informative notification administration system that will truly benefit the industry, companies and consumers.

At the same time, there are several major adjustments in the draft regulations in terms of the definition and scope of cosmetics, the supervision of specific products and ingredients, and labelling requirements, which will shape the supervisory framework and have a long-term impact on the industry. The working group hopes that full consideration will be given to the potential impact of these new regulations on companies and the industry in general, with a sufficient transitional period and policies that prevent short-term industry fluctuations, to ensure smooth and complete implementation of the new regulations.

Recommendations

• Fully implement streamlining and delegation in secondary legislation to establish an efficient supervision system based on risk management, mainly in relation to market and post-market supervision, with companies bearing the responsibility for product


quality and safety.
• Provide sufficient transition periods and policies for major changes that affect the industry in order to ensure a smooth and stable transition.

2. Promote the Establishment of a Comprehensive and Scientific Management System for Cosmetics Ingredients and Ensure its Full Implementation

2.1 Management of New Ingredients

Concern
The process for registering new cosmetics ingredients is long and difficult, with high rates of rejection, which blocks many new ingredients from being used in China and hinders product innovation.

Assessment
All new cosmetics ingredients in China must be registered and approved before they can be used. Currently, the registration process for new cosmetics ingredients is long, with high requirements for examination materials and process. In addition, certain data references, and acceptance and exemption clauses stipulated in the relevant regulations have not been implemented. Though hundreds of ingredients are submitted by enterprises, few are approved. In fact, since the implementation of a new ingredient registration management system in 2009, only four ingredients have been approved. The rejected ingredients cannot be used in China, affecting the domestic launch of global formulas and obstructing companies’ global marketing and innovation. This also results in certain cosmetic products only being consumed in China, impacting the ability of those Chinese-developed products to compete internationally.

With the revised regulations, non-high-risk ingredients will be managed by notification rather than registration. This change will benefit the cosmetics industry in China. When these regulations are executed, administrative licensing should be avoided in order to implement a system in which responsibility lies solely with the enterprise.

Recommendations
• Widely refer to and accept data from different sources in the evaluation of new ingredients and put forth reasonable and appropriate information requirements based on the principles of safety and risk assessment.
• Implement an administration model that combines pre-market notification based on safety risk assessments and post-market monitoring of adverse effects, for the management of the notification of non-high-risk ingredients, in order to set up a system where the main responsibility lies with the companies.

2.2 Management of Listed Cosmetics Ingredients

Concern
There is no clear system for evaluating and amending the lists of cosmetics ingredients in use.

Assessment
China has implemented a list management system for permitted substances, banned substances and restricted substances (positive, negative and restricted lists). The lists were initially established with full reference to the cosmetics regulations of the European Union. In subsequent revisions, China further drew upon and referred to the laws of other countries in the world, and selectively adopted some of the contents. However, there are no clear evaluation principles, decision-making mechanisms or processes on the inclusion, removal and modification of ingredients in these lists. Furthermore, the approach is neither scientific nor rigorous, rather subjective and conservative. Since the 2007 revision of the Technical Specifications for Cosmetic Safety, the working group has attached great importance to incorporating revisions in the positive, negative and restricted lists into these specifications. We hope to see further standardisation of the revised specifications in terms of clearer evaluation criteria, the basis for assessment and updated processes.

Since 2012, the former China Food and Drug Administration (CFDA, now NMPA) has collected and categorised cosmetics ingredients already used and marketed in China. It established the Catalogue of Names of Cosmetics Ingredients in Use, playing an important role in defining new cosmetics ingredients in
the industry. However, the CFDA clearly specified in the description of the catalogue that: 1) no organisation has evaluated the safety of the ingredients listed; and 2) the catalogue is a dynamic list that will be continuously updated with new cosmetics ingredients that meet the requirements. The CFDA thus intended to eliminate the use of unsafe cosmetic ingredients from the catalogue through subsequent dynamic management, and include qualified new ingredients that have undergone safety monitoring. The working group agrees with this approach and hopes that there will be a clear process and mechanism for the addition, evaluation and deletion of items in the lists of cosmetics ingredients in use.

**Recommendations**

- Standardise and improve the administration scheme for ingredients in positive, negative and restricted cosmetics ingredients lists in the *Cosmetics Safety and Technical Standards*; and for ingredients assessed and permitted for use by foreign authorities, apply relatively simplified assessment procedures and acceptance mechanisms.
- Set up and implement a regularly updated management mechanism for the *Used Cosmetics Ingredients Catalogue* that regulates the supplementation and assessment process and criteria, and, for the sake of the objectivity of the catalogue, differentiate the ingredients in question by providing notes instead of deleting the items.

3. Establish a Modern Risk Management System Based on Product Safety Assessments and Gradually Rescind the Mandatory Requirement for Animal Testing

**Concern**

China’s current cosmetics safety supervision system is largely based on animal tests rather than on product safety risk assessments, which hinders the fair trade of imported non-special cosmetics.

**Assessment**

As of 2018, several world economies have banned animal testing for cosmetics or are in the process of setting up a timeline to ban it. China is the only country worldwide which mandatorily requires animal testing in regulatory compliance processes for cosmetic products. This has a significant impact on the sales performance and reputation of Chinese cosmetics products launched in overseas markets, and prevents products that claim to not be tested on animals from entering the Chinese market.

Since November 2016, the NMPA (former CFDA) has published six alternative methods to animal testing, including the *Chemical Ingredients Used in Cosmetics – In Vitro 3T3 Neutral Red Uptake Phototoxicity Test*. This is a milestone in the provision of alternative methods to animal testing. Compared to the rest of the world, however, there remains a gap in both quantity and scale when it comes to alternative methods that China has validated and accepted, and these alternatives are only for cosmetic ingredients.

Instead of animal testing, common international practices on cosmetics product safety use scientific and modern methods and tools to evaluate formulations and ingredients and compile corresponding safety assessment reports for reference. Nevertheless, at the end of 2015, the former CFDA published the *Cosmetics Safety Risk Assessment Guideline (Draft for Comments)*, which did not specifically accept the use of modern safety evaluation principles, methods and tools that are based on various data sources, such as experiments that are alternatives to animal testing, computer models, principles of the weight age of evidence, history of safe use and toxicology-related threshold evaluation methods. This approach excluded a lot of data used in qualified industrial operations, making it extremely difficult to generate a complete safety assessment report in line with the guidelines.

**Recommendations**

- Establish a scientific product safety risk assessment system, accelerate the validation and acceptance processes for alternative experiment methods, accept data obtained from these methods in administrative permits/notifications, and gradually cease the mandatory requirement to test on animals.
- Allow qualified companies, in reference to the notification requirements for domestic non-special cosmetics, to submit safety assessment reports in place of testing the finished products on animals for the notification of imported non-special cosmetics.

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18 The *Pharmaceutical Registration Department of the China Food and Drug Administration Publicly Solicit Opinions on Cosmetics Safety Risk Assessment Guideline (Draft for Comments)*, CFDA (now NMPA), 10th November 2015, viewed 26th April 2019, <http://samr.cfda.gov.cn/W01/CL078/134401.html>
4. Improve Registration and Notification Processes for Cosmetics Products

4.1 Administrative Approval Time Limit and Review Standards

Concern
Because the current cosmetics evaluation guidelines do not contain unified criteria and binding approval times, companies face uncertainties vis-à-vis product registration/notification that increase operational burdens and impact marketing plans.

Assessment
Administrative licensing reviews have been slow in recent years, often with no specified time frame or official deadline by which the process will be completed. For new product registrations, renewals or requests for extensions, companies are often caught in a situation where they do not have any definite outcome several months after submission. Furthermore, new review requirements are often put forward, even if there is no change to current regulations and standards. Sometimes new or differing review opinions are even received for the same product. Meanwhile, there is no specific timeframe given during the transition period from old to new regulations and the review opinions from experts are often not definitive. As a result, not only is additional data required for numerous product categories, but it is also common for applications to be suspended during the review process. As companies can neither predict nor track the registration progress, new products—in particular seasonal products—may have to go to the market a year later if approved months after the due date. This severely impacts companies’ marketing plans and may lead to a huge loss of revenue and opportunities for profit-making.

Recommendations
• Further specify the administrative licensing review time limit, especially for extensions, changes of hygiene permits, and data supplementation situations.
• Improve and optimise the review processes in accordance with the safety risk level of registration review opinions, provide quick and convenient reviews of data supplementation that are not related to product safety and enhance reporting efficiency.
• Establish detailed and transparent guidelines for review, adopt unified expert review standards, conduct investigations, and publicly announce new review requirements ahead of their implementation.
• Give due consideration to changes from old to new regulations, strictly implement the time periods stated in the new regulations and allow enterprises sufficient time for transition.

4.2 Notification Management of Cosmetics Imported for Non-special Use

Concern
The examination procedure of imported non-special cosmetics is bogged down with unimportant details, the informative notification is not implemented, certain functions are disabled with the current notification system, and there are neither consistent standards nor a clear and complete administration system for supervision and verification after products are launched at the provincial level.

Assessment
When local authorities at provincial level take charge of the notification of non-special cosmetics, review requirements and standards are implemented in an inconsistent manner. In some provinces, the processes at formal review and post-notification information review stage are more complicated and stringent than at national level, which is contrary to the principle of informative notification. At the same time, uncertainties arise from the lack of review result and data archives, as some distributors refuse to sell approved products unless they see the data review.

Furthermore, the notification system often malfunctions; for instance, if the review result is not updated, modifications to records cannot take place. Also, the lack of post-notification management and incomplete administrative regulations leaves enterprises at high risk of non-compliance.

Recommendations
• Further simplify the requirements for content, form review and review of materials after notification for non-special filed materials, so all companies can benefit fully from the change to notification for information only.
• Optimise the notification system to facilitate notification and ease the application process.
• Further improve local governments’ supporting administration system for supervision both during and after notification, and standardise the criteria so
that companies have a clear guideline on risk control and management.

5. Improve the Management of Efficacy Claims and Labelling

5.1 Administration of Efficacy Claims

Concern
Certain requirements in the draft regulations on cosmetics classification and efficacy evaluation are too specific and rigid, and the acceptance of foreign data has not been considered, which is not in line with the principles of corporate self-discipline and the fact that these claims can be multi-faceted and that methods for testing efficacy claims can also develop over time, and will also delay global innovation and product launching.

Assessment
With the rapid development of the cosmetics industry, claims on product functions and forms are always changing. The draft Assessment Guidelines for Cosmetics Efficacy Claims, published in early 2018, suggested the establishment of a set of completely uniform evaluation criteria—such as the minimum number of valid human trials and consumer surveys—for different efficacy claims, which may result in wastage of research and development (R&D) resources. Also, the working group noted that the sunscreen efficacy assessment report issued by overseas laboratories may no longer be accepted in the notification application for cosmetics for special use. If the efficacy evaluation data and reports issued by overseas institutions will no longer be accepted in future, it will greatly increase the R&D costs of multinational companies, and hinder the global marketing of products.

Recommendations
• Formulate efficacy management provisions, clarify efficacy claims per enterprise self-discipline, and exempt efficacy claims from product notifications and registration.
• Remove the requirement stipulating a minimum number of cases for human trials and consumer surveys and other unnecessary requirements from the Guidelines for Cosmetics Efficacy Claims Evaluation (Draft for Comments).
• Accept efficacy validation data and reports issued by overseas agencies within reason.
• Prohibit the use of animal test data in cosmetic efficacy claim evaluations.

5.2 Administration of Labelling

Concern
The draft CSAR deviate from current practices, and are not aligned with international regulations.

Assessment
Currently, cosmetics labelling is regulated by the national standard, Instructions for Use of Consumer Products: General Labelling for Cosmetics (GB 5296.3), and the Cosmetics Labelling Administration Rules (Directive No. 100), issued by the former General Administration of Quality Supervision, Inspection and Quarantine. Most imported cosmetics apply non-country-specific packaging and can comply with Chinese laws and regulations by attaching Chinese labels. In the draft CSAR, it generally requires that ‘the sticking Chinese label must be consistent with the original label’; however, it doesn’t specify which items must be included, which will negatively impact the operations of companies.

Recommendations
• Ensure that new labelling rules are compatible with existing requirements and global practices, and only require that mandatory content in Chinese labels be consistent with those labelled in the original packaging.
• Provide the industry with adequate transition periods when formulating/revising the laws and regulations on labelling.

6. Establish a Well-organised Post-marketing Surveillance System

6.1 Random Inspection and Result Publishing

Concern
As a complete validation process for product sampling results is currently lacking, results are often publicly

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disclosed without verifying them with the relevant enterprises, which may lead to misjudgements that cause damage to those enterprises.

Assessment
In July 2017, the CFDA (now NMMPA) issued the Specifications on the Supervision and Random Inspection of Cosmetics to guide the cosmetics supervision and inspection work of administrative departments at all levels of government. However, the capabilities of these authorities and testing institutions differ greatly in many aspects, including inspection techniques, results analysis and determining responsibility. As a result, many inspection results are used for the purpose of generating fines.

Product quality inspections are often performed by government departments at different administrative levels, resulting in repeated sampling and duplicate punishments. In addition, inspection results are often published without verifying the authenticity of the product or the test’s rationality, resulting in misunderstanding, misinterpretation and unnecessary consumer panic, while also seriously damaging the company’s corporate brand.

Recommendations
• Improve the procedures for validation of product test results and postpone releasing test results until proper verification or re-examination has been carried out.
• Publish the inspection and spot-check results with due caution, along with a scientific explanation of the test results in order to avoid false media reports that can mislead consumers.
• Establish a national network of sampling systems that will avoid duplicate sampling and repeated penalties and allow companies to access this data.
• Give full play to market supervision, establish a social collaboration mechanism and standardise the items for sampling and publicity process.

6.2 Social Supervision

Concern
The current lack of supervision on third-party testing and ranking activities negatively impacts cosmetics businesses.

Assessment
Some test agencies and non-governmental organisations randomly initiate a variety of quality and efficacy testing and ranking activities—which are not conducted in line with national laws and regulations—and then publish the results without any prior authorisation. This misleads the media and consumers, and seriously disturbs the normal production and operational activities of compliant companies.

Recommendations
• Formulate relevant laws and regulations to standardise activities related to ‘social supervision’.
• Punish organisations or individuals that invent or disseminate false information in order to give full play to the role of social co-governance.

6.3 Supervision of Adverse Effect

Concern
The lack of scientific, effective and clear working guidelines for monitoring of adverse effects leads to problems for companies in market supervision.

Assessment
At present, the direction of reform is to simplify registration procedures for a product’s entry to market and to emphasise supervision after entry, which is in line with the idea of scientific supervision. However, due to the lack of clear and specific working guidelines on the monitoring and reporting of adverse effects, the operations of companies involved in the cosmetics industry are not completely in line with the various supervision and monitoring agencies throughout China.

Recommendations
• Define and scope serious adverse effects of cosmetics in reference to the definition of serious adverse effects/accidents provided by the World Health Organization.
• Define clearly the types/categories of adverse effects of cosmetics that need to be reported by the companies producing and marketing the cosmetics, as well as the assessment principles, from the perspective of scientific and efficient supervision.
• Improve and complete specific and clear working guidelines regarding the supervision and reporting of adverse effects in cosmetics, including enterprises’ self-monitoring obligations, filing of information for potential inspection and reporting if the adverse...
effects have been diagnosed by medical institutions and the cause is confirmed.

**Abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CFDA</td>
<td>China Food and Drug Administration</td>
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<td>CNY</td>
<td>Chinese Yuan</td>
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<td>CSAR</td>
<td>Cosmetics Supervision and Administration Regulations</td>
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<td>GAC</td>
<td>General Administration of Customs</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<td>MOJ</td>
<td>Ministry of Justice</td>
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<td>NMPA</td>
<td>National Medical Products Administration</td>
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<td>R&amp;D</td>
<td>Research and Development</td>
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<td>SAMR</td>
<td>State Administration for Market Regulation</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Key Recommendations

1. Energy Transition
   
   1.1 Push for the Transition from Coal to Gas in China’s Energy Mix
      
      • Enforce the State Council’s *Three-Year Action Plan for Winning the Blue Sky Defence Battle* and NEA’s *Guidance on Energy Work 2018* while carefully developing the necessary infrastructure for its implementation.
      
      • Consider the use of distributed energy (not only from renewable sources), integrated power generation and infrastructure building through careful planning and enforcement to make the energy system more flexible and efficient.
      
      • Encourage the building of necessary energy infrastructure, including power and gas storage, by setting tariffs to cover building costs, while fairly remunerating investors and operators.
      
      • Promote the bulk liquefied natural gas (LNG) supply by setting up national standards.
      
      • Update the current safety standard to make sure bulk LNG supply is accessible and safe.
      
      • Ensure fair market competition between pipeline gas and bulk LNG.
      
      • Publicly release a comprehensive annual review of the natural gas market reform.
      
      • Switch from coal to natural gas (NG) combined heat and power plants that use flexible electricity, and heat-production grids where heat storage facilities can increase overall energy efficiency.
      
      • Facilitate and support the adoption of advanced heat-storage technologies for the development of localised solutions that match the current heat supply with public demand, and help optimise the heating value chain by improving the integration of production with distribution.
      
      • Effectively open the market to foreign-invested enterprises (FIEs) for direct investments in NG liquefaction, transportation and storage management.

   1.2 Adjust the Energy System to Incentivise Decentralised Renewable Energy (RE) Development
      
      • Establish a clear nationwide RE implementation policy with a long-term tariff plan under which external environmental costs are reflected in pricing.
      
      • Implement framework regulation for micro-grid networks, including regulation for energy-dispatching services provided by the grid companies, prioritising RE power dispatch.
      
      • Encourage a functioning market for green certificates, and set renewable portfolio obligations that enable industrial and commercial power consumers to differentiate power sources and manage emissions.
      
      • Implement green financing tools to facilitate investment from small and medium enterprises (SMEs).
      
      • Implement regulation for RE development facilitation on polluted or unrecoverable lands, e.g. photovoltaic/wind on landfills, exhausted mines, quarries or remediated ex-industrial areas.
      
      • Introduce penalties against low-quality device sellers or manufacturers and publish projects that failed due to the daily use of poor-quality equipment.

   1.3 Continue Electrification of the Energy System
      
      • Release publicly a comprehensive annual review of electricity market reforms.
      
      • Reform overall grid regulation to guarantee full absorption of renewable sources.
      
      • Create a mechanism that allows renewable energy supplies to connect with grids that are
assigned a higher priority, and establish transparent grid code, fees and feed-in tariffs to ensure that electricity sales can be paid in a timely manner.

• Establish electricity tariffs to guarantee real returns on investments and incentivise energy saving.
• Create a dynamic marketplace for international businesses to be active on digital information platforms that deal with energy supplies, distribution grid automation and fleet management.
• Integrate electric vehicle (EV) charging stations into the grid to promote grid-peaks compensation, and oblige the final user to purchase renewable sources of electricity.

4. Promote the Role of Hydrogen in Optimising the Energy System

• Define specific safety standards regulations for hydrogen production, distribution and usage.
• Design a hydrogen-based storage system as a systemic ‘buffer’ for harmonising continuous production from coal and nuclear plants and intermittent production from renewables in order to optimise electricity supply/demand patterns at national and local levels.
• Promote hydrogen storage techniques as an extension of power plants to store excess energy in a more environmentally friendly and less time-sensitive manner than traditional battery storage.
• Encourage large-scale hydrogen production from offshore wind.
• Encourage the use of hydrogen in fuel cells and develop a widespread and sustainable distribution network for new energy vehicles (NEVs).
• Categorise hydrogen as an energy carrier instead of a dangerous chemical gas.
• Promote legislation, standards and remuneration to blend hydrogen into the NG pipeline.
• Set a subsidised electricity price for green hydrogen production, i.e. water electrolysis technology.
• Strictly limit the proportion of hydrogen production from fossil fuel sources to control the overall level of carbon dioxide (CO₂) emissions.

2. Energy Efficiency

4. Move to Increasingly Dynamic Energy Markets for Wholesale Power, Distributed Electricity and Heat

• Accelerate the shift to liberal and open energy markets that include renewable sources.
• Speed up the liberalisation of both wholesale and retail power pricing, the standardisation of transmission tariffs and the opening of retail distribution to non-grid companies.
• Develop a regulatory framework that offers entrants a level playing field, with third party access to infrastructure, confidentiality of transactions, non-discrimination and transparency.
• Accelerate the creation of provincial and regional spot markets for power with ensured access to reasonable supply and demand data for a fair and competitive overall market that includes international participation.
• Ensure power spot price markets foster healthy and open competition, in particular that grid companies remain as independent service operators, serving their monopoly roles in asset investment and maintenance, and safe transmission and distribution, but do not trade profits.
• Pilot large-scale renewable energy direct procurement and distributed models enabling industrial power users to source substantial amounts of power from NG or renewable sources.
• Launch a functioning renewable portfolio standard (RPS) based on utilisation, including flexible choice through markets and compliance-orientated green certificates, and non-subsidy voluntary green certificates.
2.2 Develop Methods for Incentivising the Reduction of Energy Demand

- Define a clear, regularly updated common methodology to assess energy/emissions intensity.
- Develop an energy efficiency passport mechanism to track incentives and obligations for reducing energy demand and energy/emissions intensity.
- Promote and incentivise substitution of low energy efficient electrical engines at the industrial level.
- Define standards at the industrial level, providing cap limits for energy used per production output unit, by industrial sector, while setting up ‘white certificate’ mechanisms.

3. Belt and Road Initiative (BRI)

3.1 Make the Tendering and Bidding Process for BRI Projects More Transparent

- Publish project plans online, along with engineering, procurement and construction tendering information, to make project opportunities available to all parties qualified to participate.
- Establish supervision power for the bidding process for BRI projects.
- Release information about the winning bidders and equipment suppliers for BRI projects.
- Ensure international businesses in China are treated equally in the selection process for partners and suppliers, while fully adhering to local and international legislation when bidding and assignments occur in a third country.

3.2 Apply State of the Art, Efficient Technologies and Solutions to BRI Energy Projects

- Guarantee that energy projects deployed among BRI countries fully comply with international agreements on sustainability and decarbonisation.
- Guarantee sustainable and new technologies and standards for BRI projects, thereby prohibiting the deployment of polluting technological solutions inconsistent with China’s stated goal of ‘greening’ the BRI.
- Issue ‘minimum requirements’ for sustainability standards and regulations for energy-related projects within the BRI, and enforce their execution.

Carbon Market Sub-working Group Key Recommendations

1. Increase the Accuracy, Transparency and Coherency of Greenhouse Gas (GHG) Emissions Data in China’s National Emission Trading System (ETS)

- Promote knowledge-sharing on GHG data collection, management and optimisation.
- Intensify promotion of GHG reduction solutions for the manufacturing industry, buildings and private households.
- Enhance the credibility of GHG data and transparency of methods to collect GHG data at the enterprise level.
- Improve regulations, guidelines and tools regarding GHG emissions data collection and management.

2. Explore Synergies and Co-benefits Between the National ETS and Other Related Policy Instruments

- Facilitate and support exchange among different relevant policy areas in terms of energy, environment and climate change.
- Strengthen coordination amongst different governmental sectors regarding the implementation of energy trading, carbon emissions trading, green certificate trading and environment pollutant permit trading.
Introduction to the Working Group

The energy sector is arguably the most critical supplier for human activity, as energy is the quantitative property that must be transferred to an object in order for it to work or provide heat. Energy companies work to ensure reliable, affordable and clean energy for the whole of society. This is more important than ever, as the rapid development and deployment of clean energy is critical to combatting climate change, which could have potentially disastrous effects on human life.

The Energy Working Group is composed of more than 100 energy and equipment manufacturing companies that have over 150,000 employees in China collectively. The working group seeks to establish an effective and constructive dialogue on energy policies with relevant Chinese regulators, to provide input on China’s energy policy work and to share best practices from European energy industries operating in China. The overall aim is to create a fair, transparent and level playing field to promote competition between international businesses and local companies, and to promote the development and integration of clean and renewable energies, while supporting China in its present and forthcoming energy transition.

Recent Developments

China is the world’s largest energy consumer, with an energy consumption level of 3.132 million tonnes of oil equivalent (mtoe) in 2017 that is expected to surpass 4,000 mtoe/year and account for 28 per cent of global consumption by 2040.\(^1\) China thus plays a vital role in combating climate change by lowering emissions and transitioning to clean energy. Its energy consumption growth rate has dropped from 5.9 per cent to 1.1 per cent annually, likely due to improvements in efficiency at industrial levels, a switch from manufacturing to service industries that have a lower energy intensity,\(^2\) and the rapid upgrade of manufacturing processes. China has made great strides in energy efficiency, saving 12 per cent in energy usage in 2017 alone. The working group praises this significant progress in guiding China’s energy sector towards a more sustainable model.

Despite China’s commitment to move from coal to more renewable sources, coal consumption continued to grow, as did greenhouse gas (GHG) emissions; such increases indicate the coal sector has failed to comply with government targets in cutting GHG emissions.\(^3\) The working group remains concerned with this situation, in particular that China seems to have slowed down its reduction of dependence on coal and is promoting

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polluting coal-power plants in other countries; last year Chinese institutions funded United States dollars (USD) 36 billion in coal-backed projects abroad, relying on outdated coal technology for Belt and Road Initiative (BRI) projects that would be much better served by modern and more efficient technological contributions from European companies.

Furthermore, China’s ambitions to rely more heavily on natural gas have been hampered by production, storage and transportation infrastructure insufficient to meet growing demand, particularly seasonal changes, as was evident by the major shortages during the winter of 2017–2018. China is heavily dependent on liquefied natural gas (LNG) imports but trade tensions with the US, the world’s fastest-growing gas exporter, have pressured China to diversify its LNG supply.

State-owned oil companies are expected to increase investment by 20 per cent in 2019, in an effort to stabilise energy security, which may pose serious concerns due to lack of national production ability.

China’s renewable energy capacity blossomed in the past year as 20.33 gigawatts (GW) of wind power and 44.38 GW of solar photovoltaic (PV) capacity were added to grids, although curtailment remains an issue. To boost the competitiveness of its renewables, China will also prioritise unsubsidised wind and solar projects.

Renewable sources integration within the overall energy system requires a holistic modernisation through smart grids, intelligent production planning and regulation, introducing market dynamics to energy trading and supply/demand regulation. In May 2019, after several draft policies, the government issued a finalised RPS system requires a holistic modernisation through smart grids, intelligent production planning and regulation, introducing market dynamics to energy trading and supply/demand regulation. In May 2019, after several draft policies, the government issued a finalised RPS that will aim for non-fossil fuel energy sources to reach a 20 per cent energy share.

China is also at the forefront of new energy vehicle (NEV) development and will be an early mover in vehicles fuelled by methanol, whose high hydrogen and low carbon content means it burns cleaner than gasoline and gasol (e.g. following a recent provincial-level plan in Guizhou to put 10,000 methanol vehicles on the road by the end of the year, central top-level policies are expected soon to guide methanol vehicle development). China has also begun to incorporate hydrogen fuel cells into zero-emissions vehicles and will plan for an extensive hydrogen industrial chain, but the current infrastructure for hydrogen fuel technologies is underdeveloped and quite limited.

During the April 2019 EU-China Dialogue, the European Commission’s Directorate-General for Energy and the National Energy Administration (NEA) signed a memorandum of understanding, reconfirming mutual commitment to international agreements and level playing fields. The EU-China Energy Cooperation Platform, with euro (EUR) 3.5 million in funding from the European Commission, launched in May 2019 to promote cooperation in energy transition, energy saving and market opening.

Several developments in June 2019 indicate positive steps in the opening up of China’s energy sector, such as the revision of the Negative List to lessen restrictions on foreign investment in oil and gas, as well as pipe networks. The Measures for Fair and Open Supervision of Oil and Gas Pipeline Facilities, released jointly by four departments, promises to strengthen the regulatory framework for facility operators and safeguard oil and gas supplies. The working group hopes these policies are complemented by concrete measures allowing foreign company to freely and openly invest and operate in the energy upstream, midstream and downstream sectors.

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5 China Gas Shortages Spread After Botched Coal Conversion, Financial Times, 12th December 2017, viewed 3rd May 2019, <https://www.ft.com/content/8f34570c-de84-11e9-b126-46fc3ad87f565>


14 Notice of the Four Departments on Printing and Distributing the Measures for Fair and Open Supervision of Oil and Gas Pipeline Facilities, State Council, 2nd June 2019, viewed 9th July 2019, <http://www.gov.cn/xinwen/2019-06/02/content_5396024.htm>
Key Recommendations

1. Energy Transition
   1.1 Push for the Transition from Coal to Gas in China’s Energy Mix

Concern
Despite ambitious goals to transition from coal to gas, unstructured planning, insufficient supplies of NG and inefficient networks cannot match the surge in demand, and the development of LNG as an energy source faces complex regulations and outdated safety standards.

Assessment
Boosting NG shares of the country’s energy mix is strategic for environmental reasons, increasing baseload energy flexibility, improving energy efficiency and the overall reduction of energy intensity. The government’s goals for energy transition are ambitious and have somewhat progressed, but it is still uncertain how and when more concrete actions will be taken to meet the growing demand for NG, which is forecast to reach 600 billion cubic metres (bcm) by 2040. China produced over 160 bcm of NG in 2018, and domestic production is projected to grow to 218 bcm by 2040.\(^\text{15}\)

High dependence on imports, in particular LNG imports, will therefore continue to satisfy a significant portion of NG demand in the long run as demand far exceeds domestic production.

At present, China’s NG transportation, distribution network and storage capacity are unable to satisfy the expected growth of demand. China has about 10 bcm of storage space, which at four per cent of its annual demand is insufficient to avoid supply shortfalls in winter or optimise supply/demand balance. Hence, new investments in storage, pipeline and regasification capacity, as well as new policies for NG development, are strongly encouraged to develop more sustainable models, rather than relying on massive imports. Positive signs for energy sector reform came in 2018 with the creation of a pipeline company to manage the assets and management of China National Petroleum Corporation/PetroChina, Sinopec and China National Offshore Oil Corporation, separating transmission and sales businesses.\(^\text{16}\) Yet gaps remain, for example missing mid-stream energy infrastructure to transmit and store NG upset the delicate balance between centres of production and consumption, the NG system’s ability to face seasonal changes and peaks in demand, and the possibility of optimising LNG import costs during winter peaks.

Although in 2018 coal shares of China’s energy mix declined below 60 per cent for the first time, overall coal consumption and CO\(_2\) emissions rose, the latter by three per cent.\(^\text{17}\) Further emphasis should therefore be put on a holistic energy transition that involves both domestic and foreign suppliers. Production, importation, transportation, storage, distribution and smart metering along the NG supply chain must be carefully planned and well-coordinated, as both effectiveness and efficiency bottlenecks (e.g. third party access for LNG where state-owned enterprises are reluctant to free up terminal and pipeline infrastructures) restrict market opening, while damaging the diversification of supply and holding back a rapid energy transition. Distributed energy production should be taken into consideration for the sake of designing efficient grids, and it can also contribute to the evolution of China’s energy base.

Recommendations
• Ensure fair market competition between pipeline gas and NG.
• Promote the bulk LNG supply by setting up national standards.
• Update the current safety standard to make sure bulk LNG supply is accessible and safe.
• Enforce the State Council’s Three-Year Action Plan for Winning the Blue Sky Defence Battle and NEA’s Guidance on Energy Work 2018 while carefully developing the necessary infrastructure for its implementation.
• Consider the use of distributed energy (not only from renewable sources), integrated power generation and infrastructure building through careful planning and enforcement to make the energy system more flexible and efficient.
• Encourage the building of necessary energy infrastructure, including power and gas storage, by setting tariffs to cover building costs, while fairly remunerating investors and operators.
• Ensure fair market competition between pipeline gas and bulk LNG.

• Publicly release a comprehensive annual review of the natural gas market reform.
• Switch from coal to NG combined heat and power plants that use flexible electricity, and heat-production grids where heat storage facilities can increase overall energy efficiency.
• Facilitate and support the adoption of advanced heat-storage technologies for the development of localised solutions that match the current heat supply with the public’s demand, and help optimise the heating value chain by improving the integration of production with distribution.
• Effectively open the market to foreign-invested enterprises (FIEs) for direct investments in NG liquefaction, transportation and storage management.

### 1.2 Adjust the Energy System to Incentivise Decentralised Renewable Energy (RE) Development

**Concern**
Due to the lack of clear RE utilisation guidelines in the nationwide energy framework, electricity from wind and solar power plants is either accounted as a simple add-on to the power system or eventually curtailed, while a cost focus on calculating returns and reprioritisation of sector maintenance has made the new energy sector unsustainable.

**Assessment**
In the last year, China’s RE policy underwent deep changes. Adjustment regulations were issued unexpectedly and quickly, particularly for solar PV projects, to establish a cap limit of incentivised plants. The sudden measures resulted in market uncertainty and increased financial challenges for operators already under pressure by feed-in tariffs (FIT) payment delays.

In April 2019, the NEA issued a series of announcements to firstly set guidelines to reverse bids for subsidised projects, and then to set principles to prioritise non-subsidised projects. It remains to be seen whether this change will be enough to offset the subsidy deficit or maintain momentum in renewable energy investment. Despite efforts to plan the transition from solely subsidised projects to FIT-supported and non-subsidised projects by the end of the Clean Energy Consumption Action Plan 2018–2020, the market lacks the clear regulations required to provide certainty to investors.

The NEA has also provided instructions to grid players to prioritise the use of grid-parity projects and alleviate the effects of curtailment. Despite some positive progress with regard to the discussion of a green-certificates market and bank-supported finance products tailored for renewable energy grid parity projects, more concrete steps such as grid frameworks and financing incentives are required to pave the road for RE’s smooth implementation. In this regard, the working group praises the NEA’s May 2019 finalisation of the RPS policy, which offers a benchmark to increase the energy share of non-fossil fuels to 20 per cent by 2030.

Several investments in RE projects seem to have been made with a short-term focus on obtaining incentives rather than making a real contribution to the necessary energy transition. One example of this was the NEA’s 2017 Front Runner Plan, which encouraged a continuously lower bidding price. The working group expects the government to emphasise the importance of high-quality equipment in facilitating an effective energy transition.

**Recommendations**
- Establish a clear nationwide RE implementation policy with a long-term tariff plan under which external environmental costs are reflected in pricing.
- Implement framework regulation for micro-grid networks, including regulation for energy-dispatching services provided by the grid companies, prioritising RE power dispatch.
- Encourage a functioning market for green certificates, and set renewable portfolio obligations that enable industrial and commercial power consumers to

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differentiate power sources and manage emissions.

- Implement green financing tools to facilitate investment from SMEs.
- Implement regulation for RE development facilitation on polluted or unrecoverable lands, e.g. photovoltaic wind on landfills, exhausted mines, quarries or remediated ex-industrial areas.
- Introduce penalties against low-quality device sellers or manufacturers and publish projects that failed due to the daily use of poor-quality equipment.

### 1.3 Continue Electrification of the Energy System

**Concern**

Market entry barriers, a lack of supply-side adjustment and demand regulation make it difficult to take advantage of the electrification of energy final-uses in China’s energy system, which, coupled with power generation from renewables, can pave the way towards energy transition.

**Assessment**

The electrification of transport, heating and industrial processes offer opportunities to improve the energy system and attract foreign investment. New tools are required to create a flexible and modern electricity grid that can meet the increase in renewable generation and distributed energy resources, e.g. residential solar and energy storage, while maintaining the quality that customers expect.

China’s electricity grid is slowly moving towards a market-orientated approach. The State Council’s 2015 *Opinions on Further Deepening the Reform of Power System* proposes an electricity spot market, 24 aimed at spurring competitive pricing and gradually loosening state control, while also making the power-distribution system and retail electricity sales more accessible to private companies. 25 However, it is difficult to fully assess the impact for foreign companies, or how, in a liberalised retail power market, the incumbent grid companies will allow for competition.

The National Development and Reform Commission’s (NDRC’s) *Notice of Power Users’ Electricity Use Plan [2019]* No. 1105 reiterates the intent to fully liberalise electricity use for power users, including the imperative to focus on clean energy generation. 26 The working group welcomes this affirmation of deepening power reform and looks forward to its further implementation.

In transportation, China has committed to expand NEV charging infrastructure within three years with the 2018 *Action Plan for Enhancing the Charging Capacity of New Energy Vehicles.* 27 A total of 921,000 public and private charging poles for NEVs have been built, 28 but difficulties remain in instalment and efficient operation, and the plan lacks clear guidance on regulating the energy supply. Paradoxically, a large proportion of the energy supply for these NEVs currently comes from public grids, which are fuelled by coal-fired power plants and thus do not reduce emissions. Policies also lack guidance on the asset management of a decentralised RE-electric vehicle (EV) fleet, related data acquisition and grid regulation which might otherwise provide opportunities for both foreign and domestic private companies to offer new business models in line with the reforms.

The government should thus accelerate the development of NEV charging networks and optimise network planning at national, regional, city and community levels. Setting up a digital information platform will also benefit NEV owners and help integrate clean energy into daily life. Authorities should develop regulations that allow automobiles’ electric batteries to reach their full potential when it comes to energy storage and distribution, and consider introducing regulations that support retrofitting vehicles to use NG for more flexible energy storage system and affordable energy prices.

**Recommendations**

- Release publicly a comprehensive annual review of electricity market reforms.
- Reform overall grid regulation to guarantee full absorption of renewable sources.
- Create a mechanism that allows renewable energy supplies to connect with grids that are assigned a higher priority, and establish transparent grid code, fees and feed-in tariffs to ensure that electricity sales can be paid in a timely manner.

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Section Three: Goods

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Section Three: Goods

Current hydrogen production methods rely on fossil fuels or industrial processes that produce disproportionately high CO<sub>2</sub>. Impurities such as sulphur and nitrogen oxides (NO<sub>x</sub>) pollute the catalyst in fuel cells, harming lifetime and performance. New processes of green hydrogen production are thus necessary. Water electrolysis technology can produce ultra-clean hydrogen with zero sulphur or NO<sub>x</sub> impurities, alleviating China’s severe renewable power curtailment. Installation of on-site green hydrogen production facilities at HRSs could eliminate transportation costs, bringing more economic and green hydrogen to FCV application. Subsidised electricity prices could make this technology affordable enough to achieve scale to compete as a renewable energy source, creating beneficial top-level regulation to support a hydrogen economy that is still nascent. Coal gasification techniques combined with carbon capture storage (CCS) also pose a viable option for cleaner hydrogen production; the latter technology’s introduction in Jilin in 2018—the eighteenth CCS facility in the world—marks China’s commitment to being at the forefront of climate change technologies.

1.4 Promote the Role of Hydrogen in Optimising the Energy System

Concern

Decarbonisation in China is not possible without hydrogen generation from renewable energy, but China has not yet adopted the widespread use of hydrogen as an energy carrier, and supporting policies and legislation are inadequate.

Assessment

Hydrogen presents a unique and clean opportunity for the lengthy storage of surplus energy, with key applications in fuel cells for NEVs and in increasing the efficiency of NG when blended. In 2016, the China Automotive Technology and Research Center, a state-owned research group, released the Hydrogen Infrastructure Development Blue Book, asserting that by 2050, hydrogen would be an essential part of China’s energy structure.

The China Society of Automotive Engineers’ May 2019 Hydrogen Corridor Development Plan envisions 40 hydrogen refuelling stations (HRSs) built along expressways in the Yangtze River Delta by 2021 to support fuel-cell vehicle (FCV) development.

Due to the lack of a clear national-level hydrogen strategy, hydrogen is still considered a dangerous chemical gas instead of an energy carrier. Production is confined to oil refining and petrochemical parks, and there are neither clearly defined government interfaces for hydrogen projects nor explicit limits on the amount of hydrogen produced through high CO<sub>2</sub> emission methods.

Current hydrogen production methods rely on fossil fuels and/or industrial processes that produce disproportionately high CO<sub>2</sub>. Impurities such as sulphur and nitrogen oxides (NO<sub>x</sub>) pollute the catalyst in fuel cells, harming lifetime and performance. New processes of green hydrogen production are thus necessary. Water electrolysis technology can produce ultra-clean hydrogen with zero sulphur or NO<sub>x</sub> impurities, alleviating China’s severe renewable power curtailment. Installation of on-site green hydrogen production facilities at HRSs could eliminate transportation costs, bringing more economic and green hydrogen to FCV application. Subsidised electricity prices could make this technology affordable enough to achieve scale to compete as a renewable energy source, creating beneficial top-level regulation to support a hydrogen economy that is still nascent. Coal gasification techniques combined with carbon capture storage (CCS) also pose a viable option for cleaner hydrogen production; the latter technology’s introduction in Jilin in 2018—the eighteenth CCS facility in the world—marks China’s commitment to being at the forefront of climate change technologies.

Recommendations

- Define specific safety standards regulations for hydrogen production, distribution and usage.
- Design a hydrogen-based storage system as a systemic ‘buffer’ for harmonising continuous production from coal and nuclear plants and intermittent production from renewables in order to optimise electricity supply/demand patterns at national and local levels.
- Promote hydrogen storage techniques as an extension of power plants to store excess energy in a more environmentally friendly and less time-sensitive manner than traditional battery storage.
- Encourage large-scale hydrogen production from offshore wind.
- Encourage the use of hydrogen in fuel cells and develop a widespread and sustainable distribution network for NEVs.
- Categorise hydrogen as an energy carrier instead of a dangerous chemical gas.
- Promote legislation, standards and remuneration to blend hydrogen into the NG pipeline.
- Set a subsidised electricity price for green hydrogen produced through high CO<sub>2</sub> emission methods.

production, i.e. water electrolysis technology.
• Strictly limit the proportion of hydrogen production from fossil fuel sources to control the overall level of CO₂ emissions.

2. Energy Efficiency

2.1 Move to Increasingly Dynamic Energy Markets for Wholesale Power, Distributed Electricity and Heat

Concern
The lack of competition in power markets, and ensuing limitations for end-user choice, skews energy pricing and disadvantages suitable electricity energy sources, also leaving European companies unable to comply with internal objectives to decarbonise their global carbon footprint.

Assessment
China’s energy market reforms aim to reduce energy intensity and improve economic resilience through increasingly competitive, market-based mechanisms. The process is yet incomplete, with only a partial pilot spot market for power operating in Guangdong as of January 2019, and seven other provinces set to introduce pilot spot markets later in 2019.

Recent government focus has been on lowering end-use prices for general commercial and industrial users, resulting in various incentives, subsidies and one-way trading systems. However, the overriding focus on reducing price is leading to low (and even loss-making) margins across the power sector without effectively preferring lowest cost, most efficient, least polluting, or system value-adding suppliers such as natural gas, renewable energy and power storage.

Transparent access and use of appropriate energy infrastructure are the foundations of a mature and flexible market and would grant consumers lower average prices and supply-side security. All market players should be able to efficiently conduct operations based on clear wholesale price signals to more efficiently meet demand. There is still no such marketplace where energy—power, gas and emissions—can be traded physically or in the form of financial products.33 The ability to directly procure RE, complemented by obligations to increase its proportion in energy supply and incentivise RE purchases through RPS and certification framework, would enable industrial and commercial power consumers to differentiate power sources, surpass mandatory requirements and even achieve 100 per cent renewable energy use.

Recommendations
• Accelerate the shift to liberal and open energy markets that include renewable sources.
• Speed up the liberalisation of both wholesale and retail power pricing, the standardisation of transmission tariffs and the opening of retail distribution to non-grid companies.
• Develop a regulatory framework that offers entrants a level playing field, with third party access to infrastructure, confidentiality of transactions, non-discrimination and transparency.
• Accelerate the creation of provincial and regional spot markets for power with ensured access to reasonable supply and demand data for a fair and competitive overall market that includes international participation.
• Ensure power spot price markets foster healthy and open competition, in particular that grid companies remain as independent service operators, serving their monopoly roles in asset investment and maintenance, and safe transmission and distribution, but do not trade profits.
• Pilot large-scale renewable energy direct procurement and distributed models enabling industrial power users to source substantial amounts of power from NG or renewable sources.
• Launch a functioning RPS based on utilisation, including flexible choice through markets and compliance-orientated green certificates, and non-subsidy voluntary green certificates.

2.2 Develop Methods for Incentivising the Reduction of Energy Demand

Concern
To achieve energy transition and meet the objectives set out in the 2015 Paris Climate Conference of the Parties (COP21), and reiterated in COP24 (Katowice), China must focus on energy intensity reduction and shift towards low-emission energy generation.

Assessment
China has not yet established a framework to control industries’ and buildings’ energy intensity, instead...
adopting a passive stance based on anticipated consequences of shifting from a production-driven to a service-driven economy. Measures such as energy service company subsidies for RE generation equipment, pricing reform and green building label certification have all had limited results. Further efforts to reduce emissions should implement realistic and efficient measures that can bring about a reduction in energy and emissions intensity.

Authorities should standardise methodology to evaluate energy demand performance, which may be used to offer incentives based on the evolution of energy demand or retro-finance energy actions responsible for eventual reduction. To assess the actual performance of industries and buildings, methodology should clarify when information disclosure and building upgrades are mandatory. China should consider the example of European countries that use energy passport systems and ‘white certificates’ to mandate energy efficiency baselines and reward energy saving.

Recommendations
- Define a clear, regularly updated common methodology to assess energy/emissions intensity.
- Develop an energy efficiency passport mechanism to track incentives and obligations for reducing energy demand and energy/emissions intensity.
- Promote and incentivise substitution of low energy efficient electrical engines at the industrial level.
- Define standards at the industrial level, providing cap limits for energy used per production output unit, by industrial sector, while setting up ‘white certificate’ mechanisms.

3. Belt and Road Initiative (BRI)

3.1 Make the Tendering and Bidding Process for BRI Projects More Transparent

Concern
The tendering and bidding processes and financing sources for BRI projects are opaque, creating uncertainty and even barriers for European companies regarding their potential participation.

Assessment
Energy collaboration is essential for the BRI. Although several projects have addressed energy supply shortages abroad, some investments have resulted in stranded assets due to low asset utilisation and connectivity. Multinational corporations in China have had limited participation in these projects, largely due to a lack of transparency and poorly supervised bidding processes. As reliable partners in China’s energy market, European companies bring advanced technologies, planning and operating capabilities, and should be encouraged to participate in the BRI.

Recommendations
- Publish project plans online, along with engineering, procurement and construction tendering information, to make project opportunities available to all parties qualified to participate.
- Establish supervision power for the bidding process for BRI projects.
- Release information about the winning bidders and equipment suppliers for BRI projects.
- Ensure international businesses in China are treated equally in the selection process for partners and suppliers, while fully adhering to local and international legislation when bidding and assignments occur in a third country.

3.2 Apply State of the Art, Efficient Technologies and Solutions to BRI Energy Projects

Concern
The use of outdated, non-energy efficient technologies

40 According to the European Chamber’s Business Confidence Survey 2019, 88% of respondents were unable to participate in BRI projects, with 42% of those respondents citing lack of suitable projects and 37% citing insufficient information as the main challenges for their sectors. European Business in China Business Confidence Survey 2019, European Union Chamber of Commerce in China, 20th May 2019, <https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>
by Chinese firms for projects under the BRI relocates pollution from China to host countries and deters European firms with state-of-the-art, sustainable designs and technologies from participating.

**Assessment**

China has advocated a ‘greening’ of the BRI;\(^{43}\) the second BRI Forum in April 2019 concluded with a commitment to financing practices and infrastructure projects that promote sustainable development in compliance with international standards.\(^ {44}\) Furthermore, the Asia Infrastructure Investment Bank’s *Energy Sector Strategy* aims to support investments in sustainable energy projects to increase access to clean, safe and reliable electricity across Asia in conformity with the Paris Agreement, thus financing BRI projects only if they meet overall sustainability requirements.\(^ {45}\)

China must avoid transferring polluting solutions to BRI countries through inefficient coal-powered plants, as well as other infrastructure and industrial projects that do not fulfil environmental sustainability goals in compliance with international rules or Chinese standards. Creating a level playing field for European companies would bring state-of-the-art project designs and solutions to the BRI, ensuring that sustainability and international green standards are met.

**Recommendations**

- Guarantee that energy projects deployed among BRI countries fully comply with international agreements on sustainability and decarbonisation.
- Guarantee sustainable and new technologies and standards for BRI projects, thereby prohibiting the deployment of polluting technological solutions inconsistent with China’s stated goal of ‘greening’ the BRI.
- Issue ‘minimum requirements’ for sustainability standards and regulations for energy-related projects within the BRI, and enforce their execution.

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**Abbreviations**

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<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>BRI</td>
<td>Belt and Road Initiative</td>
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<tr>
<td>BCM</td>
<td>Billion Cubic Metres</td>
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<td>CCS</td>
<td>Carbon Capture Storage</td>
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<td>CO(_2)</td>
<td>Carbon Dioxide</td>
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<td>COP21</td>
<td>21(^{st}) Conference of the Parties</td>
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<td>COP24</td>
<td>24(^{th}) Conference of the Parties</td>
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<td>EUR</td>
<td>Euro</td>
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<td>EV</td>
<td>Electric Vehicle</td>
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<td>FCV</td>
<td>Fuel Cell Vehicle</td>
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<td>FIE</td>
<td>Foreign-invested Enterprises</td>
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<td>FIL</td>
<td>Foreign Investment Law</td>
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<td>FIT</td>
<td>Feed-in Tariff</td>
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<td>GHG</td>
<td>Greenhouse Gas</td>
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<td>GW</td>
<td>Gigawatt</td>
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<td>HRS</td>
<td>Hydrogen Refuelling Stations</td>
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<td>LNG</td>
<td>Liquefied Natural Gas</td>
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<td>mtoe</td>
<td>million tonnes of oil equivalent</td>
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<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>NEV</td>
<td>New Energy Vehicle</td>
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<td>NG</td>
<td>Natural Gas</td>
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<td>NO(_x)</td>
<td>Nitrogen Oxides</td>
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<td>PV</td>
<td>Photovoltaic</td>
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<td>Renewable Energy</td>
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<td>RE-EV</td>
<td>Renewable Energy Electric Vehicles</td>
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<td>RPS</td>
<td>Renewable Portfolio Standard</td>
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<tr>
<td>USD</td>
<td>United States Dollars</td>
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43 Goh, Brenda, and Cadell, Cate, China’s Xi Says Belt and Road Must be Green, Sustainable, Reuters, 25\(^{th}\) April 2019, viewed 2\(^{nd}\) April 2019, <https://www.reuters.com/article/us-china-silkroad/chinas-xi-says-belt-and-road-must-be-green-sustainable-idUSKCN1S104I>

44 Belt and Road Cooperation: Shaping a Brighter Shared Future, Joint Communique of the Leaders’ Roundtable of the 2\(^{nd}\) Belt and Road Forum for International Cooperation, Belt and Road Portal, 27\(^{th}\) April 2019, viewed 3\(^{rd}\) May 2019, <https://eng.yidaiyilu.gov.cn/qwyw/rdxw/88230.htm>

Introduction to the Sub-working Group

The Carbon Market Sub-working Group’s overall aim is to contribute towards the creation of a fair and predictable business environment, so that international and local companies can compete on a level playing field. It also wishes to share with its Chinese partners emissions trading system (ETS) experiences from other markets, and to promote the development and integration of clean energies, while supporting China in its energy transition. It is a sub-working group of the Energy Working Group and consists of 41 company members that represent all aspects of the carbon market sector, including project developers, carbon funds, investors, lawyers, auditors and consultants, as well as financial institutions and companies under compliance obligations.

The sub-working group works with the Chinese Government and other stakeholders to ensure sustainable development of the carbon market, to reduce China’s carbon dioxide (CO₂) emissions and resolve other environmental issues. With the pilot ETS presently in operation across China and the national ETS scheduled to start by 2020, the working group is focused on understanding and improving the process from a European-business-in-China perspective.

Recent Developments

From 2017 to 2018, China’s CO₂ emissions grew by 2.3 per cent, reaching a new maximum of 10 gigatonnes.¹ According to China’s Policies and Actions on Climate Change 2018 Annual Report, CO₂ emissions per unit of gross domestic product (GDP) fell by 40 to 50 per cent.² Yet China continues to face the challenge of how to make sure its performance in emissions reduction is sustainable, while taking the economic slowdown into consideration.

On 27th June 2018, the State Council issued the Three-Year Action Plan to Win the Blue Sky Defence War, which lays down the targets of emissions and air pollutant reduction for the next three years: by 2020, the total emissions of sulphur dioxide and nitrogen oxides must be reduced by more than 15 per cent compared with 2015 levels; the average concentration of PM 2.5 in cities that fail to meet national standards will be reduced by 18 per cent compared with 2015; and 80 per cent of the days in cities at the prefecture-level and above will qualify as ‘good’ on the air quality index (AQI). The ratio of ‘heavy-and-above’ pollution days must also decrease by more than 25 per cent compared with 2015 levels.³

On 26th October 2018, the 6th Session of the Standing Committee of the 13th National People’s Congress amended the Law on Prevention and Control of Atmospheric Pollution.⁴

On 26th November 2018, the Ministry of Ecology and Environment (MEE) issued the 2018 Annual Report on China’s Policies and Actions on Climate Change. According to the report, in 2017, China’s CO₂ emissions per unit of GDP were about 46 per cent lower than in 2005; it has achieved the target of a 40 to 45 per cent reduction in carbon intensity three years ahead of schedule.

In January 2019, the MEE announced that in 2019, it will evaluate the performance of the Three-Year Action Plan to Win the Blue Sky Defence War.

Since 2011, China has been piloting ETS projects in seven provinces and cities, and in June 2013, the pilot carbon market was launched. As of November 2018, the cumulative volume of the seven pilot carbon markets exceeded 270 million tonnes, with an accumulated turnover of about Chinese yuan (CNY) 6 billion. The total amount and intensity of carbon emissions in the pilot area have doubled, and the carbon market has played a role in controlling greenhouse gas (GHG) emissions and promoting local low-carbon development. In March 2019, the MEE published the

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results of the public consultation on the draft Temporary Administrative Measures on Carbon Emission Trading. However, it remains unclear whether this regulation can help integrate the seven different trading schemes into one national system.

While the limitations of the national ETS came as a disappointment to various market players, the associated delays could be seen as an opportunity to ensure all policies and tools promulgated by Chinese authorities are efficient and well-coordinated. European companies have experience with these issues and their involvement in China’s trading scheme’s design will be key to integrating past improvements.

Key Recommendations

1. Increase the Accuracy, Transparency and Coherency of Greenhouse Gas (GHG) Emissions Data in China’s National Emissions Trading System (ETS)

Concern

Despite the efforts and progress made by the Chinese Government to improve the accuracy, transparency and coherency of data that will be applied in the forthcoming nationwide ETS, challenges still exist in areas such as legal foundations, guidelines and supervision.

Assessment

The reliability of GHG emissions data is the cornerstone of any carbon pricing policy tool. To increase reliability at the enterprise level, between 2013 and 2015 the Chinese Government released 24 national guidelines for calculating and reporting GHG emissions in various industrial sectors. These guidelines steered the industrial enterprises covered by the ETS in accounting for and submitting their GHG yearly emissions data to the authorities on an annual basis from 2013 to 2018. A web-based national GHG emission reporting system was implemented in 2018 to facilitate more efficient and streamlined data transfer and management. However, despite these efforts and some progress, challenges still exist.

Accuracy: improving monitoring, reporting and verification

In order to increase credibility, it is important that an effective and accountable regulatory framework for monitoring, reporting and verification (MRV) is developed and enforced in relation to CO₂ emissions. It is also important to introduce an appeal mechanism to allow disputes arising from enforcement to be solved in a fair and efficient way.

The Chinese Government has absorbed many good lessons from the European Union’s (EU’s) ETS on the establishment of a sound MRV system, while taking its own context into consideration. However, during the development process, some challenges have emerged that have to be addressed and overcome in order to ensure the accuracy of GHG emissions data. These challenges include:

1) The need to establish an effective legal foundation for conducting MRV—including legal measures and technical standards at the national level—to regulate and supervise the performance during the MRV process, and legitimise the obligations and duties of all stakeholders. The legislation related to MRV is still being drafted, with measures expected to be released within 2019, according to a draft of the Interim Regulations on the Management of Carbon Emissions Trading that was disclosed for public consultation in April 2019.5

2) The 24 technical guidelines issued on MRV need to be modified in response to problems that arose in practice. The MRV of GHG emissions is related to many industrial production procedures, in particular in some fairly complicated industrial sectors such as chemicals, petrochemicals, steel and cement, which require clear identification and definition of an abundance of factors, boundaries, methodologies and formulas. In the almost six years of practice in measuring GHG emissions since the first guideline was issued, manufacturers in these industrial sectors have provided a great deal of tangible feedback and suggestions based on their experiences, which should be taken into account in the modification of technical guidelines before the launch of the nationwide ETS.

3) The supervision of the performance of verification agencies needs to be strengthened. The introduction of independent third-parties to help the government verify the GHG emissions data reported by enterprises is a common method. The professionalism, compliance and technical capability

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of verifiers will affect to a large extent the credibility of the result. Taking into account the fact there are 7,000 enterprises to be covered by the first phase of the nationwide ETS, there will be a large demand for qualified verification agencies. However, currently each province selects verification agencies based on their own criteria, due to the absence of a unified national rule on the selection and performance of verification agencies. In the draft *Interim Regulations on the Management of Carbon Emissions Trading*, it states that the central government would like to disclose a list of recognised verification agencies and provide financial support from the national treasury for verification, but more details are yet to be released.

4) The capacity of enterprises on MRV still needs to be enhanced. As the most important stakeholder in the process of MRV, enterprises must understand how to apply the guidelines in their own factories or installations, and how to respond to the requests of verifiers and authorities. Despite a lot of training on MRV having been carried out for enterprises, due to the complexity of the process and frequent changes to requirements, there is still strong demand for further capacity building.

**Transparency: promoting the sharing and disclosure of climate-related information at the enterprise level**

In order to run effectively, markets rely on an unimpeded flow of information, clear rules and rigorous oversight. The Carbon Market Sub-working Group advocates for more transparency in aggregated market activities.

It is encouraging to see Article 5 in the draft *Interim Regulations on the Management of Carbon Emissions Trading* stating that the MEE under the State Council shall regularly disclose information on carbon emission allowance trading, and the completion status of carbon emission allowances submitted by entities each year. If this article is included in the final version of the law, the transparency and confidence of China’s carbon market will be reinforced significantly.

Under well-designed rules, the regulator should support the development of a transparent platform and provide access to complete, unrestricted data on trading, emissions and compliance. This would publicly promote business confidence in the environmental and the financial integrity of China’s ETS. It would also provide an additional level of scrutiny, allowing early exposure to systemic risks.

Furthermore, stakeholders need market information regarding supply and demand imbalances and CO₂ emissions in order to design and implement a sound compliance strategy. Access to information regarding power generation in the first instance should be user-friendly. As far as access to information goes, companies with large installations that are regulated by the national ETS should be prevented from profiting from ‘inside information’.

The government-imposed obligation to disclose information on GHG emissions, combined with the efforts of some international non-governmental organisations (NGOs) to promote climate data disclosure, has lead to an increase in the number of enterprises that pay more attention to this issue in the last couple of years. However, the latest review by the Task Force on Climate-related Financial Disclosures (TFCD)⁶ indicates that climate-related financial disclosures are still in the early stages. Companies are also in the early stages of evaluating the impact of climate change on their businesses and strategies. Those that have determined that climate-related issues are not material to their operations are encouraged to disclose information on their governance and risk management practices.

**Coherency: integration of MRV of GHG emission at national and provincial level**

Despite significant progress in most of China’s ETS pilot regions, one challenge cannot be ignored: how to integrate the key characteristics of pilot markets into the upcoming nationwide ETS, including a unified MRV system.

In the beginning, each pilot market formulated its own MRV regulations and standards in order to reflect the specific conditions of each region. The challenge now is how to ensure a smooth transition to the national system.

Another significant challenge will be the successful integration of the national online GHG reporting system and provincial online GHG reporting systems. Digital reporting of GHG emissions is the most efficient and applicable method for the nationwide ETS.

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However, several provinces already established their provincial level online reporting platform, through which enterprises manually submit their GHG data to authorities. Therefore, this integration must be addressed in terms of the transformation of data.

**Recommendations**

- Promote knowledge-sharing on GHG data collection, management and optimisation.
- Intensify promotion of GHG reduction solutions for the manufacturing industry, buildings and private households.
- Enhance the credibility of GHG data and transparency of methods to collect GHG data at enterprise level.
- Improve regulations, guidelines and tools regarding GHG emissions data collection and management.

### 2. Explore Synergies and Co-benefits Between the National ETS and Other Related Policy Instruments

**Concern**

There are many different policy mechanisms aiming to simultaneously achieve air quality, energy development and carbon emissions targets more effectively but which are not streamlined, and make it difficult to identify the co-benefits clearly when introducing the ETS into the policy roadmap for developing a society based on ecological civilisation.

**Assessment**

The ETS by itself may not be able to realise the Paris Agreement target of "well below 2° Celsius" at the pace and on the scale required without unacceptable costs and impacts. It is theoretically both unsound and impracticable to only rely on CO₂ pricing, as this should be complemented by other well-designed policies. All issues related to existing market-based and policy failures could influence the policymaking process, and if they are not properly addressed, the effectiveness of the ETS and other policy measures will be compromised.

Some complementary policies that could address these issues include: the introduction of different market-based mechanisms and performance standards; new rules for city design, land and forest management, and infrastructure investment; the use of financial instruments to foster private sector participation; and reducing the risk-weighted capital costs of low-carbon technologies and projects. These policies would work alongside the establishment of carbon prices in an ETS system and would lower the costs associated with reducing emissions.

The bureaucratic complexity currently faced by stakeholders in the Chinese carbon market is also something that needs to be addressed. Since 2011, the National Development and Reform Commission (NDRC) has been pushing for the ETS to move from its pilot stage into the national market. At the beginning of 2017, the NDRC, the Ministry of Finance (MOF) and the National Energy Administration (NEA) jointly launched the programme Green Certification Trading in the Power Sector, which is aimed at replacing financial subsidies for renewables with market-based trading. In 2016, the NDRC initiated the pilot programme on energy allowance trading in four provinces to realise its control target for total energy consumption. Even with this new trading mechanism, environmental pollutant trading, is still in the policy toolkit of the MEE. Therefore, having various market-based policies being implemented in parallel is feasible, and continuing with this practice will have a significant positive effect on the development of the environmental sector.

One important change to note is that the functions of addressing climate change has been shifted from the NDRC to the MEE as of March 2018. This increases the possibility of harmonising GHG emission reduction with environmental pollutant control, and also grants the Climate Change Department of MEE stronger capacity to execute related laws and regulations with the support of environmental supervision and investigation taskforces.

In this regard, the working group could play a positive role by sharing with Chinese partners the EU’s experience of integrating similar market-based policies.

**Recommendations**

- Facilitate and support exchange among different
relevant policy areas in terms of energy, environment and climate change.

• Strengthen coordination amongst different governmental sectors regarding the implementation of energy trading, carbon emissions trading, green certificate trading and environment pollutant permit trading.

• Promote systematic research on co-benefits in order to ensure the feasibility and effectiveness of policies in a synergic way.

3. Incentivise the Chinese Government to work Alongside European Governments, Civil Society and Businesses to Strengthen its Actions in Line with the Objectives of the Paris Agreement

Concern
Despite recent domestic achievements, China still faces carbon emission challenges that stakeholders in the EU can help with.

Assessment
Climate change requires collective action on a global scale, because most GHG emissions accumulate over time and mix globally. Moreover, emissions by any agent—individuals, communities, companies or countries—affect other agents. International climate change negotiations have traditionally been driven at a national level, but the Conference of the Parties (COP) in Paris resulted in the recognition that an important role can and should be played by local governments, cities, the private sector and civil society. The Paris Agreement entered into force at the end of 2016. As a long-lasting agreement, it establishes a broad desire for controlling climate change. Fortunately, the agreement has mechanisms for countries to come back to the table within the next few years to propose new plans, but of course the responsibility for staying the course lies with everyone.

Only through ambitious and collective actions can the objective of keeping global temperatures between 1.5°C and 2°C be achieved. According to the Global Energy and CO₂ Status Report, released by the International Energy Agency (IEA), higher demand for energy in 2018 drove global energy-related CO₂ emissions to rise by 1.7 per cent to a historic high of 33.1 gigatonnes of CO₂ (Gt CO₂). While emissions from all fossil fuels increased, the power sector accounted for nearly two-thirds of emissions growth. Coal use in power alone surpassed 10 Gt CO₂, mostly originating in Asia. China, India and the United States accounted for 85 per cent of the net increase in emissions, while rates declined for Germany, Japan, Mexico, France and the United Kingdom. Against this backdrop, deeper and earlier cuts from countries, as well as proactive and early actions from the private sector, local governments and civil society, are badly needed.

The EU and China have a long-standing cooperation on climate change and have agreed to further step up joint efforts. Since 2005, the EU-China Partnership on Climate Change has provided a high-level political framework for cooperation and dialogue. This was confirmed in the 2010 Joint Statement and enhanced in the 2015 Joint Statement and the 2018 Leaders’ Statement.

At the EU-China Summit in July 2018, both sides reaffirmed their commitment to advancing implementation of the Paris Agreement and intensifying their cooperation on climate change and clean energy. The EU and China agreed to strengthen bilateral cooperation on areas such as long-term low GHG emission development strategies, energy efficiency, clean energy, low-emission transport and cities, climate-related technology, investment and cooperation with other developing countries.

Recommendations
• Utilise the EU-China Energy Cooperation Platform to share best practices in reducing GHG emissions.

• Work jointly with EU counterparts at all levels to strengthen actions to achieve the targets for the reduction of GHG emissions in line with the Paris Agreement, in particular with Chinese nationally-determined contributions and the reform objectives highlighted in the 13th Five-year Plan, while putting

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10 One example of this multi-stakeholders and bottom up initiative is the US Climate Alliance created on 1st June 2017; US States Form Alliance to Meet Paris Climate Commitments, Financial Times, 6th July 2017, viewed 3rd May 2018, [https://www.ft.com/content/27c5bad2-4895-11e7-919a-1e14ce4af89b?mhq5j=e3](https://www.ft.com/content/27c5bad2-4895-11e7-919a-1e14ce4af89b?mhq5j=e3)

11 Adoption of the Paris Agreement, UNFCCC, 2015, viewed 5th May 2018, [https:// unfccc.int/resource/docs/2015/cop21/eng/09f01.pdf](https:// unfccc.int/resource/docs/2015/cop21/eng/09f01.pdf)

12 The Paris Agreement’s pledge and review mechanism aims to secure and increase the level of ambition among the Parties and is essential to keep the world on a low-emissions pathway.


15 China’s Relations with the EU, FMPRC, April 2019, viewed 3rd May 2019, [https://www.fmprc.gov.cn/web/ghdq_676201/ghdqzz_681964/1206_679930/ sbgx_679934/](https://www.fmprc.gov.cn/web/ghdq_676201/ghdqzz_681964/1206_679930/sbgx_679934/)
China on a global clean energy transition and low carbon development pathway.
• Create an accessible and business-friendly market for both European and Chinese industries and business to be part of joint solutions for a Green China’s Policy Agenda.

Abbreviations

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>AQI</td>
<td>Air Quality Index</td>
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<td>CNY</td>
<td>Chinese Yuan</td>
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<tr>
<td>CO$_2$</td>
<td>Carbon Dioxide</td>
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<tr>
<td>COP</td>
<td>Conference of the Parties</td>
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<td>ETS</td>
<td>Emissions Trading System</td>
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<td>EU</td>
<td>European Union</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>Gt</td>
<td>Gigatonnes</td>
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<tr>
<td>IEA</td>
<td>International Energy Agency</td>
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<td>MEE</td>
<td>Ministry of Ecology and Environment</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<tr>
<td>MRV</td>
<td>Monitoring, Reporting and Verification</td>
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<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<td>National Energy Administration</td>
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<td>NGO</td>
<td>Non-governmental Organisation</td>
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<td>TFCD</td>
<td>Task Force on Climate-related Financial Disclosures</td>
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Key Recommendations

1. Revisions to the Product Quality Law
   1.1 Remove the Abstract Term ‘Unqualified Product’ and Use a Product’s Conformity with Mandatory National Standards as the Criterion for Judging the Qualification Issue and Initiating Administrative Penalties
      • Use a product’s conformity with mandatory national standards as criterion for judging the qualification issue and limit administrative enforcement and penalties to violation of mandatory standards.
      • Properly define the scope of voluntary standards so that they do not form the basis for administrative penalties.
      • Lift enterprises’ liability for administrative punishment in the event that they do not meet the claimed recommended standards but should bear civil liability according to law.
   1.2 Clearly Define Balanced Penalties According to the Scale of Infringement
      • Proportion punishments, ranging from heavy to light, according to the severity of a product’s infringement, with fines being scaled accordingly:
        - Current penalties should be retained, or even increased, for infringements that endanger people’s lives or their property.
        - Current penalties should be reduced for infringements that do not endanger people’s lives or their property but may impact a consumer’s purchasing decision, with a proper ceiling for fines to be established.
        - Current penalties for goods that have substandard labelling should be abolished, and replaced with an order for mistakes to be corrected.

   • Issue the implementation rules for the Consumer Protection Law and related national judicial interpretations in a timely fashion, providing guidance on legal precedents.
   • Exclude ‘professional shoppers’ from being classified as ‘consumers’ under the Consumer Protection Law.
   • Clarify that product mislabelling that neither endangers personal safety or property nor misleads the consumer is not fraud, and therefore not applicable to the punitive damages clause of Article 55 of the Consumer Protection Law.
   • Encourage more local market supervision authorities to issue detailed guidelines to further improve the business environment.

3. Clarify the Punishments Handed Down to Laboratories and Testing Institutes That Submit Fake or Partial Test Reports
   • Increase punishments handed down to laboratories and testing institutes that commit infringements.
   • Require laboratories and testing institutes that falsify or issue false reports to provide economic
compensation to any parties that they have caused reputational or economic loss to.
• Revokes the practicing licences of those that commit serious infringements.

• Revise the mandatory national standards in the GB 18401-2010 National General Safety Technical Code for Textile Products in accordance with the definition of mandatory national standards as stated in the new Standardisation Law, and remove the requirements on colour fastness and peculiar smells.
• Increase the number of chemical safety standards that properly safeguard personal health, life and property safety in line with international market practices.
• Improve, in a timely manner, the formulation and revision of the technical standards on the safety of raw materials in the textile industry.

5. Introduce the Implementation Rules of the E-commerce Law to Clarify the Liability and Responsibility of Social Platforms with E-commerce Functions with Regard to the Spread and Sale of Fake Products
• Issue detailed standards defining the liabilities for the sale of counterfeit goods on social media platforms.
• Classify platforms according to modes of control, methods of data access and technical features and set up proper administrative measures.
• Remove Article 43 in the E-Commerce Law on counter-notices.
• Formulate policies that force platforms to improve their rules on IP protection, and encourage platforms to proactively take stronger management measures to deal with cases of apparent IP infringement.

• Streamline the requirements for privacy policies provided in the Information Security Technology: Personal Information Security Specification, after fully considering the feasibility and consumer experience.
• Allow the use of contracts to specify the privacy protection responsibilities and obligations between an enterprise and its business partners.

Introduction to the Working Group
President Xi’s report during the 19th Party Congress stated that the gap between unbalanced and inadequate development and people’s ever-growing needs for a better quality of life is now the ‘principal contradiction’ as China’s economic development gradually shifts to higher-quality growth.¹

For millennia, humans have needed to express themselves as individuals, and this has often been done through clothes and accessories. The shift in China’s economy and the expansion of its middle class, which now has more disposable income than ever before, has seen a large increase in the consumption of high-quality, luxury products that allow people to demonstrate their individuality. In fact, Chinese consumers contributed to nearly one third of the global consumption of luxury goods in 2018.²


² 770 Billion RMB, One Third of World Luxury Goods Bought by Chinese, MSN Finance, 26th April 2019, viewed 10th May 2019, <https://www.msn.com/zh-hk/money/news/7700%E5%84%84%EF%BC%81%E5%8E%BB%E5%B9%B4%E4%88%AD%E5%9C%BB%E4%BA%BA%E8%82%B7%E8%85%B0%E4%BA%86%E5%85%A8%E4%B8%96%E7%95%8C1-3%E9%A5%A2%E4%BE%8B%E9%99%88ar-BBWiVgX>
The word ‘luxury’ may be interpreted by some as referring to something useless and wasteful. In fact, it is the opposite. European luxury commodities are renowned for their safety and quality. In particular, the European fashion industry is well known for having high standards for design and manufacturing, and a long history of traditional workmanship. This means that these products are extremely sustainable and retain a high second-hand value.

In addition to exporting safe, high-quality and luxury fashion products to satisfy Chinese consumers’ increasing demands, more European companies are bringing their manufacturing centres to China. These are long-term commitments that will contribute to the Chinese Government’s goal of building China into a global manufacturing leader, and will transform Chinese goods from merely being ‘made-in-China’ to being ‘created-in-China’.

Established in 2016, the Fashion and Leather Working Group is comprised of 11 European fashion and leather enterprises that produce and import high-end apparel, leather bags, suitcases, shoes and other fashion-related products. The working group represents the high-end consumer goods industry when communicating with relevant policymakers on common industry issues. Since its establishment, the working group has actively followed relevant legislative developments and offered recommendations for creating an orderly market environment that protects the rights and interests of consumers.

The Fashion and Leather Working Group contributes directly to satisfying people’s growing needs for a better quality of life, not only through the diversity, beauty and variety of products manufactured in the fashion and leather industry, but also by providing an environment that is focused on safety, environmental protection and innovation. Furthermore, the fashion and leather industry is helping China to increase its global footprint, as it not only manufactures products in China but also involves the country throughout the global supply chain.

Recent Developments

The development of laws and regulations that pertain to textiles, apparel, leather products and other high-end consumables include the following:

Regulations on the Implementation of the Law on the Protection of Consumer Rights and Interests

Following organisational reforms in 2018, the work of drafting the Regulations on the Implementation of the Law on the Protection of Consumer Rights and Interests (Regulations) shifted from the former State Administration for Industry and Commerce to the newly formed State Administration for Market Regulation (SAMR). The responsibility of reviewing the Regulations has been shifted from the former Legislative Affairs Office of the State Council to the Ministry of Justice (MOJ).

Based on the legislative plan of the State Council for 2018, it was expected that the Regulations would be released in 2018, but this has yet to take place. As per the working group’s understanding, the draft Regulations has already been revised and amended several times since a version was published for comments in November 2016, and is now going through the final process with the MOJ. The working group hopes that the Regulations will be released within 2019, and that they will provide clear guidance on how to handle ‘professional shoppers’ (or ‘professional claimers’), a major problem in the industry. The issue of ‘professional shoppers’ will be further elaborated upon in Key Recommendation (KR) 2 of this paper.

Court and Government Documents Pertaining to ‘Professional Shoppers’ or ‘Professional Claimants’

The Supreme People’s Court (SPC) released its Response Opinion on Recommendation No. 5990 (Reply) at the fifth session of the 12th National People’s Congress on 19 May 2017. It clearly states that, “an increasing number of professional consumers and companies (groups) do not have the motive of improving markets, but are profiting or extorting merchants by capitalising on punitive damages; such behaviour is a serious violation of the principle of good faith, an ignorance of the judicial authority, and a waste of judicial resources.” The Reply quickly caught the attention of all sectors of society and, at the same

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4 Though no legal definition has been provided for professional shopper, or professional claimer, in practice it refers to people who buy products in the knowledge that they have defect(s) in order to make multiple compensation claims.

time, had a certain impact on judicial trials as well as administrative and enforcement actions in market surveillance.

The working group was pleased to see that, in October 2018, the former Shanghai Municipal Administration for Industry and Commerce, now the Shanghai Municipal Administration for Market Regulation, jointly issued the Guiding Opinions on Effectively Handling Professional Claimant and Consumer Behaviour to Maintain the Business Environment with six other government departments.6 In April 2019, the Zhejiang Provincial Administration for Market Regulation released similar guiding opinions for public consultation.7 In these two documents, professional claimers and their behaviour are listed as factors affecting the business environment and the orderly operations of enterprises, which puts a strain on limited administrative resources, while damaging the consumer environment and social ethics.

These policies show the attitude of local authorities towards restricting the behaviour of professional claimants. The working group would welcome similar guiding opinions from more local market supervision authorities, or one unified guiding opinion issued by the SAMR that will be applicable in handling professional claimant cases nationwide. This will be elaborated on in detail in Key Recommendation 2.

About Standardisation-related Work

The new Standardisation Law,8 effective since 1st January 2018, has achieved breakthroughs in areas such as the scope and classification of standards, coordination mechanisms, standard management and autonomy in formulating enterprise standards. While the working group has increased confidence in the market-orientated reforms being enacted by the Chinese Government, because the Standardisation Law’s conceptual provisions are not supported by concrete implementation rules, enterprises are still confused about the application of standards. This especially applies to the differences in implementation and regulation concerning these two kinds of standards (mandatory and voluntary). It has been always understood by the working group that compulsory standards are to be mandatorily enforced, whereas voluntary standards should reflect the legislative intent of ‘being voluntary’, instead of being interpreted as ‘quasi-mandatory’ standards.

Between October and November 2018, the SAMR initiated a public consultation on the Administrative Measures for Mandatory National Standards (Draft for Consultation),9 which clearly specifies details of mandatory national standards, such as scope, project setup, standards drafting and technical review. After taking into consideration a wide range of feedback from various groups, the SAMR released the revised Measures for the Administration of Mandatory National Standards (Draft for Review) in February 2019, soliciting further public feedback.

In the Foreign Investment Law,10 passed on 15th March 2019, legislators clearly state that foreign-invested enterprises have equal access to standard-setting work, which the working group hopes will be upheld by relevant authorities. For the fashion and leather industry, in practice, several industry standards and even some mandatory standards (e.g. GB 18401-2010 National General Safety Technical Code for Textile Products)11 are causing concern among companies, as they contain unreasonable criteria that make implementation difficult (more in-depth analysis on this is provided in KR4). The working group hopes that the Administrative Measures for Mandatory National Standards will provide further details on the process of developing mandatory national standards, and authorise foreign-invested enterprises to be involved in the drafting and revision process of such standards, as well as detailing the ways in which they can participate.

Product Quality Law

The existing Product Quality Law was formulated in

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1993 and revised in 2000, both taking place before China’s accession to the World Trade Organization (WTO) in 2001. The volume of product imports at that time was far less than it is today. According to data from the National Bureau of Statistics, China’s annual imports in 1993, 2000 and 2017 amounted to Chinese yuan (CNY) 599 billion, CNY 2 trillion and CNY 12.5 trillion, respectively, which represents remarkable growth since the last revision of the Product Quality Law. As a matter of fact, neither the formulation nor the later revisions of the Product Quality Law could have taken into account how the Technical Barriers to Trade Agreement of the WTO (WTO/TBT) will be implemented (i.e. to limit the applicability of technical norms and mandatory standards to national security, prohibition of fraud, and health, safety and environmental protection), and failed to foresee the market under economic conditions where large quantities of importation takes place. Therefore the law does not provide suitable regulations to respond to this evolvement.

The working group has keenly followed revisions to the Product Quality Law, and has set up several channels to communicate with the relevant authorities and provided recommendations on revisions to the law. In 2019, the SAMR listed the revision to the Product Quality Law as one of the items in its 2019 Legislative Work Plan, and the working group looks forward to, and will participate actively in, public consultations on the draft revision.

Key Recommendations

1. Revisions to the Product Quality Law

1.1 Remove the Abstract Term ‘Unqualified Product’ and Use a Product’s Conformity with Mandatory National Standards as the Criterion for Judging the Qualification Issue and Initiating Administrative Penalties

Concern

As the concept of ‘unqualified products’ has not been precisely defined, its application can cause conflict between enterprises, consumers and local enforcement authorities due to different respective interpretations, which ultimately impacts normal business operations.

Assessment

The existing Product Quality Law uses the concept of ‘unqualified products’ and defines the legal responsibilities of producers and sellers with respect to “selling unqualified products in the name of qualified products”. However, the term ‘unqualified product’ is not expressly defined in the Product Quality Law. In reality, its interpretation can vary depending on different subjects, standards and circumstances (for example, when a product does not fit with any particular standard). Therefore, this vaguely-defined concept can give rise to conflict between enterprises, consumers and local law-enforcement authorities. Furthermore, this practice is not in line with certain provisions of the WTO Agreement on Technical Barriers to Trade (WTO/TBT). For instance, violation of a recommended standard results in classification as an ‘unqualified product’, for which the enterprise is punished; however WTO/TBT only allows mandatory standards to be applied in consideration of national security, prohibition of fraud, and safety, health and environmental protection.

Currently, most countries would consider a product to be ‘unqualified’ if it causes damage to personal or property safety. When comparing foreign and domestic administrative priorities and practices related to product quality, it is clear that the European Union (EU), the United States and other developed countries put more focus on safety-related standards. In the textiles sector for instance, there are more than a hundred safety-based criteria in Europe derived from the General Product Safety Directive (GPSD) and the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH), that deal with carcinogens, mutagens, reproductive toxicity, sensitisation, endocrine disorders and environmental protection; whereas in China there are much fewer chemical standards for fabrics: take carcinogens for example, which has only two related standards – azo and formaldehyde. Due to a
lack of safety standards, China’s market supervision and inspection authorities are not sufficiently able to protect consumers’ health and safety. Meanwhile, the current government regulatory focus is more on non-safety-related standards, hindering innovation and the development of the industry overall.

The new Standardisation Law clarifies that standards are to be mandatorily enforced, whereas the government generally encourages the adoption of voluntary standards;\(^\text{20}\) furthermore, it also limits administrative responsibility for violations of mandatory national standards.\(^\text{21}\) This is a critical step in making administrative management more efficient and aligned with international practices, as it provides guidance for the revision of the Product Quality Law. The working group welcomes the accurate scoping of recommended standards in the new Standardisation Law. Accordingly, the working group recommends that revisions to the Product Quality Law are aligned with the new Standardisation Law, and that voluntary standards are indeed, by definition, ‘voluntary’, to resolve current challenges faced by the industry:

Challenge 1: Current recommended standards are numerous and categorised in different systems (such as local enterprise, industry enterprise). In some cases, different standards and regulations are misaligned or conflict with one another. As a result, it is challenging and burdensome for enterprises to accurately determine the applicable voluntary standards.

Challenge 2: Despite the large number of voluntary standards, they do not actually address certain special characteristics of specific products. For example, the generalised assessment indicators for the colour fastness of products in QB/T1333 Handbag and Knapsack—the widely applied standard for handbag and knapsack products—does not take into account the special characteristics of suede materials, which has led to significantly differing opinions among many experienced testing agencies on whether the colour fastness of suede handbags and knapsacks meet the standard. Some enterprises have faced administrative penalties as a result, which has provided a basis for professional shoppers to purchase such products with the ulterior motive of demanding large amounts of compensation. It was not until 2018—eight years after the voluntary standard was issued—that special regulations accounting for the special characteristics of suede materials were included in a revised draft. In view of the sheer number of voluntary standards, revising them with the support of enterprises or other societal organisations to take into consideration the special characteristics of all products will be an extremely onerous task.

Challenge 3: Strict enforcement of voluntary standards can hinder enterprises from innovating and improving their product quality and production efforts. Voluntary standards include requirements and assessment methods for specific characteristics of detailed product types, and are significantly influenced by the features of existing products, raw materials and technologies. In an effort to attain sustainable development, guided by environmentally-friendly philosophies, a significant number of enterprises have invested in developing new raw materials and innovation of manufacturing processes and technologies. Enterprises that engage in technological innovation and choose non-harmful natural colourants that do not harm the environment over artificial synthetic chemical colourants may face the risk of administrative penalties and professional claimants capitalising on the opportunity to profit, as detailed in Challenge 2. This leads to some enterprises opting to not pursue this path of innovation and improvement in order to avoid such risks, which in turn hinders the drive towards creating and sustaining a natural, green environment free from harmful substances. The working group believes that this goes against the original objectives and spirit of the Product Quality Law, which is supposed to improve product quality.

In the second and third challenges detailed here, if the Product Quality Law uses voluntary standards as a recommendation and reference—and an enterprise’s civil liability can be based on whether a product or its description actually misleads consumers and causes them losses—it would be more in line with China’s legal principles that administrative laws uphold justice, and punishment is proportional to the damage caused. Such

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\(^\text{21}\) Ibid, articles 36 and 37.
application of the law would give enterprises more room to innovate independently and raise product quality, and would also be in line with the current reform blueprint for simplifying administrative procedures.

Recommendations

- Use a product’s conformity with mandatory national standards as criteria for judging the qualification issue and limit administrative enforcement and penalties to violation of mandatory standards.
- Properly position voluntary standards so that they do not form the basis for administrative penalties.
- Lift enterprises’ liability for administrative punishment in the event that they do not meet the claimed recommended standards but should bear civil liability according to law.

1.2 Clearly Define Balanced Penalties According to the Scale of Infringement

Concern
Legal responsibilities are imprecisely outlined in the current Product Quality Law, resulting in unbalanced penalties for infringements and uneven enforcement across different jurisdictions, which has a significant impact on legal predictability.

Assessment
Product issues vary greatly, and even if a product has violated mandatory national standards, there is often a large disparity between the extent to which the law has been violated and the damages caused to the consumer. The existing Product Quality Law vaguely lists a range of penalties for a variety of infringements, ranging from 50 percent to three times the value of the goods in question. Although the law tries to differentiate between labelling issues and products not meeting the requirements for ensuring personal and property safety, it does not specify the assessment standards, nor where penalties differ. This poses a large challenge for law enforcement agencies when it comes to assigning penalties according to the type of infringement committed, leading to unbalanced penalties being handed down and uneven enforcement across different jurisdictions, which significantly impacts legal predictability.

It is necessary to have mandatory national standards for technical requirements with respect to personal health and the safety of life and property, national security, environmental safety and the management of the economy and society. However, a great number of current mandatory national standards include norms that are both relevant and irrelevant to safety. Therefore, a product that is in violation of mandatory national standards does not necessarily harm personal health or endanger the safety of life and/or property.

Infringements can be classified according to their severity and the subjective malice of the enterprise in order to be punished with corresponding penalties, including fines ranging from heavy to light, as detailed in Table 1.

<table>
<thead>
<tr>
<th>Infringement of mandatory national standards</th>
<th>Suggested penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) The infringement endangers people or their property</td>
<td>Current penalties should be retained or even increased</td>
</tr>
<tr>
<td>2) The infringement does not endanger people or their property but may impact a consumer’s purchasing decision</td>
<td>Current penalties should be reduced (a proper ceiling can be established)</td>
</tr>
<tr>
<td>3) The infringement concerns only substandard labelling issues and neither endangers people or their property nor impacts a consumer’s purchasing decision</td>
<td>Penalties should be abolished and companies required to correct their mistakes instead</td>
</tr>
</tbody>
</table>

Recommendation

- Proportion punishments, ranging from heavy to light, according to the severity of a product’s infringement, with fines being scaled accordingly:
  - Current penalties should be retained, or even increased, for infringements that endanger people’s lives or their property.
  - Current penalties should be reduced for infringements that do not endanger people’s lives or their property but may impact a consumer’s purchasing decision, with a proper ceiling for fines to be established.
  - Current penalties for goods that have substandard labelling should be abolished, and replaced with an order for mistakes to be corrected.

Concern
There is currently no effective national-level legislation to deal with ‘professional shoppers’, who hinder enterprises’ normal operations and waste administrative and legislative resources.

Assessment
Professional shoppers not only hinder the normal operations of an enterprise but also waste administrative and legislative resources. In the absence of proper legislation to contain their behaviour, they will continue to affect market order and further impact consumers’ normal interests.

The majority of lawsuits and administrative cases involving ‘professional shoppers’ concern a product’s labelling instead of its quality. While substandard labelling of commodities can cause consumers many problems, these issues are not significant in comparison to those caused by counterfeit products that endanger personal safety and/or property. It would therefore be beneficial for the government to invest its limited public resources in cracking down on the production and sale of counterfeit products instead.

So-called professional shoppers exploit goods for the purposes of making money and are not concerned with the actual quality of the product. Some professional shoppers, after obtaining private compensation, will not intervene to have the defected product removed from the market, allowing a problematic product to continue to damage the rights and interests of consumers. Some professional shoppers even blackmail enterprises to attain easy money. Ultimately, professional shoppers do not play any part in enhancing the market. Rather, they constantly raise complaints and file lawsuits using judicial institutions to claim compensation from enterprises.

Because professional shoppers purchase commodities with the aim of identifying product flaws they can exploit, they should not be classified as ‘consumers’ under the Consumer Protection Law. This is because they are already fully aware of the defects in the commodities in question before they make a purchase, so the claim that they are not properly informed by the seller is not true. They should therefore be not eligible protection under the Consumer Protection Law.

Some courts have already rejected appeals from professional shoppers and have supported opinions such as “purchasing for profit-making is not a consumer behaviour” and “professional shoppers are not deceived subjectively because they are already aware of the commodities with defects before they make a purchase”, but this is not the general consensus among judges nationwide as yet.

The working group recommends that legislators issue implementation rules for the Consumer Protection Law and related judicial interpretations in a timely fashion to provide unified legal guidance for administrative organisations, law enforcement and judicial authorities. The working group notes that market supervision authorities in Shanghai and Zhejiang Province have already issued or formulated relatively detailed guidelines pointing out ways to identify professional claimers and the process for dealing their complaints and reports. Hence, local law enforcers in these areas can be clearly guided by the same criteria when handling similar cases. These local policies in Shanghai and Zhejiang could be used as examples for government authorities in nearby areas in handling professional claimer case. This will give additional confidence and predictability to enterprises dealing with professional shoppers in these localities.

Meanwhile, the working group also notes that some professional shoppers have shifted their targets from offline to online business, which should be taken into consideration in future changes to related legislation.

Recommendations
• Issue the implementation rules for the Consumer Protection Law
• See footnotes 5 and 6.
Protection Law and related national judicial interpretations in a timely fashion, providing guidance on legal precedents.

- Exclude ‘professional shoppers’ from being classified as ‘consumers’ under the Consumer Protection Law.
- Clarify that product mislabelling that neither endangers personal safety or property nor misleads the consumer is not fraud, and therefore not applicable to the punitive damages clause of Article 55 of the Consumer Protection Law.
- Encourage more local market supervision authorities to issue detailed guidelines on dealing with professional shoppers to further improve the business environment.

3. Clarify the Punishments Handed Down to Laboratories and Testing Institutes That Submit Fake or Partial Test Reports

Concern
Many laboratories and testing institutes collaborate with professional shoppers to purposely falsify and submit incomplete test reports which prevents fair and impartial enforcement and results in reputational damage and commercial loss for the company affected.

Assessment
In recent years, many laboratories and testing institutes have, in collaboration with ‘professional shoppers’, failed to conduct impartial testing in compliance with national laws and regulations. More specifically, they do the following:

- Issue an informal document that includes a report without any authorisation or accreditation from competent authorities like the China National Accreditation Service for Conformity Assessment (CNAS). These documents are issued subjectively by the testing institutes without being rooted in any legal basis and are used by professional shoppers to blackmail the business.
- Issue a testing report without accreditation from the China Metrology Accreditation System or authorisation from CNAS. Some institutes even issue illegal reports using nonstandard methods, internal methods or subjective methods without any prior testing.
- Purposely falsify or submit incomplete reports against producers or sellers based on the results of a fake test.
- Show preference to the test commissioning party instead of dealing with the case with rigorousness and impartiality. Some submitters deliberately send badly-maintained or damaged products to test, and test agencies deliberately use certain methods with a limited frame of reference. Based on such a report on ‘disqualified product’, the submitter requires damage compensation or even blackmails the company.

As local administrative bodies and courts often use the reports from laboratories and testing institutes as the basis for administrative punishment and civil verdicts, it is urgent that the regulation of these agencies be improved, the process of individual submitter for a test be regulated and standards applied by testing institutes be clarified.

Recommendations
- Increase punishments handed down to laboratories and testing institutes that commit infringements.
- Require laboratories and testing institutes that falsify or issue false reports to provide economic compensation to any parties that they have caused reputational or economic loss to.
- Revoke the practicing licences of those that commit serious infringements.


Concern
Issues of colour fastness and peculiar smells are not safety-related concerns and therefore sit outside the definition of mandatory national standards as stated in the new Standardisation Law, meaning that the enforcement of related requirements under the law are unnecessary, and are hindering the development of innovative techniques in the textile industry.

Assessment
The new Standardisation Law expressly states that “mandatory national standards should be imposed for technical requirements that safeguard personal health, life and property safety, national security, ecological environment security and meet the basic needs of economic social management”, and that “mandatory

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The working group commends the relentless efforts made by the Chinese Government to boost standardisation reform. However, the working group also notes that current mandatory national standards still contain requirements that are irrelevant to “safeguarding personal health, life and property safety, national security, ecological environment security and meeting the basic need for the management of economy and the society”.

This causes misunderstandings among enterprises, consumers and law enforcement officers in instances when the actual contents of mandatory national standards conflict with those of the new Standardisation Law, such as the requirements for colour fastness in the mandatory national standard GB 18401-2010 National General Safety Technical Code for Textile Products. The colour fastness of a textile product refers to a colour’s resistance to fading during its production or over the period of use. It is a performance index and will not directly impact personal health, life or property safety. In other words, the only concern should be whether the dye materials or solid dyeing processes are safe, which should be, and are, managed and controlled by related laws and regulations or standards (as specified in Table 2).

Table 2

<table>
<thead>
<tr>
<th>Name of standard/law and regulations</th>
<th>Formulated by</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quantity Limit and Measurement of Heavy Metal Elements in Dye Products in GB 20814-2014</td>
<td>Ministry of Industry and Information Technology (MIIT)</td>
<td>Effective</td>
</tr>
<tr>
<td>Quantity Limit and Measurement of 23 Types of Harmful Aromatic Amine in Dye Products in GB 19601-2013</td>
<td>MIIT</td>
<td>Effective</td>
</tr>
<tr>
<td>Quantity Limit and Measurement of Aminoaazobenzene in Dye Products in GB/T 24101-2009</td>
<td>MIIT</td>
<td>Effective</td>
</tr>
<tr>
<td>Quantity Limit and Measurement of Carcinogenic Dyestuffs in Dye Products in GB/T 37040-2018</td>
<td>SAC</td>
<td>Imminent implementation</td>
</tr>
<tr>
<td>Quantity Limit and Measurement of Allergic Dyestuffs in Dye Products in GB/T 36908-2018</td>
<td>TC134</td>
<td>Imminent implementation</td>
</tr>
<tr>
<td>Quantity Limit and Measurement of Aminoaazobenzene in Dye Products in GB/T 24101-2018</td>
<td>TC134</td>
<td>Imminent implementation</td>
</tr>
<tr>
<td>Quantity Limit and Measurement of Polychlorinated Biphenyls (PCBs) in Dye Products in 20180915-T-606</td>
<td>TC134</td>
<td>Draft</td>
</tr>
<tr>
<td>Quantity Limit and Measurement of Polychlorinated Benzene in Dye Products in 20180905-T-606</td>
<td>TC134</td>
<td>Draft</td>
</tr>
<tr>
<td>New Chemical Substances Environment Management Method</td>
<td>Ministry of Ecology and Environment (MEE)</td>
<td>Effective</td>
</tr>
<tr>
<td>List of Toxic Chemicals Strictly Limited in China</td>
<td>MEE</td>
<td>Effective</td>
</tr>
<tr>
<td>List of Hazardous Chemicals</td>
<td>Ministry of Emergency Management (MEM)</td>
<td>Effective</td>
</tr>
<tr>
<td>Measures on the Registration Administration of Hazardous Chemicals</td>
<td>MEM</td>
<td>Effective</td>
</tr>
<tr>
<td>Regulations on the Safety Administration of Hazardous Chemicals</td>
<td>State Council</td>
<td>Effective</td>
</tr>
</tbody>
</table>


Many ecological, organic dyestuffs have remarkable safety performance, despite having only ordinary colour fastness, and are welcomed by consumers. In the laws and regulations related to textile products in other countries, colour fastness is included in the standards, regulations or certifications that are voluntarily adopted by an enterprise and are not subject to compulsory enforcement. For instance, in the EU, issues concerning personal health and the safety of life and property are subject to laws and regulations (e.g. REACH manages the registration, evaluation, authorisation and restriction of chemicals, and the GPSD manages the safety of all consumables directly supplied to consumers), whereas issues concerning durability or practicality of products are fully subject to the market. Only certain certifications have requirements on dyeing fastness (such as the accreditation of OEKO-TEX Standard 100 for ecological textiles), which only apply when enterprises have voluntarily adopted the standard, or when required in procurement contracts as the colour fastness requirement in Europe. This standard does not take safety into account, as the safety of the raw dyeing materials have already been guaranteed via REACH. If a non-safety performance index, such as colour fastness, is included in a mandatory national standard, which is not in compliance with the definition of mandatory national standards as stated in the new Standardisation Law, the textile industry may be confused about which standards to follow, hindering their development.

Likewise, the requirements for peculiar smells are still included in the GB 18401-2010 National General Safety Technical Code for Textile Products, which is irrelevant to personal health, life and property safety and should be removed accordingly.

Recommendations

• Revise the mandatory national standards in the GB 18401-2010 National General Safety Technical Code for Textile Products in accordance with the definition of mandatory national standards as stated in the new Standardisation Law, and remove the requirements on colour fastness and peculiar smells.

• Increase the number of chemical safety standards that properly safeguard personal health, life and property safety in line with international market practices.

• Improve, in a timely manner, the formulation and revision of the technical standards on the safety of raw materials in the textile industry.

5. Introduce the Implementation Rules of the E-commerce Law to Clarify the Liability and Responsibility of Social Platforms with E-commerce Functions with Regard to the Spread and Sale of Fake Products

Concern
Because of low entry thresholds, and the lack of corresponding supervision, the spread and sale of fake products on some social media platforms that have e-commerce functions is becoming increasingly serious, which is significantly harming the interests of both brand owners and consumers.

Assessment
In addition to established e-commerce platforms, some social media platforms are now offering e-commerce functions. For example, WeChat Moments, public accounts and mini programs enable merchants to showcase their products, exchange information and settle payments. As social media platforms offer easy entry and lack corresponding monitoring mechanisms, it has become an ideal place for the distribution of counterfeit products, taking over from e-commerce platforms that were previously favoured for this practice. Counterfeit distributors have managed to establish a presence in various social media platforms in China and overseas, which has helped rapid distribution of these counterfeit goods. This badly damages the interests of brands, enterprises and consumers. As existing laws and regulations do not set out explicit responsibilities for social media platforms with respect to selling fake products, both law enforcers and the intellectual property (IP) owners lack the framework for dealing with counterfeiters.

According to the E-commerce Law, social media platforms should in fact establish IP rules. Yet many platforms either have no rules, the rules are so vaguely described that they are hard to implement, or the level of punishment is too low to actually deter distributors of counterfeit goods.


Additionally, Article 43 of the E-Commerce Law on counter-notification is also of concern for IP owners. Countless numbers of IP infringements currently take place on social media networks and platforms, and if complaints were lodged with the competent authorities or judicial procedures had to take place for every counter-notice, the efficiency of protection would plummet while costs for IP owners would soar, resulting in a waste of enforcement and judicial resources.

Recommendations
- Issue detailed standards defining the liabilities for the sale of counterfeit goods on social media platforms.
- Classify platforms according to modes of control, methods of data access and technical features and set up proper administrative measures.
- Remove Article 43 in the E-Commerce Law on counter-notification.
- Formulate policies that force platforms to improve their rules on IP protection, and encourage platforms to proactively take stronger management measures to deal with cases of apparent IP infringement.


Concern
The Information Security Technology: Personal Information Security Specification, is difficult for many non-internet infrastructure operators/traditional industries to apply as it has too many requirements, which increases enterprises’ operating costs and ultimately undermines the consumer experience.

Assessment
The Information Security Technology: Personal Information Security Specification demands too much in terms of the content and format of privacy policies, as well as the transfer, sharing, assignment and processing of personal information. For example, it requires enterprises to carry out an inspection on its business partners (who will process the data for the enterprise), and to inform personal information owners of the type of sensitive personal information involved in the data process, the identity of the party receiving the data, and its ability to protect the data. The enterprise also needs to get the personal information owner’s consent to have their data processed in advance.

When a third party has access to the collected information, the enterprise must require the third party to equip their products or services with a system for responding to the requests or appeals of the personal information owner. The third party must also provide proper storage and perform timely updates of the collected information in a manner that allows the personal information owner to view and modify it. Enterprises should also supervise and oversee the third-party to enhance security management of personal information, and ensure timely rectification if the third party fails to implement the security management requirements and responsibilities.

During daily operations, the above requirements may be difficult to implement or greatly increase the cost of manpower for enterprises. Particularly in the case of online direct sales to consumers (B2C), privacy policy notices that frequently pop up in windows (to meet the above requirements, multiple pop-ups may need to be set) affect the consumer experience and do not truly result in protection (for instance, when consumers close pop-up windows on reflex to get rid of them without reading them). Enterprises believe that as long as they provide users with clear and easily understood notices on complete information on data collection, usage, transfer and sharing through their privacy policies or other personal information-related policies, with key information highlighted, and provided users check the boxes on their own initiative, then they are complying with the privacy policy as required. Furthermore, a guarantee of user convenience in modifying or deleting data should be enough to supplement the aforesaid obligations of the enterprise in the protection of personal privacy information.

Recommendations
- Streamline the requirements for privacy policies provided in the Information Security Technology: Personal Information Security Specification, after fully considering the feasibility and consumer experience.
- Allow the use of contracts to specify the privacy protection responsibilities and obligations between an enterprise and its business partners.
Abbreviations

B2C  Business to Consumer
CNAS  China National Accreditation Service for Conformity Assessment
CNY  Chinese Yuan
EU  European Union
GPSD  General Product Safety Directive
IP  Intellectual Property
KR  Key Recommendation
MEE  Ministry of Ecology and Environment
MEM  Ministry of Emergency Management
MIIT  Ministry of Industry and Information Technology
MOJ  Ministry of Justice
PCB  Polychlorinated Biphenyls
REACH  Registration, Evaluation, Authorisation and Restriction of Chemicals
SAC  Standardisation Administration of China
SAMR  State Administration for Market Regulation
SPC  Supreme People’s Court
TBT  Technical Barriers to Trade
WTO  World Trade Organization
Key Recommendations

1. **Strengthen Scientific Assessments and Market Forces in the Procurement of Medical Devices**
   1.1 **Adopt Value-based Approaches in the Procurement of Medical Devices, Promoting the Adoption of Health Technology Assessment (HTA) in the Procurement Process**
      - Create a solid database evaluating the clinical effects of different medical devices, and establish a HTA mechanism based on international multi-centre clinical evidence.
   1.2 **Unify the Different Diagnostic-related Group (DRG) standards and Adopt Stepwise Implementation**
      - Establish a national unified standard for DRG, including definitions of diseases, definitions of parameters and cost factors within the DRG, data acquisition and processing, as well as supervision of expenses and quality of treatment.
      - Roll out DRG gradually, starting with reliable cost factors, build up a database of cost-factors step-by-step, update the DRG database regularly to keep pace with the development of new medical technologies and allow the application of innovative treatment methods outside the DRG scheme.
      - Establish an authoritative body to develop a nationwide DRG system, supervise its operation and initiate improvements when necessary.

1.3 **Limit Administrative Interference in the Distribution of Medical Devices**
   - Avoid administrative mandatory price cuts in the procurement of medical devices.
   - Limit the scope of local ‘two-invoice systems’ to pharmaceuticals, as required by the Healthcare Reform Bureau of the State Council.
   - Maintain the right of manufacturers (and importers) to select the most suitable distributors in order to provide optimal services to hospitals without restricting the number or business location of distributors.
   - In the event a ‘two-invoice system’ is implemented in a province or municipality:
     - Allow a Marketing Authorisation Holder (MAH) who is not in possession of a medical device trading licence to authorise the physical manufacturer or a general agent, without counting this transaction as an ‘invoice’.

2. **Increase the Efficiency of Medical Device Evaluations and Market Approval**
   2.1 **Accept Manufacturers’ In-house and Third-party Type Testing Reports for Registration**
      - Allow enterprises to select qualified testing institutes, and do not limit the type of laboratory qualification.
      - Accept the latest version of the international standard in-house or third-party test reports.
   2.2 **Streamline Regulations on Clinical Requirements for Medical Device Registration**
      - Keep in line with the requirements of clinical evaluation and clinical trial stipulated in the International Medical Device Regulators Forum (IMDRF) relevant documents.
      - Accelerate the amendment of the *Guiding Principles of Clinical Evaluation of Medical Devices*.
and simplify the requirements for identifying "substantive equivalent" medical devices.

- Harmonise China’s Good Clinical Practices for Medical Devices with internationally recognised standards.
- Harmonise clinical evaluation reports of medical devices between China and Europe.
- Leverage international practice on ‘pre-submission’ for clinical investigation protocol (CIP) to ensure clinical investigations meet the requirements for cost and time effectiveness.

2.3 Reduce Administrative Requirements that Do Not Increase the Safety and Efficacy of Medical Devices
- Remove the requirement for the country of origin certificate (pre-market approval).

3. Deepen Standardisation Reform in the Medical Device Industry
- Shorten the time interval between international standard updates and corresponding adoption in China standards.
- Accelerate the execution of related standards after the adoption of international standards.
- Strengthen the integration of scientific and technological research and development, standards development and industrial development, and upgrade the standard technology level with scientific and technological innovation as the driving force.
- Expand the scope of standardisation reform to exempted areas (especially medical devices) to integrate and streamline mandatory medical device standards.
- Reduce the requirement of product performance parameters in mandatory standards.
- Rationalise, in the process of standards reform, the conformity of products that have gaps with mandatory standards, but have been on the market for a long time and have therefore been proven safe and effective by clinical use.

4. Fully Implement the State Council Notice on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment
- Examine existing government procurement measures to see contents which are out of step with State Council Document No. 5.
- Emphasise that local health commissions and hospitals shall prioritise patients and clinical needs in procurement consideration and adopt more science and value-based measures.
- Eliminate regulations that prevent access to local markets as well as fair and equal competition.
- Strengthen the implementation of the Anti-monopoly Law, and avoid administrative interference in the procurement process that renders fair market competition impossible.

5. Improve the Regulatory Framework for Adverse Events Reporting and Monitoring
- Ensure adverse events reports from healthcare institutions are authentic and accurate.
- Clarify the scope of validity of the Regulation on Medical Device Adverse Events Monitoring and Re-evaluation, and ensure that provincial authorities follow these regulations.
- Allow oversea MAHs to use the existing Periodic Risk Evaluation Reports (PRERs) as long as all products in the Chinese registration certificate are covered and the data is complete.

6. Promote Market Access for High-precision and Innovative In-vitro Diagnostics (IVDs)

6.1 Promote Market Access of Diagnostic Reagents with High Levels of Reliability and Accuracy
- Include different diagnostics methods and technologies in provincial procurement catalogues.
6.2 Shorten the Time for Modification of Registrations of IVD-reagents

- Establish a notification pathway for some simple, non-critical modifications, such as modified packaging and changes to the instructions for use (IFU).
- Establish a unified procedure for domestic and imported IVD-reagents to allow for a change of site of manufacture through a notification to the responsible Medical Products Agency (MPA).
- Establish a simple, fast-track procedure for evaluating and approving modifications.

6.3 Re-classify IVD Reagents

- Refer to international rules of classification and continue to reclassify low-to-moderate risk IVD products into Class I or II.

Introduction to the Working Group

Medical devices, including in-vitro diagnostics (IVD), play a crucial role in the prevention, diagnosis and treatment of diseases, while supporting and monitoring the convalescence of patients in hospitals, clinics and those undergoing homecare. Therefore, medical devices are key to improving the overall health of the population as laid down in the strategic plan Healthy China 2030.1 Members of the European Chamber’s Healthcare Equipment Working Group invest heavily to develop innovative treatments, and fully support the government’s efforts to ensure patients’ access to state-of-the-art, safe, efficacious and affordable medical devices. They maintain this commitment by investing in modern Chinese research, development and production facilities, as well as in the education of Chinese doctors and healthcare professionals. The working group consists of 90 companies—from multinationals to small and medium-sized enterprises—that develop and manufacture indispensable, lifesaving and disease-reducing diagnostic and therapeutic technologies.

The working group has established contact with major stakeholders both in China and in Europe. It organises regular meetings with the China National Drug Administration (CNDA), as well as health security administrations (HSAs) and health commissions at different government levels to get first-hand information on regulatory and healthcare policy developments, and to present suggestions from the European medical device industry.

To enhance international cooperation, in 2007, the working group established contact with the European Coordination Committee of the Radiological, Electromedical and Healthcare IT Industry (COCIR), a major medical technology industry association based in Europe. In April 2014, the European Chamber founded the Consumable and Medical Devices (CDMD) Advisory Committee, a group consisting of Chinese subsidiaries of international market leaders in the field of consumable medical devices and IVD. This advisory committee has since founded two subgroups—regulatory affairs and government affairs.

The Healthcare Equipment Working Group wishes to continue to engage in a constructive dialogue with all relevant government agencies, both at the national and provincial/local level in China.

Recent Developments

Healthcare reform remains at the top of China’s agenda. In March 2018, the National Health and Family Planning Commission (NHFPC) was transformed into the National Health Commission (NHC); subsequently the institutional reform was implemented at the provincial and municipal level. The responsibility for health insurance was separated from the Ministry for Human Resources and Social Security and transferred to the National Healthcare Security Administration (NHSA), also established in March 2018. The founding of a special government body for healthcare security separate from the rest of the social security system shows just how much the sector has been prioritised in China. In addition to overseeing public health insurance, the NHSA will play a decisive role in hospitals’ procurement of disposable medical devices and IVD, taking this responsibility from the NHC.

The underlying challenges to China’s healthcare
system—a rapidly ageing population and an increase of chronic, expensive diseases—have become even more prominent. In 2017, China’s overall public health expenses reached Chinese yuan (CNY) 5.23 trillion, up from CNY 4.63 trillion in 2016, an annual increase of 13.3 per cent, and well short of the former NHFPC’s target to limit the increase of expenditure to a maximum of 10 per cent per year.

Most provinces and healthcare trial cities have promulgated procurement regulations for disposable medical devices and IVD, with many of these regulations focusing largely on reducing costs. In an extreme case, Zhejiang HSA required a price-cut of 20 per cent based on the lowest price offered in China.

The working group supports the government’s efforts to keep the increase of expenditure at a reasonable rate of approximately 10 per cent annually. However, only focusing on the purchase price of medical devices may compromise the quality of treatment. Using lower quality medical devices (often equating to a product’s shorter life span) may lead to increased, not lower expenses. The working group advocates for a value-based approach in tendering (contrary to price-based), taking into account the overall benefits and expenses of a treatment.

In 2017, health authorities in China started to promote new approaches, for example case-based payment and diagnostic-related groups (DRG) for hospital payment, as well as tiered-hospital services, encouraging patients with non-serious diseases to visit a general practitioner or a district hospital. These new forms of healthcare administration are similar to those in operation in many European countries. How they will work out in China, in terms of both improving quality of care and controlling expenses, remains to be seen.

Regulatory Environment
In October 2017, the former China Food and Drug Administration (CFDA) initiated a public consultation on the Amendment of the Provisions on Medical Device Supervision (Order 680), with a second round of consultations, led by the Ministry of Justice (MOJ), following in June 2018. Promulgation of the amended version is expected in the second half of 2019. When this amendment comes into force it will pave the way for formulating a series of reform documents aiming at accelerating market access for new and innovative medical devices. While the main reforms of the registration system can only be finalised after promulgation of Order 680, the National Medical Products Administration (NMPA) and the Centre for Drug Re-evaluation are concentrating their efforts on strengthening management of adverse events reporting, with a total of eight related guidelines expected to come into force in 2019.

In 2018, for the first time, China played host to the International Medical Device Regulators Forum (IMDRF), the highest international regulatory body for the industry. This shows China’s growing influence in the international regulatory sphere. Within the framework of the IMDRF, the NMPA has started a series of international initiatives. The working group expects that the NMPA will become increasingly involved in international bodies, which will lead to a convergence of standards and regulatory requirements in China, Europe and other major markets.

Key Recommendations
1. Strengthen Scientific Assessments and Market Forces in the Procurement of Medical Devices
   1.1 Adopt Value-based Approaches in the Procurement of Medical devices, Promoting the Adoption of Health Technology Assessment (HTA) in the Procurement Process

Concern
The procurement policies for disposable medical devices are one-sided, with the aim of reducing the purchasing price while neglecting the total costs of treatment, lifecycle costs of medical devices and the variance in clinical requirements for different patients.

Assessment
Because of a lack of tools and established methods to

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evaluate the clinical use of medical devices, procurement authorities tend to adopt a ‘price decides all’ approach. However, to satisfy the increasing demands of the population for first-class healthcare, and to reach the targets set in Healthy China 2035, more elaborate approaches need to be adopted.

In China, centralised purchasing started in 2002, and was rolled out nationwide in 2011. Since then, several rounds of price negotiations have eliminated the most unreasonable price mark-ups. However, in the same period, only very limited research has been done on assessing the clinical value of medical devices.

The price of medical devices should not be the main criteria for clinical use. Procurement of the most suitable devices may actually decrease the overall healthcare expenses. In the last few years, HTAs, life-cycle costs and value-based payment have become hot topics in the international medical community. For example, in January 2018, the European Union (EU) initiated a programme on HTAs. However, similar initiatives have not yet been developed in China on procurement policies.

Medical devices differ from pharmaceuticals, in that there are very few identical medical devices. To decide which one will bring the best result depends largely on the individual medical condition of a patient. This requires comprehensive post-market clinical studies and corresponding databases to be created. To increase the number of cases and reliability of clinical data, product and technology assessments require international cooperation between all major stakeholders: healthcare authorities, hospitals and manufacturers.

Recommendation

- Create a solid database evaluating the clinical effects of different medical devices, and establish a HTA mechanism based on international multi-centre clinical evidence.

### 1.2 Unify the Different DRG standards and Adopt Stepwise Implementation

**Concern**

In China, conditions are not ripe for a short-term application of DRG in hospital payments as there is no unified standard for DRG and no reliable data about the expenses for treatment of diseases, which may lead to miscalculation of payments for treatment, resulting in under-funding of hospitals and possibly a deterioration in the quality of medical services.

**Assessment**

Most developed countries have been using DRG since the 1980s. In China, there are more than 10 different DRG variants that have been used in about 20 small-scale trials. Up to now, Chinese hospitals have been charging patients based on lists of specific service items; there is no holistic approach to calculate the expenses for different patient groups and different grades of severity of diseases. This kind of data would form the basis for a well-functioning DRG-based payment scheme; however, hospitals in different regions of China have varying cost structures, making it difficult to merge existing data.

To ensure correctness of data entry for DRG, supervision (either human or automated) will be necessary, yet so far there exists no concept on how to realise such supervision. Expenses for treatment change continuously, caused by salary increases and varying purchasing prices of pharmaceuticals and medical devices, but mostly because of the development of new medical technologies. This requires that DRG databases are regularly maintained. Patients should get access to new medical technologies as soon as possible, so it is important that the acquisition of complex data necessary for the application of DRG should not delay the introduction of new treatment methods.

**Recommendations**

- Establish a national unified standard for DRG, including definitions of diseases, definitions of parameters and cost factors within the DRG, data acquisition and processing, as well as the supervision of expenses and quality of treatment.
- Roll out DRG gradually, starting with reliable cost factors, build-up a database of cost-factors step-by-step, update the DRG database regularly to keep pace

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with the development of new medical technologies and allow the application of innovative treatment methods outside the DRG scheme.

- Establish an authoritative body to develop a nationwide DRG system, supervise its operation and initiate improvements when necessary.

1.3 Limit Administrative Interference in the Distribution of Medical Devices

Concern
Disproportionate administrative interference in pricing and distribution channels—especially mandatory price cuts, restricting the number of distributors and the application of the ‘two-invoice system’ to medical devices—may deprive hospitals from state-of-the-art treatment methods, as well as know-how in service and training.

Assessment
Some provincial authorities use their administrative power to order mandatory price cuts. In March 2018, the Zhejiang HSA published a document for public consultation, requiring that, during tendering, consumable devices must be offered at a price 20 per cent below the previous minimum price, otherwise the offer will automatically be rejected. According to articles 18 and 19 of China’s Price Law, the government can determine prices of important public welfare services, and the relevant services must be listed in a pricing catalogue approved by the central government. However, disposable medical devices are neither part of the central pricing catalogue published in 2015 by the National Development and Reform Commission, nor in the newest 2018 version of the pricing catalogue issued by Zhejiang Province. If this requirement is enforced, there is a high risk that high-quality medical devices that are urgently needed by hospitals will no longer be available on the provincial market.

The ‘two-invoice system’ is the direct English translation for a set of regulations that limit the number of distributors of medical devices. The manufacturer (or in the case of imported products, the importer) sells their products to a distributor (first invoice), with the distributor then selling directly to the hospital (second invoice). According to the ‘two-invoice system’, secondary distributors are not permitted. Local distributors of medical devices provide valuable services to hospitals, including training, commissioning of devices necessary for surgery, maintenance and repair. Before a distributor can be qualified, intense training is required. This service needs to be close to the customer, therefore a rigid ‘two-invoice system’ may prevent the manufacturer from selecting the most suitable distributors.

Starting in 2017, several provinces and healthcare reform trial cities started to promulgate their own local ‘two-invoice systems’, sometimes with additional restrictions to the number of distributors. For example, in Fujian, each manufacturer may appoint a maximum of two distributors per district, a requirement that is very difficult for manufacturers with a wide range of different products to meet.

The working group acknowledges the need to reduce unjustified mark-ups in the supply chain and the need to eliminate corruption. However, there are sufficient tools, like case-based payment and transparent centralised procurement, to reach these goals.

Recommendations
- Avoid administrative mandatory price cuts in the procurement of medical devices.
- Limit the scope of local ‘two-invoice systems’ to pharmaceuticals, as required by the Healthcare Reform Bureau of the State Council.
- Maintain the right of manufacturers (and importers) to select the most suitable distributors in order to provide optimal services to hospitals without restricting the number or business location of distributors.

In the event a ‘two-invoice system’ is implemented in a province or municipality:
- Allow a MAH who is not in possession of a medical device trading licence to authorise the physical manufacturer or a general agent, without counting this transaction as an ‘invoice’.

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2. Increase the Efficiency of Medical Device Evaluations and Market Approval

2.1 Accept Manufacturers’ In-house and Third-party Type Testing Reports for Registration

**Concern**

In 2017, the then CFDA promulgated a series of promising documents on the reform of medical devices supervision, including acceleration of type testing, however the legislative procedure, with the amendment of Order No. 680 at its core, has not yet been completed.

**Assessment**

On 25th June 2018, the MOJ initiated a public consultation on the draft Regulations of the Supervision and Administration of Medical Devices (amendment of Order No. 680).9

The working group is pleased to see that the draft amendment of Order No. 680 states that, “the product testing report may be the self-inspection report of the medical device registration applicant of the record holder, or the testing report issued by an entrusted qualified medical device testing institute”. This is in line with the reform and development needs of the initiative, which is welcomed by the industry. Considering that the testing reports submitted at the time of registration are important review information, and that the implementation of in-house testing and third-party testing is in the initial stages, the working group recommends to not limit the type of laboratory qualification, but instead allow enterprises to select qualified testing institutes.

In addition, due to the gap between transforming and implementing international standards to Chinese standards, the in-house test and third-party test reports are likely to conform to the new edition of international standards, while the local standard is based on the old edition. It is recommended that both the latest version of the international standard in-house test and third-party test reports should be accepted in this case.

**Recommendations**

- Accept the latest version of the international standard in-house or third-party test reports.

2.2 Streamline Regulations on Clinical Requirements for Medical Device Registration

**Concern**

Requirements for clinical evaluation and investigation are still different from the guidelines agreed upon by the IMDRF, which were formulated with the participation of China’s regulatory authorities.

**Assessment**

The IMDRF is formed by a group of medical device regulators from around the world that have come together to build on the strong foundational work of the Global Harmonization Task Force on Medical Devices (GHTF). Its aim is to accelerate international medical device regulatory harmonisation and convergence.

On 21st March 2019, draft outcome documents of the IMDRF Medical Device Clinical Evaluation Working Group, chaired by the China NMPA, were approved by the IMDRF Management Committee.10

These IMDRF documents11 explained the process for clinical evaluation, including: how detailed the clinical evaluation should be; clinical evidence – key definitions and concepts; when a clinical investigation should be undertaken for a medical device; and the general principles of clinical investigations involving medical devices.

The implementation of these guidance documents will improve the effectiveness and efficiency of premarket reviews by: promoting increased global harmonisation in terms of approach and the requirements for leveraging and evaluating the available clinical evidence; reducing the number of redundant clinical investigations; integrating the principles of post-market clinical follow up and real world evidence, as applicable; and accelerating the introduction of new, safe and effective medical devices/technologies to the patients in various jurisdictions.

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Recommendations

- Keep in line with the requirements of clinical evaluation and clinical trial stipulated in the relevant IMDRF documents.
- Accelerate the amendment of the Guiding Principles of Clinical Evaluation of Medical Devices, and simplify the requirements for identifying “substantive equivalent” medical devices.
- Harmonise China’s Good Clinical Practices for Medical Devices with internationally recognised standards.
- Harmonise clinical evaluation reports of medical devices between China and Europe.
- Leverage international practice on ‘pre-submission’ for clinical investigation protocol (CIP) to ensure clinical investigations meet the requirements for cost and time effectiveness.

2.3 Reduce Administrative Requirements that Do Not Increase the Safety and Efficacy of Medical Devices

Concern

Current Chinese medical device regulations hamper flexible, globalised marketing and production, with the requirement to obtain market approval in the country of origin before starting registration in China delaying market access by at least 18 months.

Assessment

Currently there is no requirement for the Country of Origin (CoO) certificate (pre-market approval) for registration submissions of innovative medical devices. The working group suggests to apply this to all registration submissions. With the continuous accumulation of experience within the Centre for Medical Device Evaluation (CMDE) of the NMPA, the maturity of the team of reviewers, and the ongoing improvements to China’s standard and regulatory system, it is suggested that for all submissions, if type tests and clinical evaluations or investigations are required, the CoO requirement for the registration of all imported new products should be removed. If a CoO certificate is required, it should refer to the common practice of other countries, whereby the requirements for type tests and clinical evaluations/investigations are removed, which avoids the duplication of work and the accompanying waste of resources.

Recommendation

- Remove the requirement for the CoO certificate (pre-market approval).

3. Deepen Standardisation Reform in the Medical Device Industry

Concern

Medical device products made by international companies are normally sold in foreign markets, however, they sometimes cannot be launched in China due to the inconsistency between Chinese mandatory standards and international standards.

Assessment

The entire cycle for drafting and revising standards in China is longer than most globally developed markets, which means that China is lagging behind the pace of industry development. The newly revised China Standardisation Law provides that “it shall be less than five years when the standard is reviewed again”. However, when the drafting and revision process of a mandatory standard is initiated, it may take three to four years to complete. For example, the revision of YY 0017-2008 Implants for Osteosynthesis – Metallic Bone Plates was started in 2014, with the revised version YY 0017-2016 being implemented in June 2018.

Medical devices also have very stringent market access requirements in China. For registration, applicants must compile a comprehensive document called Product Technical Requirements (PTR). Then type testing according to PTR is also a must. After type testing, a series of documents must be reviewed and approved by the NMPA before products can be launched in the Chinese market. For post-market surveillance, there are also comprehensive supervision systems for products, quality system auditing and site inspections, among others, to ensure product safety and effectiveness. Therefore, there is no need to set too many product standards, or to cover too many product performance parameters in the mandatory standards.

Recommendations

- Shorten the time interval between international standard updates and corresponding adoption in China standards.
- Accelerate the execution of related standards after the adoption of international standards.
- Strengthen the integration of scientific and technological
research and development, standards development and industrial development, and upgrade the standard technology level with scientific and technological innovation as the driving force.

- Expand the scope of standardisation reform to exempted areas (especially medical devices) to integrate and streamline mandatory medical device standards.
- Reduce the requirement of product performance parameters in mandatory standards.
- Rationalise, in the process of standards reform, the conformity of products that have gaps with mandatory standards, but have been on the market for a long time and have therefore been proven safe and effective by clinical use.

4. Fully Implement the State Council Notice on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment

Concern
The Notice on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment (State Council Document No. 5),\(^\text{12}\) has not been implemented effectively across China since it was approved by the State Council in 2017.

Assessment
The State Council released Document No. 5 on 17\(^{th}\) January 2017. Clause 11 states that government procurement processes will be reformed, and products manufactured by foreign-invested enterprises (FIEs) in China will be treated equally in the bidding process of government procurement.

In December 2017, the National Development and Reform Commission (NDRC) and two other ministries jointly published the Notice on the Working Plan 2017/2018 to Abolish Anti-competition Policies.\(^\text{13}\)

However, many local procurement policies include a provision that hospitals are encouraged to buy domestically-made medical devices as long as they meet quality requirements, and even explicitly stipulate the purchase of “domestic brands”.\(^\text{14}\)

First, the requirement to purchase “domestic brand” medical equipment violates the principle of fair competition and equal treatment of registered companies in China, and is furthermore an insurmountable trade barrier for FIEs. Such exclusion of foreign brands fully demonstrates that foreign-funded and Sino-foreign joint ventures have been subject to discriminatory treatment in the medical equipment market. This has also affected the fairness of procurement and greatly undermined the attractiveness of China as a destination for foreign investment in medical equipment manufacturing.

Secondly, the allocation and use of medical equipment and instruments in public hospitals should be based on open market competition, the needs of medical service providers and the choice of the best clinical outcomes for patients, instead of focusing solely on the origin of the brand. In the process of procurement, the government should give priority to patients’ and clinical needs, and conduct evidence and value-based procurement.

On 14\(^{th}\) August 2018, the Health Commission of Shenzhen city released an approval list to local hospitals, on the allocation of Type-B large medical equipment (see Table 1).

<table>
<thead>
<tr>
<th>Table 1: Approval List</th>
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<tbody>
<tr>
<td><strong>Total</strong></td>
</tr>
<tr>
<td><strong>Approved type-B large medical equipment</strong></td>
</tr>
<tr>
<td>CT</td>
</tr>
<tr>
<td>MRI</td>
</tr>
<tr>
<td><strong>Must be with domestic indigenous brands</strong></td>
</tr>
<tr>
<td>Units</td>
</tr>
<tr>
<td>Must be with domestic indigenous brands</td>
</tr>
<tr>
<td>7</td>
</tr>
<tr>
<td>10</td>
</tr>
</tbody>
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Recommendations
- Examine existing government procurement measures to see contents which are out of step with State Council Document No. 5.
- Emphasise that local health commissions and hospitals should prioritise patients and clinical needs in procurement considerations and adopt more science- and value-based measures.
- Eliminate regulations that prevent access to local

\(^{12}\) Notice on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment, State Council, 2017, viewed 28\(^{th}\) April 2018, <http://www.gov.cn/gongbao/content/2017/content_5168474.htm>


\(^{14}\) Approval on Allocation of Type B Large Medical Device Equipment to Medical Institutions (Shen Wei Ji Fa [2018] No.39), Health Commission of Shenzhen, 14\(^{th}\) August 2018, viewed 4\(^{th}\) May 2019.
markets as well as fair and equal competition.

- Strengthen the implementation of the Anti-monopoly Law, and avoid administrative interference in the procurement process that renders fair market competition impossible.

5. Improve the Regulatory Framework for Adverse Events Reporting and Monitoring

**Concern**
The challenges of the Periodic Risk Evaluation Report (PRER) considerably increase the burden of medical device manufacturers.

**Assessment**
The *Regulation on Medical Device Adverse Events Monitoring and Re-evaluation (Regulation)* came into force on 1st January 2019. It defines the main responsibilities of MAHs, strengthens risk management requirements and increases the penalties for non-compliance. The PRER is equivalent to the Periodic Safety Update Report (PSUR) in the EU, but details of the regulation and the required data are rather different from the European reporting system.

The Centre for Drug Re-evaluation (Centre) organised training, symposiums and seminars during the implementation phase of the *Regulation*. The working group appreciated the efforts made by the Centre. However, the series of new requirements and the new reporting system have resulted in great challenges for medical device manufacturers, regulators and the Centre itself.

**Improve the Quality of Individual Cases Reported by Medical Institutions**
According to the *Annual Report of National Adverse Events Monitoring of Medical Devices (No. 25 of 2018)*, 326,622 reports were submitted by medical institutions in 2017, accounting for 86.8 per cent of the total amount. The National Adverse Event Monitoring System forwards these reports to the manufacturers, which are responsible for taking appropriate action. However, many of these reports were not related to (potential) patient injury and should therefore not have been reported within the Adverse Event Reporting framework. As a result, it consumed a great deal of companies’ resources for verification. In addition, because each report needs to be reviewed and approved by ADR centres at both the local and national level, this resulted in an additional burden for regulators and a risk of over-reporting of adverse events.

**Clarify the Scope of Validity of the Regulation**
Local authorities require that manufacturers submit a PRER even for medical products that were registered or filed before the *Regulation* came into force on 1st January 2019. This is in violation of the Legislative Law, Article 93 of which stipulates that "laws, administrative regulations, local decrees, autonomous decrees, special decrees, and rules shall not be retroactive, except for special provisions made for the better protection of the rights and interests of citizens, legal persons, and other organisations." Hence, the *Regulation* should be applied only to medical products registered or filed after 1st January 2019.

**Allow Overseas MAH to Use the Existing PRERs**
The requirements in the draft PRER guideline are very different from international practices in several respects, including product scope and data collection time frame. This makes it impossible to directly adopt reports that have already compiled by foreign MAHs. The requirement of preparing two reports for one product will unnecessarily double the workload.

**Recommendations**
- Ensure adverse events reports from healthcare institutions are authentic and accurate.
- Clarify the scope of validity of the *Regulation*, and ensure that provincial authorities follow these regulations.
- Allow overseas MAHs to use the existing PRERs as long as all products in the Chinese registration certificate are covered and the data is complete.

6. Promote Market Access for High-precision and Innovative IVD
6.1 Promote Market Access of Diagnostic Reagents with High Levels of Reliability and Accuracy

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Concern
Inflexible procurement regulations frequently result in hospitals purchasing reagents with limited reliability and accuracy, possibly leading to erroneous diagnosis results and the delay of efficacious treatment.

Assessment
Different diagnostic methods and technologies should be applied depending on the different stages of a particular disease, e.g. prevention, initial diagnosis, treatment and follow-up care. Different diagnostic methods have different focuses and different advantages – to use a non-optimal diagnostic method may compromise the precision of the diagnosis result. Very specific, precise diagnosis methods can be used to not only identify diseases, but also to give the doctor reliable information about the effects of modifying or weaning off a medication during treatment. This is impossible with traditional simple diagnostic methods.

However, many provincial procurement catalogues are not sufficiently specific, as they don’t distinguish by method and technology, resulting in procurement of only the most simple and cheapest IVD products.

Recommendation
• Include different diagnostics methods and technologies in provincial procurement catalogues.

6.2 Shorten the Time for Modification of Registrations of IVD-reagents

Concern
The modification of valid registrations for IVD-reagents requires an excessively long time, endangering the quality and supply of reagents. Modifying a valid registration to reflect a change of site of manufacture outside China is much more complicated and time-consuming than the same process for local Chinese products.

Assessment
According to the Provisions of IVD Registration (Order No. 5), released on 1st October 2014,\(^\text{18}\) the CNDA requires the same amount of time for the modification of a registration of IVD-reagents as for a new registration. The typical timeframe for the technical evaluation is seven to nine months for Class II, and nine to 11 months for Class III reagents.

Different from medical devices, for IVD-reagents there is no pathway for notifying the authorities of modifications to the instructions for use (IFU). Each update to the IFU requires a modification of the registration. The typical life cycle of IVD reagents, from market approval in the country of origin to discontinuation, is four to five years. Within one year, about 20–30 per cent of all IFUs are updated. Handling of modifications at the CNDA cannot keep pace with the rapid development of these types of products.

According to Article 58 of Order No. 5, “if one of the following points of the registration certificate and its annexes have changed, the applicant shall apply … for modification of the registration: (7) the site of manufacture of imported IVD-reagents”.\(^\text{19}\) However a change of site of manufacture of domestic products only requires a much easier notification. Modification of the registration of imported IVD-reagents requires chemical tests of three consecutive batches, with the whole approval procedure taking about a year longer than for domestic products.

Recommendations
• Establish a notification pathway for some simple, non-critical modifications, such as modified packaging and changes to the IFU.
• Establish a unified procedure for domestic and imported IVD-reagents to allow for a change of site of manufacture through a notification to the responsible Medical Products Agency (MPA).
• Establish a simple, fast-track procedure for evaluating and approving modifications.

6.3 Re-classify IVD Reagents

Concern
China assigns more diagnostic reagents to a higher risk class than other countries, leading to additional clinical trials and delayed market access.

Assessment
China is an active member of the Regulated Product Submission Working Group of the IMDRF. However,
the former CFDA assigned a substantial number of IVD reagents into a higher risk class than the classification rules of the IMDRF specify. This higher risk classification leads to rising product development costs and expensive clinical trials without providing additional patient safety, ultimately hindering the development of the IVD industry.

In February 2017, the CFDA published the Amendment to the Provisions on IVD Product Registration.20 This update states that “the CFDA may adjust the classification rules according to the changing risk of IVD reagents”. The official interpretation of this amendment states “in the future, the CFDA will … adjust classification rules and catalogues based on the risk of IVD reagents.”21

In March 2018, the Notice on Re-classification of Several IVD Reagents came into force.22 However, this notice covers only a small fraction of IVD products. The working group welcomes the start of the re-classification process and recommends that additional IVD reagents be re-classified in the near future.

Recommendation

- Refer to international rules of classification and continue to reclassify low-to-moderate risk IVD products into Class I or II.

Abbreviations

ADR: Adverse Drug Reaction
CDMD: Consumable and Disposable Medical Devices
CFDA: China Food and Drug Administration
CIP: Clinical Investigation Protocol
CMDE: Centre for Medical Device Evaluation
CNDA: China National Drug Administration
CNY: Chinese Yuan
CoO: Country of Origin
COCIR: European Coordination Committee of the Radiological, Electromedical and Healthcare IT Industry
DRG: Diagnostic Related Groups
EU: European Union
FIE: Foreign-invested Enterprise
GHTF: Global Harmonization Task Force on Medical Devices
HSA: Healthcare Security Administration
HTA: Health Technology Assessment
IFU: Instructions for Use
IMDRF: International Medical Device Regulators Forum
IVD: In-vitro Diagnostics
MAH: Marketing Authorisation Holder
MOJ: Ministry of Justice
MPA: Medical Products Agency
NDRC: National Development and Reform Commission
NHC: National Health Commission
NHFPC: National Health and Family Planning Commission
NHSA: National Healthcare Security Administration
NMPA: National Medical Products Administration
PRER: Periodic Risk Evaluation Report
PSUR: Periodic Safety Update Report
PTR: Product Technical Requirements

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Key Recommendations

1. Sustainability and Green Chemistry
   
   1.1 Ensure the Effective and Well-communicated Implementation of Sustainability Policies for China’s Chemical Industry
   
   • Strengthen cooperation between the government and international businesses and encourage China’s central authorities to involve these companies as key stakeholders in policy development.
   
   • Implement the Emissions Trading System (ETS) and take further steps to enhance its legal foundation, transparency and mechanism-building.

   1.2 Strengthen Governmental Authorities and Chemical Industry Cooperation to Promote Sustainability Through Best Practice Sharing and Innovation on Safety Management and Green Development
   
   • Recognise that there are different levels of operational practices in the chemical industry, and avoid ‘one size fits all’ solutions when enforcing compliance.
   
   • Establish regular, formal communication channels and cooperation mechanisms between chemical companies and government officials to share experiences, and help the local government to effectively implement chemical safety and sustainable management policies.
   
   • Create platforms to ensure that the voice of chemical companies will be heard and reasonable comments can be taken into consideration, and improve collaboration between domestic and international businesses, to share and leverage Responsible Care (RC) principles and promote best practices on sharing and innovation in green development.
   
   • Create a national platform to apply the circular economy principles on chemical waste management such as re-utilisation and re-use as a raw material.

2. Investment and Manufacturing Costs

   2.1 Guarantee Fair and Reasonable Treatment by Local Authorities with Respect to Relocations and Temporary Closures of Enterprises
   
   • Ensure that any criteria provided and actions undertaken to have businesses relocate or temporarily close are transparent and published well in advance.
   
   • Inform international businesses in advance of relocation criteria and pollution control plans to avoid disrupting chemical supply chains.
   
   • Reach mutual agreement on relocation timelines to decrease associated costs for companies.
   
   • Offer clear incentives at the local level to upgrade the industry.
   
   • For large-scale state events, reconsider disruptions to chemical supply chains as part of central planning.

   2.2 Facilitate the Diversity and Competitiveness of the Oil and Gas Sectors
   
   • Fully deregulate oil prices and remove price ceilings to deliver a competitive retail oil market in China, and establish a clear time schedule for the deregulation of product prices.
   
   • Remove the stipulation that the government retains the right to control prices during abnormal fluctuations.
3. Chemicals Management

3.1 Develop a Well-debated and Practical Overarching Regulation for Chemical Risk Assessment and Control

- Develop detailed criteria to determine substances for priority evaluation or control, with proportionate control options.
- Encourage enterprises to actively participate in risk assessment discussions with the government, working towards an agreement by which companies play a critical role in protecting intellectual property rights and economic benefits.
- Develop, adjust and publicise the Inventory of Chemicals for Priority Control according to the degree of harmfulness and influence of substances on ecological and human health.
- Exempt from most regulations substances with production or import volumes less than 100 kilogrammes/year and other specific conditions as per the European Union’s Regulation on Chemical Environmental Risk Assessment and Control (REACH).
- Focus on chemicals with large volume and high environmental risk for information reporting, and reduce the frequency of reporting to facilitate more practical and efficient chemical management and minimise the administrative burden on enterprises.

Introduction to the Working Group

Chemicals are essential for manufacturing all kinds of products and are therefore indispensable. The industry is one of the largest in the global economy and a critical supplier for businesses covering manufacturing, sales, transportation, distribution and disposal.

The Petrochemicals, Chemicals and Refining (PCR) Working Group represents the leading European companies in the petroleum and chemical industry in China, many of which are global Fortune 500 companies. The aim of the working group is to improve the operating conditions for PCR companies in China by facilitating communication between member companies, the government and Chinese industrial associations. The working group provides up-to-date information on pressing issues related to the petrochemical industry and the effects from various locally-enacted regulations.

Recent Developments

The working group has maintained an ongoing strategic dialogue with the Chinese Government and relevant institutions, including high-level meetings with the following authorities: the Ministry of Ecology and Environment (MEE), the Ministry of Emergency Management (MEM), the Ministry of Commerce, the Ministry of Transportation, the State Administration for Market Regulation (SAMR), the Ministry of Industry and Information Technology (MIIT), the National Development and Reform Commission (NDRC), the European Chemicals Agency (ECHA), and senior European Commission officials. The working group greatly appreciates the constructive exchanges that have taken place between European industries and Chinese officials as well as the market-driven approach taken by much of the new domestic legislation regulating the PCR industry.

The working group maintains a close relationship with the Chinese chemicals sector, including the Association of International Chemical Manufacturers (AICM) and the China Petroleum and Chemical Industry Federation (CPCIF). The AICM, the CPCIF and the working group share the aim of making the Chinese manufacturing industry more sustainable and innovative.

Sustainability and Green Chemistry

As a result of the April 2017 crackdown on environmental law violations, more than 30,000 companies and over 5,700 officials have been fined. Analysts estimate that up to 40 per cent of China’s manufacturing capability may have been suspended during 2017, resulting in

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widespread disruption along the chemical supply chain.\textsuperscript{2,3,4,5} These regulatory crackdowns have continued with an ever-expanding list of laws targeting polluters and vastly increasing inspection numbers. For example, 8,982 violations and enforcements were recorded from June to August 2018,\textsuperscript{6} and the government set quotas to shut down a certain number of factories to curb pollution.\textsuperscript{7}

The central government has also updated its Pollution Discharge Permit (PDP) programme, strengthening a 2016 provisional document that lacked unified standards.\textsuperscript{8} This cross-industry initiative supervises emissions by requiring manufacturers to apply for permits before they begin discharging pollutants and to closely monitor emission levels. The programme supersedes the previous Environmental Impact Assessment. It also brings additional administrative burdens such as the inability to revise paperwork once submitted,\textsuperscript{9} which may hinder innovation in manufacturing processes, and the requirement to publicly disclose potentially sensitive proprietary information.

**Investments and Manufacturing Costs**

The relocation of chemical factories, warehouses and facilities to chemical parks has been strongly encouraged by the national government\textsuperscript{10} following the Tianjin incident in August 2015,\textsuperscript{11} and more recently the Yancheng factory blast in March 2019.\textsuperscript{12} From the working group’s perspective, the State Council’s issuance of Circular [2017] No. 77 on the Relocation of Hazardous Chemicals Production Enterprises from Urban Populated Areas (Circular 77)\textsuperscript{13} is a positive step to make relocation criteria more transparent, but should still be properly and effectively followed up at the provincial level.

In the wake of the Yancheng disaster, the Jiangsu provincial government announced plans to shut down a considerable number of chemical companies by 2020.\textsuperscript{14,15} Although the working group welcomes an increased emphasis on safety, excessive shutdown measures may disrupt chemical supply chains.

**Chemicals Management**

In January 2019, the MEE released the draft Regulations on Chemical Environmental Risk Assessment and Control,\textsuperscript{16} a milestone in Chinese chemical management. The working group recommends the relevant authorities adopt science-based approaches, in line with European Union (EU) standards such as the Risk Management Option Analysis (RMOA),\textsuperscript{17} to further analyse the intrinsic properties of these diverse groups of chemical and accurately identify which substances deserve control or prohibition. The working group welcomes efforts by the authorities to raise industry safety standards, but expects further transparency and regulatory predictability, which is crucial for increasing chemical operators’ business confidence.


\textsuperscript{3} Anhydrous Hydrofluoric Acid Prices Soar Due to Plant Shutdowns in China, Japan Chemical Daily, 16th October 2017, viewed 15th April 2019, <https://www.japanchemicaldaily.com/2017/10/16/anhydrous-hydrofluoric-acid-prices-soar-plant-shutdowns-china/>


\textsuperscript{8} Zheng, Jirann, China Updates Pollutant Emission Permit System, China Daily, 18th January 2018, viewed 15th April 2019, <http://china.dailymail.co.uk/2018/01/18/w558a98f94310e4b483e3e707.html>


\textsuperscript{10} Ministry of Industry and Information Technology Issues Guidelines for Promoting the Development of Chemical Parks, MIIT, 10th December 2015, viewed 26th April 2019, <http://www.mii.gov.cn/xxgk2018/100185285/n1652930/n45509650/n4533634/content.html>


\textsuperscript{17} Circular on the Relocation of Hazardous Chemicals Production Enterprises from Urban Populated Areas, State Council, 27th August 2017, viewed 15th April 2019, <http://www.gov.cn/zhengce/content/2017-09/04/content_52223568.htm>
Key Recommendations

1. Sustainability and Green Chemistry

1.1 Ensure the Effective and Well-communicated Implementation of Sustainability Policies for China's Chemical Industry

Concern
Key industry players often receive little notice from authorities on important developments, such as the implementation of the national emissions trading system (ETS).

Assessment
In December 2017, the NDRC launched China’s national ETS, which is expected to become the largest carbon emissions trading programme in the world. It will cover 30 per cent of China’s national emissions, deeply transforming the petrochemical and chemical industries. This system represents a major effort to cap carbon dioxide emissions in China. The seven ETS pilots that currently exist, covering the non-power sectors, will gradually be integrated into the national system once the latter has been finalised.

Although the market was expected to enter a trial period in 2019, it has been delayed without adequate notice and explanation. Draft rules were released for public consultation in April 2019, the first official document for ETS trading parameters, nearly one and a half years after the project’s announcement. An MEE official recently estimated that the first trade under the ETS will occur in 2020. The working group understands the need for a gradual phase-in to ensure proper infrastructure and date accuracy, but expects a significant lead time for implementation and to make any necessary changes to maximise stakeholder engagement.

Recommendations

• Strengthen cooperation between the government and international businesses and encourage China’s central authorities to involve these companies as key stakeholders in policy development.
• Implement the ETS and take further steps to enhance its legal foundation, transparency and mechanism building.

1.2 Strengthen Governmental Authorities and Chemical Industry Cooperation to Promote Sustainability Through Best Practices Sharing and Innovation on Safety Management and Green Development

Concern
Recent government policies reinforced negative views concerning the state of the chemical industry in China and ignored its significant contributions to promote a green and innovative economy as well as the potential application of circular economy principles.

Assessment
The chemical industry is a key stakeholder in the development of an urgently needed, clear and comprehensive strategy on creating a sustainable, green industry and circular economy. China has already one of the world’s strictest sets of environmental and safety laws and regulations, but the chemical industry has not been a main interlocutor for authorities, especially since the 2015 Tianjin incident.

Recent severe incidents such as the Yancheng explosion have led to a further deterioration of the chemical industry’s public image and its activities have faced increased scrutiny. National and regional governments have also become extremely sensitive towards chemical safety issues. Their concern is legitimate, as there are more...
than 28,000 chemical enterprises in China, which vary greatly in their scope of stakeholders, activities and operating conditions, and every misstep can still damage the overall reputation of the industry. At the same time, the AICM shows in its 2017–2018 Responsible Care Report 27 that in China very few accidents occur each year among its 70 member companies, all of which are foreign multinationals.

International chemical companies and large state-owned enterprises usually implement comprehensive and sound policies based on Environmental Health and Safety Assistant systems. In addition, international firms deploy RC practices, an initiative developed by the International Council of Chemical Associations, which China joined in 2014.

Many accidents stem from a lack of risk awareness and knowledge about best practices. The key differences between multinational corporations and domestic companies with respect to their maturity on health, safety and environment matters are not being recognised by the authorities, who still insist on a ‘one size fits all’ approach to the chemical industry. 28 To avoid these problems, a formal channel of communication and cooperation between chemical companies and government officials is needed to dramatically promote the implementation of responsible and sustainable practices, and improve measures for the prevention of potential incidents. This collaboration should include chemical parks or associations such as the AICM or CPCIF. Practical tips like providing English versions of policies and more opportunities for comments and discussion could facilitate communication.

Although the authorities have ambitious plans for greening the economy, promoting innovation and increasing digitisation, these initiatives lack the appropriate mechanisms for facilitating cooperation among companies and institutions. The government should also establish sound and practical communication platforms for encouraging industries to cooperate on reducing their impact on the environment, and fully utilising existing resources in an innovative manner, for example in hazardous waste management.

Recommendations

• Recognise that there are different levels of operational practices in the chemical industry, and avoid ‘one size fits all’ solutions when enforcing compliance.
• Establish regular, formal communication channels and cooperation mechanisms between chemical companies and government officials to share experiences, and help the local government to effectively implement chemical safety and sustainable management policies.
• Create platforms to ensure that the voice of chemical companies will be heard and that reasonable comments can be taken into consideration, and improve collaboration between domestic and international businesses, to share and leverage RC principles, promote best practices sharing and innovation in green development.
• Create a national platform to apply the circular economy principles on chemical waste management such as re-utilisation and re-use as a raw material.

2. Investments and Manufacturing Costs

2.1 Guarantee Fair and Reasonable Treatment by Local Authorities with Respect to Relocations and Temporary Closures of Enterprises

Concern

The relocation of chemical facilities to chemical parks due to safety or environmental reasons, as well as forced shutdowns or reductions around important state events, badly disrupts supply chains and in some cases may pose serious safety and ecological risks, causing great disruption to production.

Assessment

After the March 2019 explosion in Jiangsu, provincial authorities announced a rapid shutdown plan of Yancheng’s Xiangshui Chemical Industrial Park. They also called for a significant reduction of the number of enterprises operating, 2930 and prohibited new chemical projects or chemical parks from operating within one kilometre of the Yangtze River. 31 In other cases, with the increasing intensity of environmental inspections and associated law enforcement, some petrochemical joint

27 Responsible Care Report 2017-2018, AICM, Beijing, 2017
venture plants have been receiving notifications more frequently from the authorities requesting reductions in production, or even shutdowns, for reasons including summer ozone control, autumn-winter transition (Blue Sky Programme) air quality control, or major events nearby.\textsuperscript{33}

The working group fully understands the pressure on safety and environmental risks; however, this kind of sudden-stop policy focuses on quotas rather than performance,\textsuperscript{34} which can damage the chemical supply chain and have negative industrial repercussions. These shutdowns can pose not only challenges to a plant’s daily operations but also potential safety risks; some plants use carbon monoxide as upstream feedstock, so significant production reduction or plant shutdowns can cause a huge amount of carbon monoxide to burn in flare and be released, ironically resulting in increased carbon emissions.

The State Council’s Circular [2017] No. 77 on the Relocation of Hazardous Chemicals Production Enterprises from Urban Populated Areas (Circular 77)\textsuperscript{35} was a positive step towards making relocation criteria more transparent. The central government’s recent cross-ministry dialogue reflects coordinated efforts to address this relocation issue,\textsuperscript{36} but such initiatives should involve foreign companies and be replicated within provinces as well. The working group hopes international businesses requested to relocate are treated equally to local companies, receive clear information and relocation criteria, are able to discuss relocation timelines with local authorities to decrease the associated costs, and receive fair compensation after relocating.

In certain cases, an alternative to relocation might be upgrading the chemical facility. In April 2017, the Shanghai People’s Municipal Government issued the Opinions on Further Opening up and Accelerating the Pace of Building a New Economic System Based on Openness,\textsuperscript{37} which states: “Foreign investment will be supported to participate in the upgrade of traditional manufacturing industries like automotive, iron and steel, chemicals and shipping.” However, no further announcements have been made on how foreign investment will actually be supported.

**Recommendations**

- Ensure that any criteria provided and actions undertaken to have businesses relocate or temporarily close are transparent and published well in advance.
- Inform international businesses in advance of relocation criteria and pollution control plans to avoid disrupting chemical supply chains.
- Reach mutual agreement on relocation timelines to decrease associated costs for companies.
- Offer clear incentives at the local level to upgrade the industry.
- For large-scale state events, reconsider disruptions to chemical supply chains as part of central planning.

### 2.2 Facilitate the Diversity and Competitiveness of the Oil and Gas Sectors

**Concern**

Despite an increasingly open oil market and signals of opening up the retail fuel sector, regulations and price ceilings continue to hinder foreign investment and the progress towards a competitive retail market.

**Assessment**

The deregulation of China’s oil market progressed in 2018. Restrictions limiting foreign investments in petrol stations were lifted,\textsuperscript{38,39} and Shell was the first international oil company (IOC) to be awarded a licence to independently trade in China’s wholesale market.\textsuperscript{40}

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\textsuperscript{34} AICM’s Suggestion on the ‘Emergency Notice on Soliciting Opinions on the Regulation and Improvement Plan for Jiangsu Chemical Industry (Draft for Public Comment)’, AICM, 26th April 2019, viewed 15th May 2019, <http://aicm.cn/download-newsletter>


\textsuperscript{37} Opinions on Further Opening up and Accelerating the Pace of Building a New Economic System Based on Openness, Shanghai People’s Municipal Government, 26th April 2017, viewed 20th March 2018, <http://www.shanghai.gov.cn/xw2/rw2314/rw2319lw12344/lw26626r26162.html>

\textsuperscript{38} Zheng, Xin, Shell to Expand Nationwide Gas Station Network, China Daily, 23rd August 2018, viewed 15th April 2019, <http://www.chinadaily.com.cn/a/201808/23/W5507e0a4a3100d114378447.html>


\textsuperscript{40} Zeng, Lingke and Han, Wei, Shell Unit Gets Nod to Tap China’s Wholesale Oil Market, Caixin, 3rd January 2019, viewed 15th April 2019, <https://www.caixinglobal.com/2019-01-03/shell-unit-gets-nod-to-tap-chinas-wholesale-oil-market-101365787.html>
Foreign companies now account for four per cent of the petrol station market share.¹¹ Prices are currently regulated through a system of price caps by the central government and only tenuously linked to international oil prices. ¹²

There have been several positive signals in recent years that suggest the government intends to deregulate the retail fuel sector. The Several Opinions on Deepening Oil and Gas Sector Reform (Opinions), released by the State Council in May 2017,¹³ advocated a central role for the market in guiding oil prices, however the actions encouraged by the Opinions have not been forthcoming.¹⁴

Deregulating oil prices and removing price ceilings would deliver a competitive retail market in China, with several key benefits. The first would be to support President Xi’s 2018 commitment to continue the economic reform in light of the 40th anniversary of China’s ‘reform and opening up’.¹⁵ A fully functioning retail fuel market will also boost service and product quality by offering consumers greater choices between high- and low-quality fuel.¹⁶ Despite government concerns that full market deregulation will lead to price volatility, retail fuel market opening has led to price decreases because it attracts IOCs and investment, and therefore increases competition.¹⁷

Recommendations

• Fully deregulate oil prices and remove price ceilings to deliver a competitive retail market in China, and establish a clear time schedule for the deregulation of retail oil product prices.
• Remove the stipulation that the government retains the right to control prices during abnormal fluctuations.

## 3. Chemicals Management

### 3.1 Develop a Well-debated and Practical Overarching Regulation for Chemical Risk Assessment and Control

**Concern**

The MEE’s overhaul of the chemical management legislation framework through the addition of the Regulation on Chemical Environmental Risk Assessment and Control (REACH),¹⁸ currently in its public consultation stage, has proposed several lists of substances for priority assessment or control, but the criteria development and reporting requirements require more scientifically robust approaches and less administrative burdens.

**Assessment**

China represents both a major chemical manufacturer and a strong chemical consumer worldwide. China’s top legislative bodies and major chemical regulators have long been aware of the urgent need for a comprehensive and well-coordinated legislative framework for chemical management.

Safety issues have long attracted attention from the Chinese Government. An increased focus on safety convinced the State Council to release the Regulation on Safety Management of Hazardous Chemicals in 2002,¹⁹ which was updated in 2011.²⁰ The MEM adopted the Catalogue of Hazardous Chemicals to manage 2,828 chemicals with significant toxic, explosive, corrosive, flammable properties.²¹ For all other existing chemicals and new chemicals, there was no higher-level regulation available until the MEE released the updated draft of REACH in January 2019.²²

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Besides reconfirming the current Inventory of Existing Chemical Substances in China, the List of Strictly-restricted Chemicals, the List of Prohibited Chemicals and the new chemical registration procedure, the draft also mandates several lists of substances, multiple control options, and requirements for adequate information disclosure to stakeholders. These include lists of chemicals for priority assessment and control, as well as toxic and harmful contaminants of air, water and soil. Substances on these lists are subject to special regulatory controls. Prohibited chemicals cannot be manufactured, processed, used, imported or exported. Strictly-restricted chemicals are only allowed for authorised applications and their import-export is subject to both Chinese government permission and international Prior Informed Consent. The control options for Inventory of Chemicals for Priority Control are more complicated, including mandatory clean production review, application authorisation/restriction, and concentration restriction in end products. Discharging substances that are defined as toxic or harmful contaminants require a PDP and complete self-monitoring records.

The development of these lists and ensuing enforcement of control options should appropriately factor in the intrinsic properties, background concentration, exposure route, exposure level, bioavailability, and bio-elution of certain substances. Risk Management Option Analysis (RMOA), an approach widely used in the EU, could facilitate deciding which chemicals to include. Chemicals listed for priority assessment should not be automatically defined as chemicals for priority control without additional analysis, as best operational practices can prevent risks more effectively. The MEE should therefore work with related ministries to develop, adjust and publicise the Inventory of Chemicals for Priority Control based on the different levels of hazards and impacts different chemicals can impose on both the ecological environment and human health.

The draft also mandates an annual report of basic chemical information to the MEE, online information disclosure to the public, and information transmission to downstream users. The working group welcomes transparency, but the report to the MEE should exempt substances in categories such as: chemicals that naturally exist; inseparable intermediates; steel, alloys, products not manufactured for commercial purpose or intentionally, etc. Information disclosure to the public and downstream users should also protect commercial confidentiality.

Countries with similar substance management maintain an exemption clause according to the quantity (up to one ton) of production. China should adopt the international general practice of quantity exemption and add other considerations—such as for chemicals temporarily stored in bonded areas or warehouses, free trade experimental areas and customs supervision areas without any processing—on top of exemptions already adopted in the Ministry of Environmental Protection’s (now MEE) Order 7, which is similar to REACH. Order 7 already simplifies the recording requirement for new chemical substances under 0.1 metric tonnes (100 kilogrammes) per tonnes year for scientific research; no physical, toxicological or eco-toxicological data is required. Such exemption may reasonably be extended to existing substances, and will encourage enterprises to innovate, promote new product listings and reduce costs.

Legislation and enforcement should be science-based and proportionate. Legislators, industries and relevant stakeholders should work together to prevent overcautious legislation for chemicals and avoid stigmatisation of certain elements, as well as to share scientific knowledge with the public.

Recommendations
• Develop detailed criteria to determine substances for priority evaluation or control, with proportionate control options.
• Encourage enterprises to actively participate in risk assessment discussions with the government, working towards an agreement by which enterprises play a critical role in protecting intellectual property rights and economic benefits.
• Develop, adjust and publicise the Inventory of Chemicals

for Priority Control according to the degree of harmfulness and influence of substances on ecological and human health.

• Exempt from most regulations substances with production or import volume less than 100 kilogrammes/year and other specific conditions as per the EU REACH.
• Focus on chemicals with large volume and high environmental risk for information reporting, and reduce the frequency of reporting to facilitate more practical and efficient chemical management to minimise the administrative burden on enterprises.

Abbreviations

AICM  Association of International Chemical Manufacturers
CPCIF  China Petrochemical and Chemical Industry Federation
ECHA  European Chemicals Agency
ETS  Emissions Trading System
EU  European Union
ICAP  International Carbon Action Partnership
IOC  International Oil Company
MEE  Ministry of Ecology and Environment
MEM  Ministry of Emergency Management
MIIT  Ministry of Industry and Information Technology
NDRC  National Development and Reform Commission
PCR  Petrochemicals, Chemicals and Refining
PDP  Pollution Discharge Permit
RC  Responsible Care
REACH  Regulation on Chemical Environmental Risk Assessment and Control
RMOA  Risk Management Option Analysis
SAMR  State Administration for Market Regulation
Key Recommendations

1. Coordinate Different Measures for Intellectual Property (IP) Protection and Ensure Their Adequate Implementation
   • Set up a clear timetable to launch implementation rules for regulatory data protection (RDP) and Patent Term Extension (PTE).
   • Give the pharmaceutical industry more room to participate in the policymaking process and contribute to the formulation and successful implementation of IP protection laws and regulations.

2. Create a Clear, Transparent, Workable and Sustainable Rare Disease Policy that Ensures Patient Access to Medicines and Clarity for the Industry
   • Establish a central office responsible for rare diseases in order to improve and strengthen inter-ministerial communication and coordination.
   • Increase public awareness of rare diseases and improve the diagnosis and treatment capacity of healthcare institutes and personnel by engaging different stakeholders, such as academics, not-for-profit organisations and patient organisations.
   • Clarify the criteria for the inclusion of rare diseases, and take rare gene mutations as well as industry feedback into account in order to expand the Rare Disease List.
   • Improve accessibility to rare disease drugs by introducing an expedited evaluation and approval registration process, issuing corresponding specific measures for drugs not yet launched in China, and accelerating the process of adding new Rare Disease and Orphan Indications for drugs already on the market.
   • Optimise market access by establishing a dynamic adjustment mechanism for the rare disease drugs list.
   • Include more rare disease drugs in the coming National Reimbursement Drug List (NRDL) adjustment, or establish a special national fund to aid rare disease patient treatment in order to improve the affordability of their drugs.
   • Set up a rare disease legislative framework that would include provisions on patient care and drug accessibility.

3. Promote the Reform of the Public Medical Insurance System
   • Incorporate genetic testing that guides tumour-targeted therapy into medical insurance coverage in order to further improve treatment effectiveness and the efficient use of medical insurance funds.
   • Leverage medical insurance designated (specific drug) pharmacies to improve the supply of negotiated Basic Medical Insurance (BMI) anti-cancer drugs.
   • Run medical insurance payment pilots for the treatment of chronic diseases such as hypertension and diabetes in designated pharmacies.
   • Align with international practices by fully leveraging the strength of commercial insurance, and promote the reform of the medical insurance payment system.
   • Build an evidence-based reimbursement negotiation procedure for innovative drugs to allow companies to apply for reimbursement negotiation.
4. Further Improve the Implementation of the Volume-based Procurement (VBP) Policy to Ensure Market Competition as well as Patients’ and Doctors’ Access to High-quality, Safe and Efficacious Drugs

• Ensure an open and fair tendering mechanism in any new VBP, and for the products included in the previous 4+7 VBP, a tendering process should be introduced to select the winner(s) in any province/city outside of the 11 cities.
• Conduct comprehensive tender evaluation and avoid selecting winners purely based on lowest price.
• Carefully extend the VBP pilot and define the scope, time and region for the next round of implementation until more drugs (at least three generic drugs per molecule type) pass the Generics Quality Consistency Evaluation (GQCE).
• Further evaluate therapeutic substitution and rational use of drugs at the operational level in hospitals.
• Apply fair competition principles to non-winning products that participated in the VBP bidding instead of gradual price reductions or setting price limits, and avoid compulsive or disguised compulsive reduction for non-winner products by administrative measures.
• Allow hospitals to purchase products according to the actual needs of patients if the procurement progress of selected products is on track within the city or hospital alliances, and adjust and allocate procurement volume according to the actual situation among different medical institutions in the middle of the procurement cycle (e.g. at the sixth month of implementation).
• Separate biosimilar from generic products and make biosimilar products independent from generic scope with regard to their complexity and specialty.

5. Build a Favourable and Effective Regulatory Environment for Innovative Vaccines

• Reform China’s procurement criteria and process to include all National Medical Products Administration (NMPA)-approved vaccines, imported and locally manufactured, for its National Immunisation Programmes (NIPs), to enable access to more innovative vaccines and build a more sufficient and sustainable supply to address public health needs.
• Build a favourable and effective regulatory environment for innovative vaccines, including but not limited to International Multi-centres Clinic Trial (IMCT) and Overseas Marketing Authorisation (OMA), in order to reduce current delays of up to six to eight years in addressing public health demands with new innovative vaccines.
• Promote the harmonisation of Chinese Pharmacopeia (ChP) with international standards.

Introduction to the Working Group

The Pharmaceutical Working Group represents approximately 35 international pharmaceutical manufacturing companies operating in China. It serves as a communication platform between the European pharmaceutical companies and Chinese authorities and regulators. The working group engages in a constructive dialogue with all relevant government agencies at national, provincial and local levels and shares its expertise and international best practices with Chinese regulators. The working group encourages government policies that support the creation of a sustainable environment, which foster innovation and the healthy growth of the pharmaceutical industry as a whole, while improving patients’ access to affordable, innovative and high-quality medicines. The Pharmaceutical Working Group also offers recommendations based on experience accumulated during decades of healthcare reform in European countries that may further support the development of China’s healthcare system.

Recent Developments

Outlook for China’s Pharmaceutical Industry

Despite the overall economic slowdown, the growth of
the pharmaceutical industry in China remained robust in 2018. According to statistics released by the China Pharmaceutical Industry Association (CPIA), the industry grew by 9.8 per cent in 2018. That is 3.6 percentage points higher than the growth of industrial enterprises above a designated size (where a company’s annual revenue is higher than euro (EUR) 2.76 million).1,2 The revenue and profit of pharmaceutical companies in this category reached Chinese yuan (CNY) 2.43 trillion (EUR 320 billion) and CNY 309.4 billion (EUR 40.74 billion) in 2018, with a year-on-year growth rate of 12.4 per cent and 9.5 per cent respectively.3

Recent Policy and Regulatory Developments
Following the 2018 government restructuring, the Chinese authorities launched a series of reforms that have had a significant impact on the domestic pharmaceutical industry. These include but are not limited to:

- The issuance of a list of 40 drugs of clinical importance launched abroad, along with its updated work procedures, by the National Medical Products Administration (NMPA) in November 2018,4 and a second list, which contained 26 products, in May 2019.5
- The public consultation on the draft Regulations on Protection of Drug Study Data organised by the NMPA on 25th April 2018;6 and the inclusion of Patent Term Extension (PTE) for invention patents in the draft amendments to the Chinese Patent Law, led by the National People’s Congress (NPC) in January 2019.8
- The issuance of the Work Procedure for the Issuance of Rare Disease Lists9 and the First Rare Disease List by the National Healthcare Commission (NHC) in June 2018,10 and the implementation of the value-added tax (VAT) reduction policy for rare disease drugs, led by the State Council in February 2019.11
- After three rounds of revisions and public consultations, the Vaccine Administration Law was passed by the NPC in June 2019.12 The Law stipulates the strictest management of vaccine products by requiring a whole-process supervision system.
- The inclusion of 17 anti-cancer drugs in Category B of the National Reimbursement Drug List (NRDL) under the Basic Medical Insurance (BMI), Occupational Injury Insurance and Maternity Insurance Programmes by the National Healthcare Security Administration (NHSA) in October 2018.13
- The approval of the National Centralised Volume-based Procurement (VBP) Pilot by the Comprehensive Reform Committee of the Communist Party of China’s (CPC) Central Committee, on 14th November 2018.14 The pilot implementation began in 11 key cities in March 2019.15

The working group is impressed by the reforms implemented by Chinese authorities over the last few years to improve drug review and approval processes. Significant strides to accelerate the listing of innovative drugs have also been made recently. The working group encourages the Chinese Government to maintain the pace of regulatory reforms and to continue improving access to innovative medicines for the whole population.

1 Enterprises above designated size refers to all industrial enterprises with annual main business income of CNY 20 million (EURO 2.76 million) and above.
11 VAT for the First List of 21 Rare Disease Drugs Reduced to 3 Per Cent Since March, State Council, 14th February 2019, viewed 17th April 2019, <http://www.gov.cn/zhengce/content_5356508.htm>
14 Xi Jinping Chairs the 5th Meeting of the Comprehensive Reform Committee of the CPC Central Committee, Xinhua, 14th November 2018, viewed 8th April 2019, <http://www.xinhuanet.com/politics/leaders/2018-11/14/c_11237714393.htm>
Key Recommendations

1. Coordinate Different Measures for Intellectual Property (IP) Protection and Ensure Their Adequate Implementation

Concern
Although the pharmaceutical industry is encouraged by the recently proposed policies and initiatives to improve IP protection, the detailed rules, which are key for any policy’s successful implementation, have yet to be decided.

Assessment
China has recently been actively encouraging basic research, drug discovery and clinical development in the life sciences sector. Since July 2015, the former China Food and Drug Administration (CFDA) (now the NMPA) has issued a series of policies and regulations that optimise review and approval procedures of new pharmaceutical products. China is at a critical stage, as it moves towards its ultimate goal of evolving from the role of a generics producer to that of an originator. High risk, large investment and long periods of time are characteristic of the research and development (R&D) of new drugs, but the results, i.e., the new drug, are easily copied. Therefore, IP protection is the backbone for an innovation-driven pharmaceutical industry.

In the past two years, the Chinese Government has published several policies to strengthen drug IP protection. In May 2017, the former CFDA published the draft document Encourage Innovation of Drugs and Medical Devices, Rights of Innovators (Document No. 55).16 In October 2017, the CPC Central Committee and the State Council jointly published the document Opinions on Deepening the Reform of Evaluation and Approval to Encourage Innovation of Drugs and Medical Devices (Opinions).17 On 13th April 2018, the State Council called for extending patent protections by a maximum of five years if a manufacturer applies for parallel registration for its innovative drugs in China and abroad. On 25th April 2018, the NMPA published the draft Regulation on Drug Regulatory Data Protection for public consultation.18 On 4th January 2019, the NPC released draft amendments to the Patent Law—which includes PTE for invention patents of innovative drugs—for public comment.19

The working group is encouraged by the recent policies and the proposed amendments to the Patent Law to encourage innovation and strengthen IP protection. The working group believes that establishing a multi-level protection mechanism, which includes patents and regulatory data protection (RDP), will help China become a medical power and a major pharmaceutical innovator. In addition, the industry is keen to see a clearer timetable regarding the publication of PTE and RDP implementation rules. It is important that China creates a predictable regulatory environment so that companies can plan their research and launch efforts accordingly. In the process of forming a multi-level protection mechanism, the working group also wants to have greater opportunities for making suggestions and contributing to the formulation and successful implementation of IP protection rules and regulations.

Recommendations
• Set up a clear timetable to launch implementation rules for RDP and PTE.
• Give more room to the pharmaceutical industry to participate in the policymaking process and contribute to the formulation and successful implementation of IP protection laws and regulations.

2. Create a Clear, Transparent, Workable and Sustainable Rare Disease Policy that Ensures Patient Access to Medicines and Clarity for the Industry

Concern
Rare disease patients in China currently have limited access to care, as few rare disease drugs are registered, diagnostic capabilities are limited and public medical insurance does not cover their conditions.

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16 Encourage Innovation of Drugs and Medical Devices, Rights of Innovators, former CFDA, 12th May 2017, viewed 7th May 2018, <http://www.gov.cn/xinwen/2017-05/12/content_5193269.htm>
17 Opinions on Deepening the Reform of Evaluation and Approval to Encourage Innovation of Drugs and Medical Devices, State Council, 8th October 2017, viewed 8th May 2018, <http://www.gov.cn/xinwen/2017-10/08/content_5230105.htm>
Assessment

Over 20 million Chinese are affected by rare diseases, according to the Rare Disease Diagnosis and Treatment Guide 2019 published by the NHC in February 2019. However, due to relatively low public awareness, inadequate diagnostic and treatment capabilities and scarce reimbursement opportunities, most patients have limited access to care. The Chinese Government has acknowledged the urgency to improve rare disease patients’ access to innovative and safe treatment and shown their ambition to do so by enacting new regulations.

In 2015, the former CFDA (now the NMPA) started granting innovative drugs and rare disease drugs priority review and approval. In November 2018, the NMPA issued a list of 40 urgently needed drugs launched abroad and updated its work procedures. In May 2019, a second list of 26 urgently needed drugs launched abroad was issued by the NMPA, including 17 rare disease drugs.

In June 2018, the NHC issued the Work Procedure for the Issuance of the Rare Diseases Lists and the First Rare Disease List, which established the foundation for rare disease diagnosis; in February 2019, the NHC set up the National Rare Disease Diagnosis and Treatment Coalition. Also in February 2019, the State Council reduced VAT on 21 rare disease drugs and four active pharmaceutical ingredients (APIs) to three per cent.

The working group believes these announcements will improve patients’ accessibility to rare disease drugs and make them more affordable. However, among the 121 diseases included in the First Rare Disease List, only 83 drugs treating 53 diseases are available on the Chinese market, and only 55 drugs have been registered for 31 rare disease indications. To allow greater access to treatment for patients with rare diseases, the working group suggests the Second Rare Disease List be expanded to include more diseases. To do so, the regulators will have to clarify the criteria for the inclusion of rare diseases and take the industry feedback into account.

As rare disease-related matters are currently managed by different ministries, the working group recommends the setting up of a cross-ministerial coordination mechanism responsible for establishing and regularly updating the rare disease drug list, as well as regularly updating the Rare Disease Lists. Such a mechanism would also provide the foundation for corresponding market access and VAT reduction policy measures.

Accurate diagnosis is essential to ensure the most effective treatment. The working group recommends the NHC to take steps to further regulate the diagnosis and treatment of rare diseases and improve the ability of medical workers to identify, diagnose and treat rare diseases.

The absence of a national and sustainable funding solution to reduce out-of-pocket (OOP) payment by patients is another challenge faced by rare disease patients. Few rare diseases drugs are included in the NRDL so far. The working group recommends integrating more rare disease products into the NRDL to lower patients’ OOP expenses. In addition, increasing cooperation between government agencies and public-private partnerships will allow diversification of funding and decrease the financial burden on patients and their families.

Recommendations

• Establish a central office responsible for rare diseases in order to improve and strengthen inter-ministerial communication and coordination.
• Increase public awareness of rare diseases and improve the diagnosis and treatment capacity of healthcare institutes and personnel by engaging different stakeholders such as academics, not-for-profit organisations and patient organisations.
• Clarify the criteria for the inclusion of rare diseases and take rare gene mutations as well as industry...
feedback into account in order to expand the Rare Disease List.

- Improve accessibility to rare disease drugs by introducing an expedited evaluation and approval registration process, issuing corresponding specific measures for drugs not yet launched in China, and accelerating the process of adding new Rare Disease and Orphan Indications for drugs already on the market.
- Optimise market access by establishing a dynamic adjustment mechanism for the rare disease drugs list.
- Include more rare disease drugs in the coming NRDL adjustment, or establish a special national fund to aid rare disease patient treatment in order to improve the affordability of their drugs.
- Set up a rare disease legislative framework that would include provisions on patient care and drug accessibility.

3. Promote the Reform of the Public Medical Insurance System

Concern
The disconnect between commercial health insurance and basic medical insurance does not meet patients’ needs, and the lack of genetic testing—which guides targeted cancer therapy—in China’s NRDL may result in patients missing timely access to the most beneficial treatments.

Assessment
With the development of pharmaceutical research, cancer treatment is moving from chemotherapy to precise treatment, including targeted therapy and immunotherapy.

On 10th October 2018, the NHSA issued the Notice on the Inclusion of 17 Oncology Drugs in Category B of the NRDL under the BMI, Occupational Injury Insurance and Maternity Insurance Programmes.27 The 17 oncology drugs include 12 solid tumour drugs and five haematological tumour drugs used for treating non-small cell lung cancer, kidney cancer, colorectal cancer, melanoma and lymphoma, among others. The reimbursement of these clinically-necessary drugs can significantly reduce patients’ financial burdens.

Genetic testing is essential in most targeted cancer therapies. It plays a crucial role in ensuring the effectiveness of targeted drugs for both initially diagnosed and recurring carcinoma. Results of genetic testing reveal whether individual cancer patients are suitable for specifically targeted drugs. It also supports doctors in screening focus groups and optimising treatments. The non-inclusion of genetic testing in China’s BMI adds to patients’ economic burden, affects therapeutic decisions and is likely to have an impact on their survival rates as well. Therefore, the working group advocates that the social reimbursement system not only incorporate additional urgently needed anti-cancer drugs, but also the genetic testing fee to best utilise limited medical insurance resources.

In addition, the coverage of oncology drugs in Category B of the NRDL under the BMI leads to a significant increase in medical insurance expenditures – especially for regions with inadequate reimbursement funding available. The government indicated that hospitals’ total reimbursement budget shall exclude the 17 negotiated drugs in 2018, and be evaluated on rational usage of all drugs in 2019. Furthermore, drug capping (the percentage of drug revenue among the total medical revenue) and the total reimbursement budget shall not affect the necessary usage of the negotiated anti-cancer drugs in hospitals. However, actual implementation may vary across regions. With growing concern among hospital directors about cost control and reimbursement supervision, patients’ access to these drugs may be affected. To strengthen the implementation of the negotiated BMI drugs and to allow more patients to benefit from China’s healthcare reform, the working group recommends conducting a dual-channel pattern in areas where the negotiated BMI drugs can only be purchased at hospitals. By allowing patients to get prescription drugs at designated retail pharmacies and reimburse the cost via the BMI, the dual-channel pattern will effectively solve the problem of difficult implementation of the negotiated BMI drugs in hospitals and broaden patients’ access to required medicine.

In addition, the working group recommends running reimbursement pilots through the unified planning fund of the BMI for chronic diseases such as hypertension and diabetes via designated retail pharmacies to improve the accessibility of drugs. The 2019 Government
Work Report indicates the government will increase reimbursement on drugs treating chronic diseases like hypertension and diabetes for outpatients. In China, hundreds of millions of patients are affected by chronic diseases. By allowing medical insurance reimbursement in designated (special drug) pharmacies, the pressure on outpatient services will be greatly reduced, and become more convenient for patients.

Lastly, with the increasing burdens on medical insurance funds, it is necessary to further promote the combination of commercial health insurance and the BMI. In this regard, China could align with international practices by fully leveraging the strength of commercial insurance and promote the reform of medical insurance payments. Commercial insurance should be encouraged to cover innovative drugs and methods of diagnosis and treatment. Commercial insurance should also undertake and supplement personal BMI accounts, such as outpatient and hospitalisation expenses under the deductible line and above the capping line, and the drug and medical treatment that is within the government policy’s scope of self-payment. In the future, the medical insurance system should be designed to allow patients to reimburse their personal BMI accounts by purchasing commercial insurance, thus securing patients’ right to choose different medicines.

Recommendations

- Incorporate genetic testing that guides tumour-targeted therapy into medical insurance coverage in order to further improve treatment effectiveness and the efficient use of medical insurance funds.
- Leverage medical insurance-designated (specific drug) pharmacies to improve the supply of negotiated BMI anti-cancer drugs.
- Run medical insurance payment pilots for the treatment of chronic diseases such as hypertension and diabetes in designated pharmacies.
- Align with international practices by fully leveraging the strength of commercial insurance, and promote the reform of the medical insurance payment system.
- Build an evidence-based reimbursement negotiation procedure for innovative drugs to allow companies to apply for reimbursement negotiation.

4. Further Improve the Implementation of the Volume-based Procurement (VBP) Policy to Ensure Market Competition as well as Patients’ and Doctors’ Access to High-quality, Safe and Efficacious Drugs

Concern

China’s VBP policy has significantly reduced drug prices, however, the one winning bidder principle has impacted both patients’ and doctors’ access to drugs and taken a strong toll on market competition.

Assessment

On 14th November 2018, the Comprehensive Reform Committee of the CPC Central Committee approved the National Centralised VBP Pilot. The policy states that only one winner per molecule name—among a total of 33 molecule names that have passed the Generics Quality Consistency Evaluation (GQCE)—will be given over 70 per cent market shares in 11 key cities. On 7th December 2018, the tender results of 25 molecule names were announced. The lowest bidding price was automatically chosen for drugs with three or more bidders. Drug prices subsequently dropped by as much as 96 per cent, with an average decrease of 52 per cent.

The industry fully supports the government’s goal of reducing patients’ financial burdens, but is concerned that awarding such a significant market share to one company could potentially create unfair competition and set unreasonable or higher-than-necessary access thresholds for multinational pharmaceutical firms. In addition, there are many risks associated with extremely low-price bids such as long-term supply reliability and quality maintenance. The ‘winner takes all’ approach of this pilot risks patients being treated inadequately due to a lack of different options. Every patient and his/her condition is different, therefore a choice of drugs for the same indication is necessary to address all needs to ensure tolerability and efficacy.

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29 Xi Jinping Chairs the Fifth Meeting of the Comprehensive Reform Committee of the CPC Central Committee, Xinhua, 14th November 2018, viewed 8th April 2019, <http://www.xinhuanet.com/politics/leaders/2018-11/14/c_1123714393.htm>
30 Beijing, Shanghai, Tianjin, Chongqing, Shenyang, Dalian, Guangzhou, Shenzhen, Xi’an, Chengdu and Xi’an, Analysis: National VBP – Six Major Changes, Sina, 16th October 2018, viewed 8th April 2019, <https://lmed.sina.com/article_detail_103_1_54148.html>
31 Xi Jinping Chairs the Fifth Meeting of the Comprehensive Reform Committee of the CPC Central Committee, Xinhua, 14th November 2018, viewed 8th April 2019, <http://www.xinhuanet.com/politics/leaders/2018-11/14/c_1123714393.htm>
The industry further suspects this policy may contribute to abuse of administrative power by restricting market competition. Many hospitals in the 11 cities have delisted or stopped procuring non-winning drugs in order to reach the procurement volume committed to the winning bidders. This has posed a great challenge to originator drugs produced by foreign pharmaceutical companies. The industry expects, in accordance with the spirit of the Notice on Promoting the Reform of Drug Price (No. 904 NDRC Price [2015]), which encourages market competition, that full competition and reasonable market price formation by market means can be promoted. Under the current VBP management model, the winning bid and non-winning products are purchased on a 1:1 ratio, and actual needs of patients in different medical institutions are not fully reflected.

Additionally, a few provinces outside of the 11 key cities, such as Fujian, Qinghai and Hebei are directly allocating volume to the 11 city VBP winners without launching a tendering process. This approach deprives the industry of the opportunity and right to participate in an open and fair tendering process.

Therefore, the working group recommends that the next round of VBP implementation should wait until more drugs pass the GQCE. The next round should be based on a comprehensive review of the experience of the first round.

Recommendations
- Ensure an open and fair tendering mechanism in any new VBP, and for the products included in the previous 4+7 VBP, a tendering process should be introduced to select the winner(s) in any province/city outside of the 11 cities.
- Conduct comprehensive tender evaluation and avoid selecting winners purely based on lowest price.
- Carefully extend the VBP pilot and define the scope, time and region for the next round of implementation until more drugs (at least three generic drugs per molecule type) pass the GQCE.
- Further evaluate therapeutic substitution and rational use of drugs at the operational level in hospitals.
- Apply fair competition principles to non-winning products that participated in the VBP bidding instead of gradual price reductions or setting price limits, and avoid compulsive or disguised compulsive reduction for non-winner products by administrative measures.
- Allow hospitals to purchase products according to the actual needs of patients if the procurement progress of selected products is on track within the city or hospital alliances, and adjust and allocate procurement volume according to the actual situation among medical institutions in the middle of the procurement cycle (e.g. at the sixth month of implementation).
- Separate biosimilar from generic products and make biosimilar products independent from generic scope with regard to their complexity and specialty.

5. Build a Favourable and Effective Regulatory Environment for Innovative Vaccines

Concern
Foreign vaccine companies are facing a number of market access challenges in China, such as cumbersome registration processes and the lack of alignment between the Chinese Pharmacopeia’s (ChP) specificities and international standards.

Assessment
The government’s new healthcare policy is prioritising disease prevention through significant growth of China’s vaccine market by expanding China’s National Immunisation Programmes (NIPs), while maintaining a relatively high immunisation rate for eligible children. Following several vaccine scandals in 2018, the safety of vaccine products has drawn increasing attention from the Chinese Government. On 29th June 2019, the NPC passed the Vaccine Administration Law. The law aims to strengthen vaccine management, ensure quality and supply, standardise vaccination, promote the development of the vaccine industry, and safeguard public health. Vaccine R&D on major disease prevention has also been incorporated into national strategies and given priority support.

Despite these developments, imported foreign vaccines are still subjected to stringent regulatory barriers. China’s vaccine market consists of a public market

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with Class 1 vaccines, which are all covered under the government-funded NIP and are provided to children and high-risk groups, and a private market where Class 2 vaccines are paid for by consumers. The national procurement of Class 1 vaccines is open to domestically-produced products only. More Class 2 vaccines that are safe, urgently needed and affordable are expected to be included in the NIPs – thereby closing access for international pharmaceutical companies.

Besides market access barriers, the working group sees the longer review and approval process for vaccines as another major challenge for business in China. The accelerated regulatory pathway for innovative drugs, specified in 2017, does not cover vaccines. Vaccines are still excluded from the International Multi-centres Clinic Trial (IMCT) and mandated by the Overseas Marketing Authorisation (OMA). The Pharmaceutical Working Group acknowledges the recent progress made by the NMPA in piloting the vaccine review and approval process. The working group also understands a similar regulatory reform for vaccines may soon be launched, in which these products could have up to six years’ acceleration for registration in the China market. The working group appreciates the Chinese Government’s efforts in this regard but hopes vaccines can explicitly benefit from accelerated registration pathways.

The ChP lists over 5,000 types of products, including vaccines. The edition of the ChP expected to be released in 2020 will probably add 800 types of products and increase quality requirements. The working group recommends further evolving ChP standards and monographs to achieve closer convergence and harmonisation with current global standards. The working group also urges for internationally-recognised pharmacopoeias to be accepted as interchangeable standards to the ChP to enhance market accessibility. This would reduce the need for modification in manufacturing/additional testing, not just for imported vaccines from other countries but also for the exportation of Chinese vaccines. Allowing experts from foreign pharmaceutical manufacturers to participate in the ChP Committee would further benefit China by ensuring it can draw on knowledge and best practice sharing, and receive high-level support from the European and US Pharmacopoeia.

Recommendations

• Reform China’s procurement criteria and process to include all NMPA-approved vaccines, imported and locally manufactured, for its NIPs, to enable access for more innovative vaccines and build a more sufficient and sustainable supply to address public health needs.
• Build a favourable and effective regulatory environment for innovative vaccines, including but not limited to IMCT and OMA, in order to reduce current delays of six to eight years in addressing public health demands with new innovative vaccines.
• Promote the harmonisation of the ChP with international standards.

Abbreviations

API   Active Pharmaceutical Ingredient
BMI   Basic Medical Insurance
CFDA  China Food and Drug Administration
ChP   Chinese Pharmacopoeia
CPC   Communist Party of China
CPIA  China Pharmaceutical Industry Association
EUR   Euro
GQCE  Generic Quality Consistency Evaluation
IMCT  International Multi-centres Clinic Trial
IP    Intellectual Property
NHC   National Health Commission
NHSIA National Healthcare Security Administration
NIP   National Immunisation Programme
NMFA  National Medical Products Administration
NPC   National People’s Congress
NRDL  National Reimbursement Drug List
OMA   Overseas Marketing Authorisation
OOP   Out-of-pocket
PTE   Patent Term Extension
RDP   Regulatory Data Protection
R&D   Research and Development
SAMR  State Administration for Market Regulation
VAT   Value-added Tax
VBP   Volume-based Procurement
Shipbuilding Working Group

Key Recommendations

1. Engage Constructively, Through Relevant Global and Bilateral Channels, Towards Building Effective Solutions to Restore Normal Competitive Conditions and a Level Playing Field in Shipbuilding
   - Engage constructively with the European Union (EU) in all relevant international fora, including in the context of the ongoing World Trade Organization (WTO) reform discussions, in pushing for effective rules to address all trade distorting factors in shipbuilding in order to restore healthier and competitive market conditions, taking into account the limits of the current international trade disciplines.
   - Explore the possibility of concluding a parallel bilateral sector-specific agreement to send a very strong joint signal in favour of a level playing field and reciprocal market access in the maritime technology industry.

2. Facilitate the Access to, and Participation of European Companies in, China’s Maritime Markets by Granting them National Treatment and by Removing Market Access Barriers
   - Conclude a mutual recognition agreement between the EU and China on approval or certification of marine equipment.
   - Ensure that European maritime equipment manufacturers can compete on equal terms with local equipment manufacturers or with manufacturers owned by the Chinese State.
   - Exempt imported ship components from the payment of value-added tax (VAT).

3. Expand Financing Opportunities for Foreign-invested Firms in the Shipbuilding Industry
   - Expand financing opportunities for foreign companies.
   - Allow Chinese leasing houses to finance foreign-invested shipyards.

4. Expand Opportunities for Foreign-invested Firms in the Shipbuilding Industry to Access Research and Development (R&D) Funds
   - Clarify how foreign-invested companies can gain access to funds destined for R&D activities.
   - Create a transparent platform that can enable foreign-invested enterprises to gain access to R&D funds.
Introduction to the Working Group

The Shipbuilding Working Group represents European, world-leading companies that design, manufacture, maintain and repair ships, as well as maritime equipment manufacturers, classification societies, service providers and cruise operators. In a world that is more interconnected than it has ever been, the shipbuilding sector is a strategic driver for the development of a competitive and sustainable maritime transportation system. In this regard, shipyards and manufacturers of ship components play an essential role in satisfying the increasing global demand for cleaner and safer transportation systems. European companies in the sector have a long track record of contributing to the environmental sustainability and increased energy efficiency of ships.

Having operated in China for more than 20 years, European manufacturers of ships and ship components are deeply committed to the market and want to continue to contribute their know-how and best practices to its development. This is in line with the goals of the 19th Communist Party of China (CPC) National Congress and the second and third plenary sessions of the 19th CPC Central Committee, where the aim was stated that China will build “a manufacturing power and maritime power, centring on improving the quality, efficiency and the benefits of shipbuilding, focusing on comprehensively promoting digital shipbuilding”, as well as to “promote innovation, improve weak links, strengthen the foundation and set good examples to promote the digital and networked integration of ship design, building, management and service.”

Recent Developments

Since China’s accession to the World Trade Organization (WTO) in 2001, China’s shipbuilding industry has undergone tremendous growth, especially in terms of output, which further intensified after 2006 when Beijing recognised the industry as strategic. While in 2002 China was representing only 7.3 per cent of the world total of 21.4 million compensated gross tonnage (CGT), in 2018 its share had risen to 35.8 per cent of the total 32.14 million CGT delivered globally.

In tonnage terms, in 2018 China kept its position as the global shipbuilding leader in the commercial orderbook, with 27.7 million CGT corresponding to 32.7 per cent of the market share, and an output level of 11.5 million CGT, roughly 35.6 per cent of the market. China’s production capacity remains centred on bulk carriers, oil tankers and container ships. In terms of order acquisition, China obtained 24.7 per cent of the global market in 2018.

In 2017, China produced 32 per cent of the world’s container ships and 30 per cent of tankers, accounting for 20 per cent of global ship deliveries. It was also able to capture a higher share of the current orderbook at 37 per cent. For shipbuilding companies, the orderbook is of consequence because it determines the period of time the company has work scheduled for. This period of time is usually measured using the ‘forward cover’, which is calculated by dividing the current orderbook by the previous year’s output in CGT terms. In 2018, China registered 2.4 years of forward cover, whereas the European Union (EU) registered 4.9 years. Usually shipbuilding companies consider 24 months the minimum forward cover necessary to assure a minimum level of planning security.

China’s low forward cover is paired with a lower market share in terms of value, more-or-less on a par with Europe, with a share of about 30 per cent, due to the fact that the portfolio of Chinese companies is still centred on lower-end, low-added value products.

Throughout 2018 and in the first quarter of 2019, China’s

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2. Compensated Gross Tonnage (CGT) is an international unit of measure that facilitates the comparison of different shipyards’ production. More specifically, it is an indicator of the amount of work that is necessary to build a given ship and is calculated by multiplying the tonnage of a ship by a coefficient, which is determined according to type and size of a particular ship.  
5. Data source: IHS Markit, paid subscription service.  
6. In 2018, South Korea regained the lion’s share in new ordering, surpassing China and achieving a 40 per cent market share in CGT terms. The impressive increase in the ordering levels at South Korean yards was largely as a result of a strong government intervention in support of local shipyards and a recovery in some market segments (LNG carriers).  
Shipbuilding industry witnessed an overall decline in terms of industry performance, with a 30.8 per cent drop year-on-year in terms of output and 16.2 per cent in terms of profits.\(^8\) The main drivers behind this decline have been the overall overcapacity of the domestic industry coupled with insufficient demand in the global market.\(^9\) To counter this issue, the main domestic players increased their spending on research and development (R&D), especially in relation to the production of smart and green low-speed diesel engines, devices for recycling exhaust gasses and 25 megawatt (MW) dual-fuel, gas turbine generators. Nonetheless, the country’s market share continued to fall behind in key high added-value sectors such as the construction of large crude oil vessels, large containerships and large liquid natural gas (LNG) carriers. As a result, the industry is under pressure to increase efficiency and focus on more profitable sectors, especially as China’s shipbuilding sector is plagued by rapidly increasing manufacturing costs.\(^10\)

China has already overtaken Germany to become the world’s second largest cruise market after the United States. China is seeing a double-digit annual increase that may allow it to reach 10 million customers by 2026. This result, however, is still marginal if we compare it with the penetration rate of cruises in the industry’s traditional markets of Europe and North America. Chinese cruise tourist numbers still represent only 0.5 to one per cent of travellers globally, compared with 3.5 per cent for both Europe and North America. However, among the 4.05 million cruise passenger from Asia, China accounted for more than 60 per cent of them in 2017.\(^11\) Meanwhile, Chinese tourists have also developed sophisticated demands for services that do not necessarily match how cruise ships have been built so far: among these are more digital connectivity, different types of cuisines, more gaming and karaoke facilities, cabin configurations to accommodate larger families and enhanced shopping choices. Chinese passengers’ expectations will be the driver for a ‘revolution’ in the concept of cruise ships.\(^12\)

However, cruise operators in China—both domestic and foreign-invested—face many challenges that negatively impact the sustainability of their business. First of all, they are not allowed to sell cruise tickets directly to customers, and instead have to go through travel agencies. As a result, cruise operators are not allowed access to their customers’ data, thus often struggle to adapt their offers to meet market demands.

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\(^8\) Data on China’s shipbuilding industry do not include foreign-invested enterprises (FIEs).


\(^12\) This analysis originally appeared in Fresh Horizons: Prospects for Growth in China’s Cruise Shipbuilding Industry, EURObiz, 11th April 2019, viewed 22nd May 2019, <https://www.eurobiz.com.cn/fresh-horizons/>
Furthermore, due to geopolitical tensions as well as the strict regulations on the number of ports that ships flying foreign flag can access, cruise operators struggle when it comes to offer articulated routes and are limited to a small number of destinations.

Currently, China has two shipbuilding companies involved in building cruise ships: Waigaoqiao and China Merchants Heavy Industries. The latter will complete the construction of China’s first Infinity-class cruise vessel—a large sea cruise vessel—in 2019. This constitutes a milestone for the company, which traditionally built cruise vessels for the Yangtze river and is now investing heavily to expand its building capacity to manufacture ocean cruise ships. A third company is expected to enter the market. China is expected to be able to build six cruise ships per year in 2030.\(^{13}\)

Furthermore, China is also ramping up its capabilities to build RoPax vessels,\(^ {14}\) and is expected to deliver eight of them in the next three years. On average, Chinese shipyards are expected to build three RoPax vessels per year until 2029.

China’s large shipbuilding companies are also moving up the value chain into ship equipment and components and carrying out vertical integration to enhance their competitiveness and profitability. The ship equipment industry is an important part of the shipbuilding industry. Ship-specific equipment—including power systems, electronic and electrical equipment, deck machinery and accommodations—accounts for from about 40 up to as much as 70 per cent of total ship value. From a value chain perspective, due to high technical barriers and concentration levels, the upstream ship equipment industry has a much higher gross margin level than downstream shipbuilding and assembly activities.

High-end diesel or dual fuel engines, propulsion systems, and communication and navigation equipment and other more complex or high-end types of marine equipment are areas in which European marine equipment manufacturers today have a world-leading position that Chinese marine manufacturers have a strong interest in catching up on. In the field of power systems, domestic diesel engines have achieved technological breakthroughs and gained market recognition.

The transformation and upgrading of the Chinese shipbuilding industry has created new opportunities for ship equipment companies and investors, and will bring more opportunities for high-end ship equipment. The future upgrading of the Chinese product mix to more high-value-added ship types will bring incremental demand for high-end marine equipment.

Multinational ship equipment companies can secure key accounts and gain first-mover advantage by leveraging their technological advantages and relationships with global shipowners. At the same time, they can deploy and develop distribution networks to strengthen their customer relationship management with local large shipyards. A local procurement, original equipment manufacturer (OEM) or other viable localisation plan would reduce cost and improve price competitiveness of the products.\(^ {15}\)

**China’s Shipyards**

In the first two months of 2019, Chinese shipyards experienced a 25 per cent year-on-year decline, with orders for 65 vessels and a combined level of 1.2 million CGT. Nonetheless, it is important to note that such a decline is part of a broader, global trend. China’s shipyards remained focused on the construction of bulk carriers that, consisting of 23 vessels of a combined 2.8 million deadweight tonnage (dwt), still represented 61 per cent of the total in CTG terms.\(^ {16}\)

The Chengxi shipyard, located in Jiangsu province, proved to be China’s fastest growing shipyard for the second year in a row. This is partly due to the fact that it is diversifying its portfolio by adding chemical tankers and feeder containership in addition to its traditional focus on bulk carriers.

**Policy Updates**

The shipbuilding industry is unique for three main reasons. First, it is a strategic industry because it allows the development of technologies that can have military and civilian applications at the same time. Second, it has global dimensions that cannot be restrained to a single country or region. In fact, being the primary transportation mode throughout the globe, ships are rarely imported or exported into a single country and

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14 RoPax vessels or Ro-Ro (roll on, roll off) ships are ships or ferries that can be used to transport both passenger and goods.
### Section Three: Goods

#### European Business in China Position Paper

Output data for China’s Six Largest Shipyards

<table>
<thead>
<tr>
<th>Shipbuilder</th>
<th>Shipyard Data</th>
<th>2018 Output</th>
<th>2019 Output</th>
<th>Global Ranking</th>
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<td>Chengxi</td>
<td>5</td>
<td>516</td>
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Instead are deployed and constantly moved all over the planet. Finally, given the high cost and the long time necessary to build a ship, the sector is cyclical, non-repetitive and capital-intensive. As a result, the industry is understood by global leaders and policy-makers alike as a symbol of economic development and long-term prosperity. This is why it is incentivised by governments with long-lasting effects that have global repercussions.

China has no exception since 2006, when, with the 11th Five-year Plan, Beijing recognised shipbuilding as a strategic industry and deployed a wide number of subsidies to support it. Thanks to those subsidies, the country’s market share doubled in less than three years from 25 to 50 per cent in the late 2000s. In 2009, the central government doubled down on these efforts with the Shipbuilding Scapping and Newbuilding Subsidies Programme that was extended until 2017. At the core of this policy were strict regulations and high subsidies aimed at forcing the demolition of old and energy-inefficient vessels, so as to stimulate the demand for new ships. The plan also encouraged shipowners to place orders at Chinese shipyards. As a result, whereas in 2013 only 28 per cent of the orders made by Chinese shipowners were directed to domestic shipyards, the number doubled to 56 per cent by 2016. The State owns 94 per cent of Chinese shipyards, and more than 90 per cent of them were included in the so-called ‘white-list’. Shipyards included in the list were allowed to benefit from government funds and special bank loans. The list was first introduced in 2014, and officially abolished on 2nd April 2019. 18, 19

In 2016, the Chinese Government published the China Manufacturing 2025 development plan, which clearly stated that Beijing aims to take over Europe’s global leadership in building complex and technology-intensive ships and in manufacturing of high-end and complex categories of marine equipment.

This wide range of policies proved to have a distortive effect that reverberated globally, and, above all, determined a vicious cycle that still chokes the sector to this day. Such tremendous incentives led shipyards to fill their production facilities and accept loss-making orders, which often unbalanced the supply and demand ratio, further bringing down building-price levels. With such low prices, shipyards ended up with an unsustainable business model that often pushed them into bankruptcy. However, since Beijing recognised the sector as strategic, and given the high number of jobs created by the industry, the bankruptcies prompted interventions from the government that, in almost all cases, bailed them out. This further distorted the market and maintained the cycle of adverse effects, such as overcapacity and prices well below production costs, that are continuing to negatively affect the global market.

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On the top of that, this distortive system not only directly damaged European shipyards but also excluded foreign-invested equipment manufacturers from the Chinese industry. In fact, to implement the Shipbuilding Scarping and Newbuilding Programme and the Shipbuilding Action Plan (2016–2020), the government pushed for 70 per cent of marine equipment to be acquired from local suppliers first, and 50 per cent after 2016. This unfairly excluded European manufacturers from providing key components such as engines, which alone constitute 40 per cent of a ship’s equipment.  

Albeit many of the subsidies to the industry were toned down in 2017, they continued under the form of import taxes and tax exemptions, as stipulated in the Catalogue of the Models of Energy-Saving and New Energy Automobiles Entitled to Vehicle and Vessel Tax Reduction or Exemption (Sixth Group), and in the Notice of the Ministry of Finance, the National Development and Reform Commission, the Ministry of Industry and Information Technology, et al, on Adjusting the Relevant Catalogues of the Import Tax Policies for Crucial High-Tech Equipment, as Amended 2018. 

In 2018, speaking at the Bo’ao Forum, President Xi Jinping declared that “China’s door will not be closed and will only open wider and wider.” This announcement seemed to be followed by concrete actions in the shipbuilding sector, as the industry was removed from the 2018 Foreign Investment Negative List. This action was followed up with the release of the Action Plan for Sustainable and Healthy Development of Offshore Engineering Equipment Manufacturing Industry (2017–2020) that aimed to deepen reform and boost innovation, intensify structural adjustment and speed up the process of opening up. 

Nonetheless, the removal of the restrictions on foreign investment in the sector remains incomplete as there is a lack of clear implementing guidelines. In addition, as stated earlier, China did not put an end to all the practices the country has promoted over the last 20 years, which distorted the market and made its shipbuilding sector a global leader. In this regard, Beijing’s ambition to take over Europe’s global leadership position in complex shipbuilding and advanced maritime technology has been translated into active policy with the Action Plan to Promote the Smart Transformation Shipyards and Shipbuilding (2019–2020) and the Intelligent Ship Development Action Plan for 2019–2021. Those two action plans set a wide range of goals and actions through which the central government aims to upgrade its domestic shipbuilding industry in terms of added value. More specifically, the two plans set tasks and ambitions to strengthen organisation and coordination within the industry, improve support for innovation and enhance financing mechanisms. These tasks are further articulated in a series of steps the industry is to take, such as making breakthroughs in a number of key technologies, building a group of intelligent manufacturing standards and platforms, and promoting the refinement and digitalisation of basic management control. The long-term goal is unequivocal: “China’s shipbuilding industry is at the strategic juncture of transformation from large to strong. Shipbuilders should grasp the opportunity, comply with the trend, take the initiative, catch up with and surpass developed countries on the basis of establishing the modern shipbuilding model in an all-round way, to push the intelligent level of China’s final assembly shipbuilding to a new level.” 

On 2nd July 2019, listed units of the China State Shipbuilding Corp (CSSC) and of the China Shipbuilding
### Key takeaways of the two 2019–2021 action plans for the shipbuilding industry

|-------|--------------------------------------------------------------------------------------------------|--------------------------------------------------|
| Issued by | • MIIT  
• State Administration of Science, Technology and Industry for National Defence | • MIIT  
• Ministry of Transport  
• State Administration of Science, Technology and Industry for National Defence |
| Status quo | • Development of information and communication technology  
• Development and address deficiencies of China’s intelligent shipbuilding | • Development and deficiency of global intelligent shipping |
| Strategic goals | Become a manufacturing and maritime power | Become a manufacturing, maritime and transportation power |
| Action goals | Establishing intelligent shipbuilding technology innovation system and standard system within three years | Establishing intelligent shipping standard system within three years |
| Major tasks | • Key generic technology and imperative equipment of intelligent shipbuilding  
• Development of key intelligent equipment in areas where China lags behind  
• Management refinement and digitalisation  
• Information infrastructure of shipyards  
• Standard system of intelligent shipbuilding  
• Full 3D digital design  
• Intelligent workshop  
• Digital integration (design, production and management information along supply chain) and service of shipbuilding | • Mid- and long-term development plan, definition clarification, classification, categorisation, regulations, etc.  
• Core technology (intelligent sensing systems, network and communication systems, intelligent navigation systems)  
• Intelligent upgrading of shipping equipment  
• Cyber and information security  
• Testing and verification capacity  
• Norms and standards  
• Pilot demonstration  
• An ecosystem of synergetic development (ships, berths, ports; navigation, management, goods; ship design, building, testing) |

Corp (CSIC) made several stock fillings and revealed that they are in advanced talks over a strategic merger. The two enterprises used to be a single company until 1999, when Premier Zhu Rongji split them in an effort to break monopolies and boost competition. The move has been motivated as a way to consolidate the industry and tackle over-capacity. Nonetheless, it also appears to be in line with the strategy of Made in China 2025—where shipbuilding is labelled as a “key industry”—especially if seen in conjunction with the two action plans mentioned above. The merger is expected to create a giant that will control 20 per cent of the global market and have annual sales amounting to over CNY 400 billion.

### Key Recommendations

1. **Engage Constructively, Through Relevant Global and Bilateral Channels, Towards Building Effective Solutions to Restore Normal Competitive Conditions and a Level Playing Field in Shipbuilding**

**Concern**

Government interventions and trade-distorting practices have the potential to prolong the severity of the current excess capacity problem in shipbuilding, jeopardising the recovery path of the global market towards a healthier business environment and more profitability.

**Assessment**

Both Europe and China together with the rest of the world are facing severe challenges in the shipbuilding...
and shipping sector, due to persistent global excess capacity and supply of vessels and historically low newbuilding prices. The menace of overcapacity in both the production as well as the operation of ships reduces the maritime industry of its capacity to deliver on urgent societal challenges, including decarbonisation. In the present situation of low shipbuilding activity, the magnitude of trade-distortive government interventions and practices becomes apparent, jeopardising the global market’s recovery towards a healthier business environment and more profitability. By way of example, the persistence of such measures has recently been subject to a WTO dispute settlement procedure initiated by Japan against South Korea.29

Due to the specificity of the shipbuilding industry, the current international trade rules are ineffective in preventing and deterring the build-up of market distorting factors that are largely responsible for the present situation.

The general discipline of the WTO Agreement on Subsidies and Countervailing Measures (ASCM) only prohibits the use of subsidies that are contingent upon export performance or upon the use of domestic over imported goods.30 However, these cover only a fraction of subsidies in shipbuilding. For instance, subsidies in the form of restructuring aid are categorised as ‘actionable subsidies’ and can be disputed only if they result in adverse effects, which are extremely difficult to prove. Moreover, since ships are rarely imported permanently, it is nearly impossible for the appropriate countermeasures listed by the WTO to be applied at customs in response.

In fact, the usual counteraction to subsidies is based on a dual-track approach that encompasses on the one hand countervailing duty measures at the border and, on the other hand, dispute settlement at the WTO. Given that, as mentioned above, it is not possible to apply countervailing measures, the only possible recourse is dispute settlement. Even in this case, the tools offered by the WTO’s rule system are ineffective. In fact, if the ASCM wins a dispute, it can only order cessation of subsidies, which does not solve the problem because once the order has arrived the transaction has already been completed, and the ship delivered.

Similarly, the WTO Anti-dumping Agreement (ADA) has been proven to be ineffective because ships are rarely imported in the common customs sense, and no activity takes place in the buyer country.31 Moreover, ships are usually not built in series; they are constructed to satisfy specific needs and, as they are a large investment, buyers rarely buy more than one. As a result, it is difficult to establish a ‘like product’ and calculate the related dumping margins on it.

Government subsidies and practices that distort the market have long-lasting detrimental impact on the health and profitability prospects of both the shipbuilding and shipping industry. The creation of effective safeguards to normal competitive conditions, through effective disciplines tailored to the specificities of the shipbuilding industry, should be a shared interest for Europe and China to pursue through all relevant bilateral and international fora.

Recommendations
- Engage constructively with the EU in all relevant international fora, including in the context of the ongoing WTO reform discussions, in pushing for effective rules to address all trade distortive factors in shipbuilding in order to restore healthier and competitive market conditions, taking into account the limits of the current international trade disciplines.
- Explore the possibility of concluding a parallel bilateral sector-specific agreement to send a very strong joint signal in favour of a level playing field and reciprocal market access in the maritime technology industry.

2. Facilitate the Access to, and Participation of European Companies in, China’s Maritime Markets by Granting them National Treatment and by Removing Market Access Barriers

Concern
Despite the shipbuilding industry having been removed from the Foreign Investment Negative List, European companies struggle to access the sector due to hidden

market access barriers and discriminatory treatment arising from the proliferation of subsidies, tax benefits and preferential treatment extended to state-owned enterprises (SOEs).

**Assessment**

The draft *Catalogue on Encouraging Foreign Investment Industries*, published in 2019, is a clear example of how Beijing uses government policies to encourage forms of technology transfers aimed at advancing the competitiveness of the domestic industry. The catalogue encourages foreign investments in activities related to designing and projecting ships and ships components, whereas production is openly excluded. Hence, it appears that the government’s intent is to encourage foreign companies to share their know-how and best practices, while leaving to their Chinese counterparts the economic and industrial benefits related to selling and producing.

Moreover, foreign owners of certain types of ships built at Chinese shipyards face limitations that give unfair advantages to Chinese competitors. For instance, foreign owners of dredgers built in Chinese shipyards are not allowed to use these vessels in areas the Chinese Government designated as strategic, such as the South China Sea, whereas their Chinese counterparts are not subjected to the same kind of restrictions.

Another notable example of this wider trend is the fact that China does not accept the Marine Equipment Directive (MED) certification procedure and the wheel mark for equipment, components or materials destined for China flagged ship classes, although the China Classification Society (CCS) is authorised to perform MED certification.

As a result, European equipment manufacturers are forced to apply and obtain CCS certification, and this additional procedure often burdens them with additional costs. This practice is unfair as Chinese marine manufacturers can automatically obtain a MED certification from CCS or another class society approved by the EU, which allows them full access to the European market and to vessels flying flags of any Member State. Some European manufacturers are also subject to higher certification costs at CCS than local manufacturers even though the products are similar and have similar safety criticality or environmental performance.

Similarly, it has been unclear whether Chinese authorities will approve ballast water treatment systems (BWTS) manufactured by EU or other foreign equipment manufacturers to be installed on Chinese vessels, irrespective of having International Maritime Organization Type-approval Certification (IMO TAC) issued by CCS or another class society.

There have been indications that Chinese equipment manufacturers and equipment manufacturers owned by the Chinese state have been granted priority in shipbuilding projects – in particular in those involving Chinese shipowners – to the detriment of European-owned maritime equipment manufacturers.

Finally, in contrast to international industry norms, Chinese shipbuilders that acquire and import ship components from outside China have to pay value-added tax (VAT) on them. This unfairly impacts the competitiveness of foreign component manufacturers.

**Recommendations**

- Conclude a mutual recognition agreement between EU and China on approval or certification of marine equipment.
- Ensure that European maritime equipment manufacturers can compete on equal terms with local equipment manufacturers or with manufacturers owned by the Chinese State.
- Exempt imported ship components from the payment of VAT.

### 3. Expand Financing Opportunities for Foreign-invested Firms in the Shipbuilding Industry

**Concern**

Foreign-funded companies engaged in the Chinese shipbuilding industry face restrictions when it comes to finding channels to finance their activities, which creates an uneven playing field that unfairly advantages domestic players and effectively limits European companies’ access to the market.
Assessment

Before the 2008 global financial crisis, and the 2016 overcapacity crisis in the Chinese shipbuilding industry, shipowners purchased ships through a six-mode instalment payment method. The most widely used practice saw shipowners pay 10 per cent of the price when signing the contract, 10 per cent once building began, 20 per cent when the shipyard loaded the ship berth, 20 per cent once the ship was launched, 20 per cent when the shipyard tested the ship, and 20 per cent after delivery. Since 80 per cent of the ship price was paid before delivery, shipyards could schedule with ease without having to constantly find new financing sources. The situation is more difficult for shipyards building cruise ships; for them only 20 per cent of the total price is paid before delivery. Considering that on average a cruise ship costs United States dollars (USD) 1 billion, this practice, combined with a lack of financial institutions willing to sustain and shelter shipyards in the market, creates a situation where shipyards are always on the brink of bankruptcy and face high risks when building cruise ships.

Nonetheless, the dramatic fall of global trade caused by the 2008 financial crisis and the excess of supply caused by Chinese government policies, coupled with rising production costs due to higher prices of raw materials, limited the bargaining power of shipyards and pushed them into a price war. As a result, shipbuilding companies have been forced to accept a situation where currently only 10 to 20 per cent of the ship price is paid before delivery. This exacerbated a problem that was previously largely unknown to the industry, namely the constant struggle to find methods and sources to finance their operations. As ships are extremely costly, take years to be build and cannot be produced on scale, shipyards have to make consistent investments to build a vessel.

Currently, Chinese shipyards use three financing methods: loan financing; ship financing lease; and internal financing. Among them, only the last option is open to foreign-funded enterprises. In fact, loan-financing encompasses funds given by either the government or banks. However, the application process to obtain funds from the government is extremely complicated and only open to SOEs. Moreover, under the current regulatory system, in order to provide loans to shipyards, banks have to take the ship under construction as collateral. As the value of a not-yet-completed ship is very low, banks have to stipulate a credit insurance that dramatically increases the cost of the loan.\(^{34}\)

For these reasons, the ship-financing lease is the method preferred by shipyards all over China. This model effectively separates the right-to-use from ownership, allowing charters to lease the ship that is instead owned by investors. However, in October 2017, the Ministry of Industry and Information Technology (MIIT), having received complaints from China’s two biggest shipbuilding companies (CSIC and CSSC), reportedly asked leasing houses to not finance newbuilding projects at foreign-invested shipyards. The working group believes that such requests unfairly impact foreign companies and deeply damage the market environment.\(^{35}\)

As a result, European shipbuilders operating in China can only finance their activities through internal funds. This method presents several problems. First of all, the industry is highly affected by external variables, such as global macroeconomic trends and geopolitical factors. Since a ship requires years to be built and decisions have to be made well in advance, using internal funds to finance a ship that has been only partially paid for by a buyer that may be bankrupt when the building process is over is extremely risky. This high risk impacts the solvency of shipbuilding companies, which are forced to accumulate high volumes of assets to protect themselves. Thus, their operational capacity—their ability to use their assets to generate revenues—is negatively impacted. As a result, shipbuilding companies have to boost their profitability to finance themselves internally. However, SOEs can count on easy and less-costly financing methods and, since they can benefit from subsidies and grants, they can price their ships well beyond production costs. To compete with SOEs and to maintain their market shares, European companies have to lower their prices, which in turn lowers their profitability and their ability to finance internally.

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34 Zheng, L., 2013, Repayment responsibility of the bank under the advance repayment guarantee in the new shipbuilding financing. Journal of Dalian Maritime University (Social Science Edition), vol. 6, pp.60-64.

Recommendations

• Expand financing opportunities for foreign companies.
• Allow Chinese leasing houses to finance foreign-invested shipyards.

4. Expand Opportunities for Foreign-invested Firms in the Shipbuilding Industry to Access Research and Development (R&D) Funds

Concern
Due to unclear access mechanisms, foreign-funded companies engaged in the shipbuilding industry are restricted from obtaining research and development funds that the Chinese Government makes available to domestic companies.

Assessment
The Chinese Government launched a wide range of policies and proposals, such as the China Manufacturing 2025 initiative and the two previously mentioned action plans launched by the MIIT, which include a large volume of funds that companies can use for R&D purposes. However, there is a lack of transparent hard or soft platforms that can enable foreign-invested firms to access these funds. As a result, despite the absence of any law or regulation that explicitly excludes foreign-invested enterprises from accessing such funds, FIEs are effectively unable to take advantage of such opportunities.


Recommendations

• Clarify how foreign-invested companies can gain access to funds destined for R&D activities.
• Create a transparent platform that can enable foreign-invested enterprises to gain access to R&D funds.

Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>ADA</td>
<td>Anti-dumping Agreement</td>
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<tr>
<td>ASCM</td>
<td>Agreement on Subsidies and Countervailing Measures</td>
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<tr>
<td>BWTS</td>
<td>Ballast Water Treatment System</td>
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<tr>
<td>CCS</td>
<td>China Classification Society</td>
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<tr>
<td>CGT</td>
<td>Compensated Gross Tonnage</td>
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<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
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<tr>
<td>CPC</td>
<td>China’s Communist Party</td>
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<tr>
<td>CSIC</td>
<td>China Shipbuilding Industry Corporation</td>
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<tr>
<td>CSSC</td>
<td>China State Shipbuilding Corporation</td>
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<tr>
<td>DWT</td>
<td>Deadweight Tonnage</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>FIE</td>
<td>Foreign-invested Enterprise</td>
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<tr>
<td>IMO</td>
<td>International Maritime Organization</td>
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<tr>
<td>IMO TAC</td>
<td>International Maritime Organization Type-approval Certification</td>
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<tr>
<td>LNG</td>
<td>Liquified Natural Gas</td>
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<tr>
<td>MED</td>
<td>Marine Equipment Directive</td>
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<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
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<tr>
<td>MW</td>
<td>Megawatt</td>
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<tr>
<td>OEM</td>
<td>Original Equipment Manufacturer</td>
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<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
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<tr>
<td>USD</td>
<td>United States Dollar</td>
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<tr>
<td>VAT</td>
<td>Value-added Tax</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Section Four
Services
The Services section of the Position Paper includes four working groups and two sub-working groups of the European Chamber:

- Aviation and Aerospace
- Construction
  - Heating
- Information and Communication Technology
  - Cybersecurity
- Logistics
  - International Liner Shipping

According to the National Bureau of Statistics (NBS), the total value of China’s service industry in 2018 was Chinese yuan (CNY) 46.96 trillion (United States dollars (USD) 7.4 trillion), up 7.6 per cent from 2017. The industry accounted for 52.2 per cent of gross domestic product (GDP), compared to 51.6 per cent the previous year.¹

While investment still accounts for a larger share of GDP, consumption is growing at a faster rate. This makes consumption the key growth driver for China’s economy, with final consumption expenditure contributing 76.2 per cent of GDP growth for 2018. Of the total household consumption per capita, 44.2 per cent was on services, up 1.6 per cent year-on-year.²

Data from the Ministry of Commerce (MOFCOM) show that China’s total foreign trade in services amounted to USD 758 billion in 2018, which is a 11.5 per cent increase year on year.³ In 2017, China ranked fifth in global trade in services after the US, the UK, Germany and France, and is the world’s second largest importer of commercial services behind the US with a 9.2 per cent share, according to the World Trade Organization’s (WTO’s) World Trade Statistical Review 2018.⁴

European Union (EU)-China bilateral trade in services experienced a steady increase over the past few years. According to the European Commission, EU-China trade in services accounted for more than 10 per cent of total bilateral trade in 2017, with the EU’s exports of services to China making up 19 per cent of the EU’s total exports to China.⁵

According to the Services Trade Restrictiveness Index (STRI) published in December 2018 by the

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Organisation for Economic Co-operation and Development (OECD), 22 sectors in China remain restricted to foreign service providers. On a scale where the lowest scores are considered the best, China has a below average score in only one of these 22 sectors—architecture services—a sector not mentioned in either the Special Administrative Measures (Negative List) for the Access of Foreign Investment (2019 Version) (2019 Foreign Investment Negative List) or the Special Administrative Measures (Negative List) for the Access of Foreign Investment in Pilot Free Trade Zones (2019 Version) (2019 FTZ Negative List). However, foreign construction service providers still face legal barriers to operating in the Chinese market: they are allowed to set up wholly foreign-owned construction enterprises (WFOCEs) but are only allowed to undertake certain types of construction projects in China. In 2016, the total value of output of WFOCEs accounted for less than 0.3 per cent of the overall value of output of all construction service providers in China.

According to the OECD report, telecommunication services, postal and courier services, and motion picture services rank the highest in China relative to the average STRI score for all other countries, meaning that the Chinese market remains very restrictive to foreign companies in these sectors. In the 2019 Foreign Investment Negative List and the 2019 FTZ Negative List, ownership restrictions on providing e-commerce, domestic multi-party communication, storage and forwarding, and call centre services have been removed.

The European information and communications technology (ICT) industry welcomes this improvement, however further opening up measures need to be introduced to improve market access for European businesses and attract real investment from Europe in this sector. China’s overall score on the STRI has come down from 0.74 to 0.39 in the period 2003 to 2017, which is “still far higher than the 0.08 OECD average” according to McKinsey Global Institute analysis.
According to the OECD report, although China’s service sector has undergone continuous expansion, it lags significantly behind the commodities industry, and accounts for only 25 per cent of Chinese imports, 10 per cent of Chinese exports and 6.4 per cent of global service trade. These shares are significantly lower than average for a middle-income country. The liberalisation of services is a necessary step in closing the productivity gap between China and other developed countries, and anticipates higher quality in China’s service sector as a result of trade liberalisation and competition.

One of the aims of China’s 13th Five-year Plan (2016–2020) is to increase the contribution of services in the country’s GDP. In February 2019, Chinese media reported MOFCOM’s commitment to “expand [China’s] service exports, boost service consumption and push poverty reduction through the development of the household services industry”. Xian Guoyi, head of the MOFCOM’s Department of Trade and Services, also said that the “country will also work to promote high quality development of the service trade and commercial service sector, and expand the overseas services market with a focus on countries along the Belt and Road”.

On 10th April 2019, the MOFCOM published the revised Catalogue Encouraging Services Imports, which includes 16 types of services in four different sectors: R&D, energy-saving and environmental protection,
environmental services and consulting services. The aim is that by increasing the import of services in these sectors, China can build up its own capacity and contribute more to green development.

On 30th June 2019, the National Development and Reform Commission (NDRC) and the MOFCOM jointly published the 2019 Foreign Investment Negative List and the 2019 FTZ Negative List, with items in the respective lists having been reduced from 48 to 40 and 45 to 37. Improvements have been seen in such sectors as automotive, energy, ICT and international liner shipping. For example, the removal of the restriction for joint venture shipping agency companies to be majority Chinese-controlled is welcomed by the International Liner Shipping Sub-working Group. However, the working group is not sure this will result in business opportunities. Furthermore, restrictions remain on legal services and value-added telecoms services (VATS), sectors for which European business have long requested opening up.

The ongoing boom in the ICT industry—with a growth rate of 30.7 per cent, according to the NBS—has great potential for boosting the development of the service industry. China’s restrictions on cross-border data flows and data localisation requirements, enshrined in the Cybersecurity Law and related implementation regulations, severely restrict cross-border transfer of information. Furthermore, restrictions in China’s ICT industry limit foreign companies from providing cloud computing services to Chinese customers, and require foreign firms to enter into partnership with domestic enterprises before they can enter the market. Innovation in this field requires global knowledge of networks, people, goods and services, therefore China would benefit from more open markets for services.

Individual working groups have elaborated on the specific challenges they have faced trying to invest in China’s services sector and have provided constructive recommendations in their respective position papers in the interest of improving China’s overall operating environment, both for international and domestic enterprises.

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19 For more information, please refer to the International Liner Shipping Sub-Working Group Position Paper.
20 For more information, please refer to the Legal and Competition Working Group Position Paper.
21 For more information, please refer to the ICT Working Group Position Paper.
23 For more information, please refer to the ICT Working Group Position Paper and the Cybersecurity Sub-working Group Position Paper.
Key Recommendations

1. Create a Stable Airworthiness Environment
   • Make the airworthiness process more predictable and transparent, and ensure dialogue and collaboration continue on airworthiness.
   • Utilise the trust already established between the Civil Aviation Administration of China (CAAC) and the European Aviation Safety Agency (EASA) by allowing the Bilateral Aviation Safety Agreement (BASA) and associated procedures to play a role in reducing the burden associated with product validation.
   • Allow the BASA and associated procedures to continue to develop amid continuous technology and industry development by establishing a regular European Union (EU)-China aviation summit/forum.

2. Continue to Increase the Efficient Use of China’s Airspace
   • Enhance the utilisation of new air and ground ATM technologies in the aviation sector to ease airspace congestion and improve efficiency in the short term.
   • Reform China’s airspace management to improve operational efficiency.
   • Implement a top-level national air traffic management (ATM) system design based on a single concept of operations (defining how airspace and flights will be managed in the future as air traffic doubles).
   • Continue to expand the scope of flexible use of air routes for flights using Chinese airspace, particularly China-Europe flights, in order to relieve growing China-Europe air traffic pressure.
   • Leverage EU air traffic flow management (ATFM) expertise to tailor-make a national ATFM system for China.
   • Study as early as possible the integration of ATM and unmanned aircraft system (UAS) traffic management (UTM) to ensure fast and safe development of the UAS market in China, and enhance exchanges with EU authorities and industry to enable harmonisation of unmanned aerial vehicle (UAV) standards and regulations.

3. Enhance Dialogue Between Authorities and Industry Players
   • Extend the time period for responding to calls for comments.
   • Provide official English versions of all the policies and regulations for consultation phases, as well as in the final version.
   • Allow participation of the EU-China Aviation Partnership Project (APP) in policy implementation in China.
   • Open low altitude airspace further to facilitate the development of the general aviation (GA) market.
   • Ensure passenger rights align with international norms.
   • Launch cooperation projects to prepare relevant infrastructure, such as pilot training, maintenance, repair and operations (MROs) and air traffic control (ATC).
Introduction to the Working Group

Aeroplanes are a convenient and efficient way to move people and goods. Over the past few decades, the number of flights worldwide has dramatically increased, reflecting both its wider accessibility and its efficiency. Today, more people are flying to holiday destinations or to visit friends and family, and air freight is largely accepted as the most efficient method for moving cargo. Reliable air links are extremely important to businesses, as they provide access to new markets and are an integral part of our overall transportation network.

From an economic point of view, the aerospace and aviation sector is crucial for both the European Union (EU) and China. It drives economic growth, creates jobs and facilitates trade. Today the European aviation industry represents 26 per cent of the world’s market, contributing euro (EUR) 510 billion annually to Europe’s gross domestic product, and supporting 9.3 million jobs. As for China, its aviation sector has enjoyed exponential growth in recent years, and it is predicted that China will be the world’s largest aviation market by 2025.1

Both the aviation and the aerospace working groups were integral parts of the European Chamber after their founding in 2000. Since the merger of the two groups in 2015, the Aviation and Aerospace Working Group has spoken with a unified and inclusive voice to increase both the quantity and quality of political-level dialogue and industry advocacy.

The working group includes passenger and freight air carriers, as well as companies that manufacture a wide range of aerospace products, including civil aircraft, engines, helicopters, space systems and other products across the supply chain. It is also comprised of maintenance and service companies that carry out repairs, training, and other activities that support aviation and aerospace industries.

Recent Developments

Aviation is a crucial industry for both the EU and China. It drives economic growth, creates jobs, facilitates trade and is a highly efficient way of connecting people.

Rapid developments in China’s civil aviation industry were seen over the last year, with 167 new international routes being launched. By the end of 2018, there were 60 air transport enterprises, 423 general aviation (GA) enterprises and 61,621 pilots with valid licences in China.

China’s civil aviation industry completed a total turnover of 123 billion tonne-kilometres in freight transport last year, an increase of 11 per cent year-on-year; passenger traffic volume stood at 610 million passengers, also an increase of 11 per cent; cargo and mail transportation volume was 7.5 million tonnes, an increase of 4.6 per cent overall, with international cargo shipping volume increasing by 9.3 per cent year-on-year.2

Regarding safety, based on the data for the 2018 safety performance of the commercial airline industry released by the International Air Transport Association (IATA), general safety improvements continued in the world range, but there was an increase in accidents compared to 2017. The all accident rate (measured in accidents per 1 million flights) was 1.35, or the equivalent of one accident for every 740,000 flights. This was an improvement over the all accident rate of 1.79 for the previous five-year period (2013–2017), but a decline compared to 2017’s record performance of 1.11.3

In China, in 2018, the civil aviation industry achieved 11.5 million hours of safe flights for transport aviation, an increase of 8.9 per cent year-on-year. The accident rate was down 8.3 per cent year-on-year. By 7th January 2019, China’s transportation aviation sector set a new safety record of 100 months and 68.36 million hours of continuous safe flights, and at the same time achieved a record 16 years and eight months of incident-free aviation security.4 However, there were several accidents related to airplane operational control, which impacted the smooth development of safety management in Chinese civil aviation. From July to November 2018, over 10 accidents were publicised, including the runway incursion by a Japan Airlines (JAL) airplane, which resulted in the rejected take-off of a Delta Air Lines (DAL) airplane. This serious incident rang alarm bells for the Civil Aviation Administration of

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China (CAAC), and accelerated the process of trying to implement a solution.\(^5\)

The crash of an Ethiopian Airlines Boeing 737 MAX 8 on 10\(^{th}\) March 2019 was the second crash involving this plane model in six months, after the Lion Air disaster in Indonesia on 29\(^{th}\) October 2018. There are certain similarities between the two air crashes in that they both involved newly delivered Boeing 737 MAX 8 aircraft and they both occurred shortly after take-off. In line with the management principles of zero tolerance for safety hazards and strict control of safety risks, the Civil Aviation Authority required domestic airlines to suspend the commercial operation of Boeing 737 MAX 8 aircraft.\(^6\)

In terms of technology designed to aid air traffic control, the 4D trajectory control test system installed in the Guangzhou Air Traffic Control Centre realised the digital cooperative control of flight path, the terminal area for the test aircraft, and the precise control of timed arrival. The test was a success, and China became only the second country or region in the world to launch this new technology after Europe.\(^7\)

Following on from the joint statement released during the EU-China Summit in March 2019, the EU and China signed a Bilateral Civil Aviation Safety Agreement (BASA) in May 2019 to strengthen aviation cooperation. It is hoped that this will serve to boost the competitiveness of the EU’s aeronautical sector and enhance overall EU-China aviation relations. It will remove unnecessary duplication of evaluation and certification activities for aeronautical products by the civil aviation authorities, and therefore reduce costs for the aviation sector and facilitate market access for European aeronautical companies to the very important Chinese market.

The BASA will promote cooperation between the EU and China in their attempts to establish a high level of civil aviation safety and environmental compatibility. With this horizontal aviation agreement, China also recognises the principle of EU designation.\(^8\)

### Key Recommendations

#### 1. Create a Stable Airworthiness Environment

**Concern**
The European aviation industry is facing difficulties introducing products into China’s market as several parts of the airworthiness validation process are unpredictable, which ultimately makes European aviation development in China resource-intensive and slow.

**Assessment**

Europe and China both have a long-standing interest in the aviation industry. As safety is a must for the development of the aviation industry, airworthiness is considered far and away the most important issue for national aviation authorities. The EU and China announced the negotiations of the BASA in 2015, an agreement that aims to harmonise airworthiness certification processes, thus enabling further development of the aviation industry for both sides in terms of being able to quickly introduce and integrate new products into each other’s market. The BASA was signed on 20\(^{th}\) May 2019 by the EU and China to strengthen their aviation cooperation. The horizontal agreement will bring bilateral air services agreements between China and EU Member States into conformity with EU law – a renewed legal certainty which will be beneficial to airlines on both sides.\(^9\) However ratification and promulgation of technical implementation documents is still pending, therefore it will take time for the BASA to bring tangible improvements for the industry. Given that airworthiness is by far the most important issue for any national aviation authority, the EU-China Aviation Partnership Project (APP) is also working towards harmonising airworthiness certification by promoting the creation of an EU-China aviation summit, where European and Chinese stakeholders can exchange views on the industry and on other relevant international issues. More efficient communication channels between the APP, BASA, CAAC and other related industry organisations need to be established, including a regular EU-China aviation summit/forum system.

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\(^8\) EU-China Aviation Agreement, EUbusiness, 21\(^{st}\) May 2019, viewed 23\(^{rd}\) May 2019, <https://www.eubusiness.com/topics/airlines/aviation-china>

\(^9\) Ibid.
Recommendations

- Make the airworthiness process more predictable and transparent, and ensure dialogue and collaboration continue on airworthiness.
- Utilise the trust already established between the CAAC and the EASA by allowing the BASA and associated procedures to play a role in reducing the burden associated with product validation.
- Allow the BASA and associated procedures to continue to develop amid continuous technology and industry development by establishing a regular EU-China aviation summit/forum.

2. Continue to Increase the Efficient Use of China’s Airspace

Concern

With the continuous growth in the number of civil flights, congested airspace due to a limited selection of air routes for foreign carriers and sub-optimal ATM efficiency have become a major challenge for China’s aviation industry as it creates negative effects for fuel usage and customer experiences, in turn leading to additional costs, longer flying times, increased flight departure delays and higher levels of environment damage.

Assessment

China’s civil aviation authorities have been under immense pressure to handle the country’s exponential growth in air travel. Many airports are reaching capacity, as is the amount of available airspace. In addition to congested airspace, inefficient slot application and approval processes—through which civil carriers are not receiving priority slot allocations—also pose challenges to ATM practices in China. As a result, the punctuality of air traffic, the environment and China’s economy have all been affected.

From an industry point of view, slot usage could still potentially improve when it comes to utilising available capacity more effectively. In the short term, possible solutions to airspace congestion could come from the utilisation of new technologies that improve the efficiency of ATM operations, such as requiring navigation performance implementation in megahub airports, re-categorising implementation to shorten the time it takes to sequence air traffic, and allowing carriers to choose the airways in a more flexible way in order to relieve airspace congestion. In the long run, some possible solutions include top level implementation of a nationwide ATM system based on a unified concept of operations, increased airspace capacity for civil aviation by opening more airways for foreign carriers’ use, and maximising the use of available space through the use of big data and air traffic flow management (ATFM). Operationally, ATFM, which manages the balancing of tactical demand/capacity, could improve the operational usage of available slots and provide better airline predictability, especially when there is a drop in capacity or surge in demand. Also, by applying advanced ATM technology, including integrated arrival flow management, the buffer for safe operation—for example, aircraft separation during landing—can be reduced to considerably closer to Western countries’ level in order to free up more capacity for future growth.

The abrupt arrival of the unmanned aircraft systems (UAS) industry in China has exacerbated safety and security challenges. Public safety incidents and airspace conflicts between unmanned aircraft vehicles (UAVs) and civil transport aircrafts are starting to become commonplace. The working group recommends that the Chinese authorities improve air safety management while promoting UAS usage. From an industry perspective, UAS traffic management (UTM) and the insertion of UAS into civil airspace should be the subjects of future research in order to optimise airspace efficiency while maintaining the current civil air-transport workload.

Looking forward, the working group would like to see both the EU and China engage in long-term cooperation on airspace management modernisation plans. This would enhance cooperation between industries and encourage the adoption of common standards and the sharing of best practices.

Recommendations

- Enhance the utilisation of new air and ground ATM technologies in the aviation sector to ease airspace congestion and improve efficiency in the short term.
- Reform China’s airspace management to improve operational efficiency.
- Implement a top-level national ATM system design based on a single concept of operations (defining how
airspace and flights will be managed in the future as air traffic doubles).
• Continue to expand the scope of flexible use of air routes for flights using Chinese airspace, particularly China-Europe flights, in order to relieve growing China-Europe air traffic pressure.
• Leverage EU ATFM expertise to tailor-make a national ATFM system for China.
• Study as early as possible the integration of ATM and UTM to ensure fast and safe development of the UAS market in China, and enhance exchanges with EU authorities and industry to enable harmonisation of UAV standards and regulations.

3. Enhance Dialogue Between Authorities and Industry Players

Concern
The deadlines for public consultations on proposed policies and regulations are often very tight, and European enterprises sometimes miss the opportunity for policy consultation and dialogue with the Chinese authorities, meaning they are either unable to fully contribute their expertise to help the authorities set up an effective oversight mechanism, or are at risk of non-compliance, which is not the authorities’ original aim.

Assessment
Chinese authorities have decided to gradually open up China’s low altitude airspace and update the relevant regulations. During the 2019 National Conference on Aviation Safety of Civil Aviation, the reform of low-altitude airspace management was emphasised. In spite of this, the available low-altitude flight airspace is limited in particular areas in China, and the pace of further release of airspace is insufficient. The low altitude airspace management mechanism needs further improvements.

European enterprises fully understand the role and function of China’s aviation authorities, but would also like to see a transparent and achievable regulatory framework that facilitates them in conducting business in the country while remaining fully compliant with all legal requirements. The CAAC, and all other policymakers related to the aviation industry, are currently in the process of making or refining policies and regulations to improve the operating environment, which is welcomed by companies engaged in the industry. When making or refining policies, there is a need for solid consultation between the aviation authorities and the industry. This includes allocating more time to respond to calls for comments, providing English language versions of legislation, and holding more forums and dialogues involving industry players.

Currently, when a new policy is released, a period of two weeks is typically given to respond to a call for comments. For example, the public consultation on Administrative Regulations on General Aviation Plan Approval and Air Traffic Operation (Trial Draft) left 10 working days for feedback. The public consultation on Data Specifications for UAV Cloud System gave stakeholders 13 working days to submit recommendations. This is not long enough, considering international companies need to translate the policy into their working language send the translation back to their headquarters for expert input, and finally translate those comments back into Chinese for submission. In addition, as translation is often done by private translation companies that are not necessarily industry experts, there is always a risk of deviation between the authorities’ original intention and enterprises’ understanding.

The EU-China APP is an excellent platform for technical exchanges prior to the finalisation of industry regulations. The APP aims to promote consistency of standards from both sides in a variety of fields, such as market distribution, passenger rights and relevant infrastructure, in accordance with the issues covered within BASA. This agreement has established a legal framework for China and the EU to conduct extensive cooperation in the fields of civil aviation safety, including airworthiness and environmental protection certification, flight operation, air traffic control services, personnel licensing and training, and even better prices for passengers while ensuring the highest levels of safety.

Recommendations
• Extend the time period for responding to calls for comments.
• Provide official English versions of all the policies and regulations for consultation phases, as well as in the final version.

• Allow participation of the APP in policy implementation in China.
• Open low altitude airspace further to facilitate the development of the GA market.
• Ensure passenger rights align with international norms.
• Launch cooperation projects to prepare relevant infrastructure, such as pilot training, MROs and ATC.

**Abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>APP</td>
<td>Aviation Partnership Project</td>
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<td>ATC</td>
<td>Air Traffic Control</td>
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<td>ATM</td>
<td>Air Traffic Management</td>
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<td>ATFM</td>
<td>Air Traffic Flow Management</td>
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<td>BASA</td>
<td>Bilateral Civil Aviation Safety Agreement</td>
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<td>CAAC</td>
<td>Civil Aviation Administration of China</td>
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<td>DAL</td>
<td>Delta Air Lines</td>
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<td>EASA</td>
<td>European Aviation Safety Agency</td>
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<td>EU</td>
<td>European Union</td>
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<td>GA</td>
<td>General Aviation</td>
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<td>IATA</td>
<td>International Air Transport Association</td>
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<td>JAL</td>
<td>Japan Airlines</td>
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<td>MRO</td>
<td>Maintenance, Repair and Operation</td>
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<td>UAS</td>
<td>Unmanned Aircraft System</td>
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<td>UAV</td>
<td>Unmanned Aerial Vehicle</td>
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<td>UTM</td>
<td>UAS Traffic Management</td>
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Construction Working Group

Key Recommendations

1. Provide New Opportunities for Foreign Investment in Different Types of Cities and Towns, While Expanding and Building Responsive and Safe Infrastructure in Rural and Urban Areas, in Particular in Small and Medium-sized Cities
   - Allow European companies to participate more widely in the process of China’s urbanisation.
   - Expedite reforms that will allow European architecture and design firms to contribute more towards green design, and the construction of smart cities and energy-saving buildings.
   - Allow European companies to bid for and participate in projects relevant to the Xiong’an New Area and the national demonstration areas under the CM2025 initiative.
   - Remove market access barriers in the construction sector.
   - Implement clear regulations connected to the new Foreign Investment Law to allow the participation of foreign-invested companies in public procurement.
   - Allow European firms to contribute to the development of small and medium-sized cities and the improvement of urban utilities and infrastructure.

2. Remove Market Access Barriers for European Construction Service Providers (CSPs) to Enable Fair Competition and Facilitate Expertise Sharing
   - Allow WFOCEs to independently carry out local investment construction projects in China.
   - Allow European service providers to bid for third-party contracts in government projects.
   - Recognise international expertise and professional qualifications to facilitate knowledge-sharing and exchange of know-how across regions.
   - Remove strict requirements associated with using standard contracts issued by the former MOC and the former SAIC to file construction projects.
   - Promote online filing for basic project and contract information only.
   - Allow qualified foreign design firms to be an official third party in the registered contract.

3. Revise Building Codes, Standards and Performance Evaluations to Allow for Flexibility and Adaptability in the Implementation of Advanced Construction Materials and Technologies
   - Set up a clear process with defined lines of communication for the delivery of codes and standards to both local and foreign companies for analysis, feedback and consideration prior to their adoption.
   - Establish an oversight committee, composed of the relevant authorities and industry experts, both from local businesses and foreign business in China, with the role of evaluating proposed changes or new codes and standards in transparency.
   - Allow local and foreign companies a longer period for consultation about proposed changes so that foreign companies can translate any documents necessary and then have a meaningful dialogue with experts and the authorities.
   - Consolidate the current book of standards and codes at all levels in the construction sector.
• Create a specialised market approval process for foreign companies acting as enablers to the Chinese market through innovation and advanced technologies, which they have developed and proven overseas.

4. Revise Regulations and Requirements Concerning Foreign Investment in the Real Estate (RE) Sector to Establish a Fair, Balanced and Open Market
• Issue the specification measurement for Circular No. 122.
• Abolish Circular No. 171.
• Simplify application procedures, requirements and bureaucratic procedures for development projects.
• Allow the establishment of foreign-invested, limited-liability partnerships with a focus on RE investments.

European Heating Industry Key Recommendations
1. Introduce a National Guideline or Policies to Promote Full Condensing Wall-hung Boilers with Class 1 Energy Efficiency
• Extend to the whole country the pilot policies promoting condensing technology in the first installation.
• Introduce subsidy programmes for promoting highly efficient and low-emissions technologies, such as the full-condensing wall-hung boilers, in key cities and regions, and further expand the programmes to more areas.

2. Establish Requirements for the Installation and Maintenance of Heating Products and Systems
• Introduce a system for qualifying heating products installation and for qualifying service engineers.
• Formulate and promote rules for the installation and servicing for heating products.
• Ensure the participation of foreign-invested enterprises (FIEs), to strengthen industry supervision of the installation and maintenance of heating products.

3. Strengthen Data Integration of Gas Equipment in Finished and Prefabricated Residential Buildings
• Consider gas heating and hot water equipment in the planning of prefabricated buildings, including technical standards, Building Information Module platform setup and building planning.
• Engage FIEs from the heating industry in policy consultations.

Introduction to the Working Group
The Construction Working Group is the voice of European, world-leading real estate investors, land developers, architects, engineers, project managers, main contractors, suppliers and other professional consultants operating in China. Despite the diversity of the sectors that members of the working group specialise in, they are united in supporting China’s transition from an economic model based on rapid, quantitative growth to one that is sustainable and qualitative. Their aims are also fully aligned with President Xi Jinping’s target of pursuing human-centred development, as declared in the 13th Five-year Plan (13FYP) and reiterated during the 19th Party Congress in October 2017.¹

Designing is the starting point of construction. From a micro perspective, such as the design of a single tool, to the macro perspective of designing homes, workspaces and eventually entire urban areas, designers carry a huge responsibility due to the influence they can have over both individual lives and entire communities.

The quality and safety of construction lies in the

implementation of each project. It requires diligent and detail-orientated work from the architects and engineers employed by construction enterprises. Over the past three years, unfortunate incidents occurred in various cities due to a lack of high-quality management models and construction materials. European construction enterprises, with their decades of experience in implementing and managing construction and engineering projects, can make major contributions to enhancing the safety and quality of China’s construction sector, helping to boost China’s economy.

Other stakeholders in the construction industry make direct and joint contributions to the market by taking a holistic approach that balances humans’ well-being with protecting the environment. Professional know-how, experience and state of the art technologies/products owned by European construction service providers (CSPs) can help to preserve the natural environment and improve living conditions through the provision of high-end residential compounds and affordable housing in both urban and rural areas. Meanwhile European investors, who operate daily in mature financial markets, can be favourable partners for assisting with the transformation of the Chinese real estate market.

The Construction Working Group was first established in 2003, to represent European CSPs operating in China. As part of the European Chamber’s working group reorganisation in March 2016, the European Heating Industry Desk became a sub-working group of the Construction Working Group.

The main objective of the Construction Working Group is to engage in dialogue with key stakeholders, including the Ministry of Housing and Urban-rural Development (MOHURD), the National Development and Reform Commission (NDRC), the Ministry of Industry and Information Technology (MIIT), the Ministry of Science and Technology (MOST), European Union (EU) institutions and construction-related organisations and associations. This cooperation provides feedback on and support for Chinese construction policies, with a current focus on sustainable urban development and the promotion of investment in high-quality, energy-efficient buildings.

Recent Developments

In 2018 and 2019, the Chinese Government released several measures related to reforming both the administrative system and urban-rural development in China. According to the Government Work Report released by Premier Li Keqiang at the National People’s Congress (NPC) and the Chinese People’s Political Consultative Conference annual plenary gatherings (Two Sessions) in March 2018, China would deepen reforms designed to delegate powers, improve regulation and provide better services to the public; make solid progress in coordinated regional development strategies; and enable investment to play a pivotal role in improving the supply structure. In 2018, Chinese yuan (CNY) 732 billion was invested in railway construction, and around CNY 1.8 trillion in highway and waterway projects, with the scale of investment in ongoing water conservancy projects projected to reach CNY 1 trillion. European businesses are looking forward to contributing to the reform and being involved in the construction projects detailed in the report.

Throughout the second half of 2018 and the first two quarters of 2019, the State Council, China’s top administrative authority, engaged in a series of regulatory reforms aimed at further opening up the market and at establishing a more competitive environment. Most notably, on 23rd April 2019, the State Council amended the Construction Law to clarify the conditions that must be met to successfully apply for construction permits by removing the unclear clause “as required by laws and administrative regulations”. Also, the period of time allowed for processing construction permit applications was changed from 15 days to seven days from when the application is submitted. The Regulations on the Implementation of the Bidding Law were also amended on 19th March 2019. The amendment was aimed at simplifying administrative procedures and reflected a deeper awareness of the critical juncture the construction industry is currently at.

In recent years, the construction industry has been among the sectors most negatively affected by explicit and implicit market access barriers, regulatory constraints and an uneven playing field. The sum of

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these elements contributed to make quantitative over-development and speculation the signature of China’s urban sector, leaving little or no space for European companies that have made high-end services and products their trademark.

To address overdevelopment and speculation in the sector, Chinese authorities started to implement a new approach to urban planning based on the concept of ‘human-centred cities’. The adoption of this new concept, which was even incorporated in Beijing’s urban and rural planning regulations, is an indication that the current model based on quantity and infrastructure-building will be abandoned to prioritise the quality of the urban environment through the development of the environmental, historical and cultural identity of every urban centre. In order to achieve this goal, policymakers declared, China needs the right competence, skills, equipment and know-how. This should open a window of opportunity in a market that has been relatively closed to foreign companies so far. In fact, this new take on urban planning will require contributions from European construction firms, service providers, suppliers, infrastructure providers and manufacturers, thanks to the rich experience they have when it comes to providing the kind of high-quality products and services that China is looking for.

This new approach to urban planning and construction projects was mirrored in the Decision of the Ministry of Housing and Urban-Rural Development on Amending the Measures for the Administration of Bidding of the Construction of the House Building and Municipal Infrastructural Projects (2018), which is aimed at decentralising power and, above all, optimising services for end users.

From 2018–2019, the Chinese Government continued to announce policies aimed at fulfilling the goals outlined in China’s National New-type Urbanisation Plan for 2014–2020 (Urbanisation Plan). In 2018, the Construction Working Group continued to see the introduction of a range of policies in green building initiatives and related measures that supported the transition to low-carbon cities and improved infrastructure in small and medium-sized cities.

In early 2017, the Chinese Government announced the further removal of foreign investment restrictions in architecture and design. This was followed with the release of the MOHURD’s Administrative Measures on Tender Invitation and Submission for Construction Engineering Design and the NDRC’s Administrative Measures for the Engineering Consulting Industry. The intent of these reforms was to encourage foreign investment in specific sectors like green and smart cities. These are positive steps in the right direction, especially as many European architecture firms have significant experience to offer their Chinese counterparts in these areas. If investment restrictions were removed completely, European firms would be able to contribute even more to China’s green city and smart manufacturing goals.

To encourage the creation of more liveable cities, the NDRC and the MOHURD continued to implement the Notice on the Release of the Carrying out Pilot Work on Construction of Climate-adaptive City (Notice), which includes a requirement for climate adaptability to be taken into consideration in urban planning and construction. China has encouraged international collaboration on the construction of pilot projects, particularly for climate-adaptive cities. The Notice elaborates on how to build safer and more responsive infrastructure that can withstand extreme weather conditions such as heavy rainfall, droughts, typhoons and smog. The Notice also makes clear that: energy-saving, green and prefabricated buildings need to be better promoted in future developments; squat settlements must be taken down; and China’s ecological system should be repaired. The working group welcomes this initiative, as European companies have experience

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5 The concept of ‘human-centred cities’ was first introduced in the New Urban Agenda of the United Nations Conference on Housing and Sustainable Urban Management in 2006.


in constructing well-rounded infrastructure and green architecture that is weather and climate adaptive.

In April 2017, the MOHURD released the 13FYP on the Development of the Construction Industry, in which it outlined several tasks European companies would be uniquely qualified for, including:

• deepening reform and modernising the construction industry;
• developing green buildings and making them more energy efficient;
• actively exploring the international market;
• improving engineering quality and safety; and
• giving a central role to industry organisations in regulating themselves.

Additionally, China has been faced with challenges due to uneven regional development, particularly in the middle and western regions of China. The European Chamber has been invited by the Ministry of Commerce (MOFCOM) to provide recommendations and suggestions on industry transformation and upgrading, development approaches to new types of cities and opening-up measures for European businesses, as well as solutions to issues in various industry and development zones in Shandong, Shanxi and Anhui provinces. The working group makes the following recommendations: policies and administrative procedures need to be transparent; regulations need to be effectively and consistently implemented; services should be tailored to also take into account foreign-invested enterprises, particularly small and medium-sized enterprises (SMEs); and the features of each city and region should be comprehensively analysed before being developed further.

The EU-China Partnership on Sustainable Urbanisation celebrated its seventh anniversary in 2019. Since its launch, expectations on the EU-China cooperation on urbanisation have been very high. Two projects have already proven to be good mechanisms for city-to-city, urbanisation have not always matched expectations. The Construction Working Group encourages all the relevant stakeholders to make sure that the essential and fruitful academic discussion that has characterised this partnership so far can be further cemented with practical results.

Nonetheless, the results reached by the EU-China Partnership on Urbanisation have not always matched expectations. The Construction Working Group encourages all the relevant stakeholders to make sure that the essential and fruitful academic discussion that has characterised this partnership so far can be further cemented with practical results.

The Beijing-Tianjin-Hebei integrated development plan has been the focus for a new type of urbanisation, particularly in the realm of city agglomeration. On 20 April 2018, the State Council approved the Planning Outlines on Xiong’an New Area (Outlines). The Outlines suggest that the Xiong’an New Area will act as a coordinated development demonstration area; an open development priority zone; a green, ecological and liveable new city; an innovation-driven, development-leading area; and an innovation and development demonstration area. According to the Chinese Government, the Xiong’an New Area development will adhere to the principle of green and low-carbon development by promoting green design, construction and operation of energy-saving residential buildings. It is also envisaged that it will use green construction materials and prefabricated and recyclable methods, and will adopt a sponge city management model within the overall smart-city concept. The European Chamber has been following the development of the Xiong’an New Area through dialogues with key stakeholders, including the China Centre for Urban Development under the NDRC, the China Academy of Urban Planning and Design under the MOHURD, the Chinese Academy of Science and Technology for Development under the MOST, the Xiong’an Group, the Xiong’an Administration Committee and the Centre of Science and Technology Development and Industrialisation of the MOHURD. Along with its member companies, the

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14 Ibid.
European Chamber is actively seeking to cooperate with the government and contribute to the development of the Xiong’an New Area, by providing state-of-the-art technology and products, advanced management models and a wealth of experience in industrial upgrading.

Key Recommendations

1. Provide New Opportunities for Foreign Investment in Different Types of Cities and Towns, While Expanding and Building Responsive and Safe Infrastructure in Rural and Urban Areas, in Particular in Small and Medium-sized Cities

Concern

Existing market access barriers are preventing European businesses from fully partnering with local companies and contributing to China’s continued urbanisation.

Assessment

Despite several announcements of further opening the sector, the construction industry was still included in the Market Access Negative List issued by the NDRC on 21st December 2018. It stipulates that in order to operate, construction companies need to be granted a series of permits and need to follow all legal procedures. Besides needing a general construction permit, construction companies also need to be approved as qualified construction enterprises, as well as needing further approval for their construction projects and anti-seismic plan, among other requirements.

These market access barriers are further exacerbated by the chronic difficulties that foreign-invested companies face when it comes to public procurement. In this regard, the Construction Working Group welcomes the new Foreign Investment Law (FIL), to come into effect on 1st January 2020, which states in articles 15 and 16 that foreign-invested companies will be granted national treatment when it comes to public procurement. However, since the FIL is a framework law, it will be necessary to see detailed implementation rules to see how it will work in practice.

There has been quite a long history of announcements and draft regulations that similarly claimed to open China’s public market to foreign-invested enterprises. A notable example is the Draft Provisions on the Scope and Threshold of Construction Projects for Bid Invitation, issued by the State Council in March 2014, which were supposed to clarify how local governments can allow foreign-invested enterprises to participate in public bids. Nonetheless, after more than five years, the provisions are still in draft form and have yet to come into effect. So, while the Construction Working Group sincerely welcomes articles 15 and 16 of the FIL, it also encourages the government to follow up with a clear timeline for the law’s actual implementation, especially for the two key areas where the contributions of European-invested companies can add a great deal of value: green construction projects and public infrastructure.

Green Construction Projects

The MOHURD laid out in its 2017 Work Points on Energy Saving in Buildings how prefabricated buildings should be constructed, along with a framework under which European companies and Chinese institutions could cooperate in building climate-adaptive structures in rural areas and small and medium-sized cities. European companies have a great deal of expertise employing energy-saving technologies in construction and can make large contributions to improving Chinese infrastructure in these areas.

A similar initiative was the 13FYP on the Development of Constructing Energy-saving and Green Buildings, in which the MOHURD outlined the general objectives for energy-saving construction and green buildings. This includes increased energy savings in construction, promoting the use of green buildings in urban development and the utilisation of renewable energy. This closely follows what was set out in the MOHURD’s 2017 Work Points on Energy Saving in Buildings.

The Chinese central and municipal governments have continued to strive towards constructing greener,
smarter cities in China. In November 2017, the State Council announced the Notice on Establishing National Demonstration Areas for the China Manufacturing 2025 Initiative. European companies have much to offer, not only in strategic and technologically key areas outlined in the China Manufacturing 2025 (CM2025) initiative, but also in the construction of demonstration areas. In March 2017, Premier Li Keqiang indicated that foreign firms would be treated the same as domestic firms when it comes to licence applications, standards-setting and government procurement, and would enjoy the same preferential policies under the CM2025 initiative. The Construction Working Group hopes that European companies will be involved in projects similar to the establishment of the Xiong’an New Area, and urges the Chinese Government to match its reform-focussed statements with on-the-ground actions regarding foreign investment in the construction sector.

Infrastructure
Maintaining infrastructure has always been one of the major underlying problems of urban development in China, which the government has attempted to address through repairs. The Construction Working Group hopes that China will formulate more detailed policies on how foreign investment can be get deeper involved in this. One such example is the Notice on Better Executing Urban Drainage and Waterlogging Construction, announced by the NDRC and the MOHURD, which addressed the repairing of urban drainage systems and provided solutions to flooding problems that affect approximately 60 cities annually.

In the Guiding Opinions on Strengthening Ecological Restoration and Urban Repair Works (Guiding Opinions), the MOHURD also signalled their intention to initiate repairs for existing infrastructure in a variety of different areas, including water supply, drainage, wastewater processing, gas supply, heating, telecommunications and power supply systems. This initiative covers infrastructures that provide public services, such as medical, educational, cultural, technological, logistics and sports facilities. With the infrastructure rebuilding plans detailed in the Guiding Opinions, Chinese architects may be able to utilise advanced European technologies.

The 13FYP on the Construction of Major National Science and Technology Infrastructure has helped foster international cooperation on important science and technology infrastructure projects, with the NDRC encouraging international collaboration on the use of overseas resources, including the sharing of advanced technologies and management expertise. This is a good fit for European businesses, and the working group expects this initiative to now follow through with detailed procedures for its implementation.

The Guiding Opinions acknowledge that China is facing serious problems, including the shortage of resources, heavy pollution and major damage to the ecological environment. China has called for systematic ecological restoration, including the repair of mountains and the treatment of lakes and rivers. The Chinese authorities have also promoted the restoration and improved use of polluted industrial land, an area where European businesses are willing to assist the Chinese Government and domestic companies.

Recommendations

- Allow European companies to participate more widely in the process of China’s urbanisation.
- Expedite reforms that will allow European architecture and design firms to contribute more towards green design, and the construction of smart cities and energy-saving buildings.
- Allow European companies to bid for and participate in projects relevant to the Xiong’an New Area and the national demonstration areas under the CM2025 initiative.
- Remove market access barriers in the construction sector.
- Implement clear regulations connected to the new FIL to allow the participation of foreign-invested companies in public procurement.
- Allow European firms to contribute to the development of small and medium-sized cities and the improvement of urban utilities and infrastructure.

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2. Remove Market Access Barriers for European CSPs to Enable Fair Competition and Facilitate Expertise Sharing

Concern
European CSPs—including architects, quantity surveyors, project managers and contractors—face legal barriers to enter the Chinese market, preventing them from sharing their world-class expertise and cutting-edge technology with Chinese CSPs.

Assessment
Construction is one of the key drivers of a country’s economy, especially for a large country like China in the midst of rapid urbanisation. The healthy development of the construction industry is of paramount importance to ensuring the effective use of resources and providing optimum living standards and environmental protection. For instance, good city planning can: optimise land use and ensure the long-standing quality of construction; positively influence peoples’ moods by providing visually attractive architecture; ensure the overall quality of a city’s construction by utilising advanced construction technology and management skills—including the proper application of new materials—which reduces the total amount needed for investment; and lower the amount of labour needed, while minimising disturbance to the environment.

However, European construction service providers willing to invest and expand their business in China face several barriers. Given that quality is a key added value of European companies, the Construction Working Group believes that by further opening the market China would be better placed to reach this target.

In most of the cases, European service providers are not allowed to bid for third-parties contracts in government projects. Frequently, they cannot be recognised as a party in government projects and can only participate as sub-contractors of local design institutes because they are unable to obtain local qualifications in all provinces. As a result, European service providers gain no due recognition for the value they add and cannot control the quality of the final design.

European qualifications are mostly not recognised in China so European service providers are often unable to participate in high-end construction projects. To provide services in the fields of planning, design, engineering, construction, surveying and construction supervision, European service providers are required to obtain various Chinese industry qualifications, which entail a declaration of the company’s registered capital, personnel, place of business and track record. This framework completely ignores the fact that many European service providers already hold top qualifications in their home countries. On the top of this, participation in high-end projects—to which the know-how of European service providers is best suited—is only open to companies that hold the very highest qualification in China. As a result, European companies’ business opportunities are extremely limited.

However, there have been recent signs that a solution to the issue is possible. For its operations in the Baoding-Shenzhen High-Tech Industrial Park, a joint investment between the Baoding and Shenzhen governments, the public/private Hebei Shenbao Corporation recognised Royal Institution of Chartered Surveyors (RICS) Quality Survey qualifications as equivalent to the China Registered Cost Engineers Tier 1 qualification. The RICS is a European professional body that promotes and enforces international standards related to valuation, management and development of land, real estate, construction and infrastructure, and its members include academics, graduates, technicians and senior professionals. Since the RICS requires its members to keep updating their knowledge and competence, membership is solid proof of owning top qualifications. The fact that Chinese authorities recognised RICS membership has allowed qualified European service providers to participate in projects without the need to obtain any further Chinese qualification.

European service providers also face legal and compliance issues because they are required by many construction authorities to use standard contracts for filing. Chinese construction authorities require European service providers to use a set of standard contracts, issued in 1999 by the former Ministry of Construction (MOC) and the former State Administration of Industry and Commerce (SAIC), for design, surveying, construction and construction supervision. Such contracts, besides being outdated, determine legal and compliance issue for European service providers that prefer to use other types of contracts.
Foreign construction companies have been permitted to establish wholly foreign-owned construction enterprises (WFOCEs) in China for more than 15 years. However, the local construction market is still not completely open to WFOCEs. They are only allowed to undertake four types of construction projects that fall under the scope permitted by their qualification grades, according to Decree 113 of the *Regulations on the Administration of Foreign-invested Construction Enterprises*. These include the following:

- Construction projects solely funded by foreign investment, foreign donations, or foreign investment and donations.
- Construction projects financed by international financial institutions and awarded through international bid invitations based on the terms and conditions of the loans.
- Sino-foreign, jointly-operated construction projects with foreign investment accounting for at least 50 per cent of the total investment, and Sino-foreign, jointly-operated construction projects with foreign investment accounting for less than 50 per cent of the total investment, (which are not possible for Chinese construction enterprises to implement independently due to technological difficulties), and approved by the administrative department in charge of construction at the provincial level, autonomous region, or municipality directly under the central government.
- Construction projects funded by Chinese investment, (which are not possible for Chinese construction enterprises to implement independently due to technological difficulties), which may be jointly undertaken by Chinese and foreign construction enterprises subject to the approval of the administrative department in charge of construction at the provincial level, autonomous region, or municipality directly under the central government.  

Most WFOCEs are not successful in this market and some have to downsize or even leave the market. Many European contractors have no motivation to expand their business in China, despite the large construction market. The total 2016 revenue of WFOCEs accounted for less than 0.2 per cent of the total revenue of all CSPs in China. The Construction Working Group recommends lifting restrictions and allowing WFOCEs to undertake local investment construction projects without barriers.

### Recommendations

- Allow WFOCEs to independently carry out local investment construction projects in China.
- Allow European service providers to bid for third-party contracts in government projects.
- Recognise international expertise and professional qualifications to facilitate knowledge-sharing and exchange of know-how across regions.
- Remove strict requirements associated with using standard contracts issued by the former MOC and the former SAIC to file construction projects.
- Promote online filing for basic project and contract information only.
- Allow qualified foreign design firms to be an official third party in the registered contract.

### 3. Revise Building Codes, Standards and Performance Evaluations to Allow for Flexibility and Adaptability in the Implementation of Advanced Construction Materials and Technologies

**Concern**

Building codes and standards in China’s construction sector are published following a few months, or less, of review and without transparent industry consultation, which results in published building codes and performance standards that are often unreasonably stringent and technical.

**Assessment**

Building codes and standards are to protect people from unpredictable damages, to improve their lives and to respect or even improve the environment. European businesses in the construction industry could facilitate the improvement of overall living conditions.

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and the environment in China by being more active in the establishment and revision of building codes or standards, leading to the application of advanced construction materials and technologies.

Currently, the involvement of European business in the drafting and revision of building codes and standards in China is limited. Therefore, the potential to transfer knowledge and provide the benefits of hard-won European experience is limited. As a result, best practices from Europe are not being fully analysed in the establishment of new codes and this represents a potentially missed opportunity for China. Foreign business sometimes only discover codes are being revised through unrelated communications with industry bodies, which means they are sometimes only discovered by chance, if at all. Regarding calls for comments on proposed amendments to standards, as the documents are understandably only issued in Chinese, the onus is on foreign business to translate them in a short timeframe, which often leads to missed opportunities.

The number of existing codes and standards is high and sometimes various standards on the same subject are developed by different bodies without any coordination, resulting in discrepancies and confusion. Subsequently there can be cause for uncertainty over what is required by law, which results in inefficiency, and in turn leads to economic constraints for both project owners and construction enterprises.

**Recommendations**

- **Set up a clear process with defined lines of communication for the delivery of codes and standards to both local and foreign companies for analysis, feedback and consideration prior to their adoption.**

- **Establish an oversight committee, composed of the relevant authorities and industry experts, both from local businesses and foreign business in China, with the role of evaluating proposed changes or new codes and standards in transparency.**

- **Allow local and foreign companies a longer period for consultation about proposed changes so that foreign companies can translate any documents necessary and then have a meaningful dialogue with experts and the authorities.**

- **Consolidate the current book of standards and codes at all levels in the construction sector.**

- **Create a specialised market approval process for foreign companies acting as enablers to the Chinese market through innovation and advanced technologies, which they have developed and proven overseas.**

### 4. Revise Regulations and Requirements Concerning Foreign Investment in the Real Estate (RE) Sector to Establish a Fair, Balanced and Open Market

**Concern**

In China’s RE sector, both foreign and domestic developers face huge hurdles in the form of strict requirements, and European land developers are still locked out due to stricter regulations and supervision.

**Assessment**

One of the most stringent regulations, the *Opinions for Regulating the Access by and Administration of Foreign Investment in the Real Estate Market (Circular No. 171)*, addresses a variety of measures for controlling the flow of foreign capital. Besides outlining the 50 per cent proportion between registered capital and investment, it lists two more conditions that restrict foreign-invested enterprises (FIEs) from using foreign and domestic loans. FIEs are not allowed to obtain loans from China or overseas before getting land certification, or before realising 35 per cent of their total investment. This creates unfair competition between local and foreign companies, especially in relation to the different requirements for registering capital. On 19th August 2015, six ministries jointly issued the Notice to Adjust Policies regarding Market Access and Administration of Foreign Investment in China’s Real Estate Market (Circular No. 122) to rescind Circular No. 171’s strict requirements relating to the full payment of registered capital by FIEs. It also removed the special requirement on the proportion of registered capital having to equal up to 50 per cent of total investment. Furthermore, it simplified the procedure that allows foreign-invested RE companies to register foreign currencies directly. The working group welcomes this improvement and recognises the positive steps being undertaken by the Chinese authorities to promote a more mature and international investment environment.

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However, the working group believes that currently outdated terms found in Circular No. 171 need to be clarified.

The Notice on Further Strengthening and Regulating the Examination, Approval and Supervision of Foreign Direct Investment in the Real Estate Industry (Circular No. 50), issued in 2007, introduced rigid controls on foreign investment in high-end RE projects, particularly for the acquisition of and investment in domestic RE enterprises. Recognising some of the inflexibility introduced by Circular No. 50, the MOFCOM released the Decision on Revising Certain Regulations and Normative Documents in 2015, and deleted the clause “or have failed to pass the joint annual inspection of foreign-invested enterprises”; however, other requirements stipulated in Circular No. 50 are still valid. Foreign investment can only be made directly in the form of registered capital, which means European businesses are held back from investing in the Chinese RE market and face large operational hurdles.

However, even if investment is encouraged or permitted, foreign investors still face approval and regulatory restrictions. These restrictions limit the introduction of foreign investment and know-how that could help build a healthier market environment. For instance, Circular No. 50 requires a filing in the MOFCOM system, which adds additional time and procedures. This runs counter to the purpose of Circular No. 122, which encourages foreign companies to register foreign currency directly.

Property funds are a commonly used corporate form of RE investment. There have been an increasing number of domestic property funds since 2011, and they form a healthy financing channel for China’s RE market. Following the issuance of foreign-invested, limited-liability partnership rules and related foreign exchange rules, foreign investors should be allowed to set up limited-liability partnerships that focus on real estate property investment. However, whether or not such an application can be accepted is still largely subject to the discretion of local government authorities on a case-by-case basis.

Similar to the rules on foreign investment, limited-liability partnerships for venture capital and equity investment are essential to issuing rules for foreign-invested, limited-liability partnerships with a RE investment focus. This would support the development of smart and green cities as outlined in the 13FYP. European companies are willing to provide the necessary know-how and technologies to properly develop these projects. However, without the right to establish a legal entity, it is impossible for them to fully contribute to the development of more harmonious and liveable cities in China.

Recommendations
• Issue the specification measurement for Circular No. 122.
• Abolish Circular No. 171.
• Simplify application procedures, requirements and bureaucratic procedures for development projects.
• Allow the establishment of foreign-invested, limited-liability partnerships with a focus on RE investments.

Abbreviations
13FYP  13th Five-Year Plan
CM2025  China Manufacturing 2025
CNY  Chinese Yuan
CSP  Construction Service Provider
EU  European Union
FIE  Foreign-invested Enterprise
FIL  Foreign Investment Law
ICD  Innovation Cooperation Dialogue
MIIT  Ministry of Industry and Information Technology
MOC  Ministry of Construction
MOFCOM  Ministry of Commerce
MOHURD  Ministry of Housing and Urban-rural Development
MOST  Ministry of Science and Technology
NDRC  National Development and Reform Commission
NPC  National People’s Congress
RE  Real Estate
RICS  Royal Institution of Chartered Surveyor
SAIC  State Administration of Industry and Commerce
SME  Small and Medium-sized Enterprise
WFOCE  Wholly Foreign-owned Construction Enterprise

Heating Sub-working Group

Introduction to the Sub-working Group

Heating mitigates the negative impacts of cold weather, playing a vital role in providing comfortable and sustainable living conditions for human beings. Bringing heating to people in an energy-efficient and environmentally-sound way is a key objective of the heating industry. The Heating Sub-working Group (or the Europe China Heating Initiative (ECHI)) seeks to promote European technologies that provide eco-friendly heating appliances and components. The aim is to ensure that energy resources are conserved, while air quality is improved by significantly decreasing pollutant emissions. The coal-to-gas transition programme is one of China’s national strategies to fundamentally reduce particulate matter and nitrogen oxide (NO\textsubscript{X}) emissions,\textsuperscript{1} as well as to achieve increased energy efficiency. European heating manufacturers can make significant contributions to the successful implementation of the coal-to-gas strategy,\textsuperscript{2,3} while helping China win the war defending blue skies.\textsuperscript{4}

The representation of the European Heating Industry in China was created in 2002. It currently consists of 11 European enterprises involved in the manufacturing of highly-efficient and renewable-based heating technologies and heating components. They manufacture heating appliances (e.g. high-efficiency heating boilers), burners, water heaters, renewables (e.g. solar and heat pumps) and industrial components. In 2016, the Heating Working Group became a sub-working group of the Construction Working Group. Together with its parent group, it strives to promote advanced European heating technology and offers information on the latest trends and developments in the heating industry.

Recent Developments

Market Development

With the rapid increase of urbanisation and the influence of further developments in e-commerce—making it easier to purchase gas appliances online—households’ increased heating demands were a major driving force for industry development in 2018.\textsuperscript{5} According to the China Gas Heating Specialty Committee (CGHC), in 2018, the total sales volume of gas-fired water heaters in the Chinese market was 3.2 million units, an increase of 52 per cent compared to 2016 (2.1 million units).\textsuperscript{6} The annual sales volume of all condensing wall-hung boilers was 280,000 units, accounting for 8.8 per cent of the total residential boiler market, an increase of 96 per cent compared to 2016 (143,000 units).\textsuperscript{7}

Full condensing technology is not widely used yet in China, a lag in development behind Europe. This technology increases energy efficiency, reduces operational costs and NO\textsubscript{X} emissions but, more importantly, benefits end users. Thus, by launching relevant policies to support full condensing technology applications in China, the government will initiate a trend to promote such technology, eventually benefitting the environment.

Regulatory Environment

The Chinese Government is currently pursuing two clear policy trends in the heating industry. The first is enacting product standardisation to promote the quality of consumer goods. The National Standard of Household Gas Instantaneous Boiler (GB 6932-2015), released by the former Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) and the Standardisation Administration of China (SAC), came into effect on 1\textsuperscript{st} January 2017. This national standard sets higher technical requirements for gas appliances. The Heating Sub-working Group believes that a standard such as this, which was developed in full consultation with experts, will continually bring about greater benefits and sustainable values to the industry.


\textsuperscript{2} Coal-to-gas strategy refers to the energy-efficiency policy of the Chinese central government and the Beijing-Tianjin-Hebei government to promote the projects of replacing coal with natural gas.

\textsuperscript{3} Notice on the Three-Year Action Plan for Winning the Blue Sky Defence War, State Council, 27\textsuperscript{th} June 2019, viewed 3\textsuperscript{rd} April 2019, <http://www.gov.cn/ gongbao/content/2018/content_5306820.htm>

\textsuperscript{4} Ibid.

\textsuperscript{5} Gas shortages are another driving force for the market development of energy-efficient gas appliances. For more analysis on gas availability in China, please see Key Recommendation 1 in the Energy Working Group Position Paper.

\textsuperscript{6} Gas-Fired Heating and Hot Water Combi-Boiler 2018 Market Statistics, China Gas Heating Specialty Committee, 20\textsuperscript{th} February 2019, viewed 18\textsuperscript{th} April 2019, <http://cghc.chinagas.com.cn/News/detail/item/2350/category/204.html>

\textsuperscript{7} Ibid.
The second trend is the introduction and implementation of distinct and comprehensive regulatory policies to increase energy efficiency and reduce pollutant emissions. As for energy efficiency, the _National Standard on Quality Inspection and Grade Evaluation for Gas-Burning Appliances_ (GB/T 36503-2018), released by the State Administration for Market Regulation (SAMR) and the SAC, rates and categorises gas appliances and components into levels A, B or C. This _Guobiao_ (GB) or national standard provides consumers with an understanding of how energy efficient their appliances are. To further promote energy-saving concepts and select the most energy-efficient enterprises in various industries, the National Development and Reform Commission (NDRC), together with six other ministries, published the _Energy Efficiency Leader Implementation Plan_, which lists the most energy-efficient manufacturers, setting a benchmark for other enterprises to follow.

When it comes to reducing pollutant emissions, on 16th May 2014, the Ministry of Ecology and Environment (MEE) issued the _National Emission Standard of Air Pollutants for Boilers_ (GB 13271-2014), the first national standard to set the maximum emission limit for boilers (<65 tonnes per hour (t/h)).

In Beijing and Shanghai, the standard for emission limits is much higher than the national level. For example, on 10th June 2015, the Beijing Municipal Environmental Protection Bureau issued emission standards for local districts as part of the implementation and revision of the _Emission Standard of Air Pollutants for Boilers_ (DB11 139-2015), the main goal of which was to control NO\textsubscript{X} emissions. According to the new standard, any NO\textsubscript{X} emission from newly-built gas-fired boilers should not exceed 100 milligrams per kilowatt hour (mg/kWh). Its counterpart in Shanghai, the _Emission Standard of Air Pollutants for Boilers_ (DB31 387-2018), limits NO\textsubscript{X} emission for boilers (<65t/h) to 150 mg/kWh up until 30th September 2020. From 1st October 2020, limits on NO\textsubscript{X} emissions will be set to 50 mg/kWh for gas-fuel boilers in Shanghai.

These policies and regulations are intended to reduce emissions resulting from loose technical product requirements and increased sales volume. They are also set to limit the presence of hazardous substances found in home appliances, such as gas appliances and air conditioners, as well as to reduce carbon dioxide (CO\textsubscript{2}) and NO\textsubscript{X} emissions. It is hoped that China’s efforts to foster energy efficiency will lead to the development of a highly efficient and energy-saving boiler market. As both the coal-to-electricity and coal-to-gas projects at both the central government and provincial levels progress further, the heating industry will face changing market demands. Government efforts to promote energy-efficient and emission-reducing policies should be part of a joint endeavour with the industry. The Heating Sub-working Group is ready to share its accrued experience during the policymaking process in order to achieve government-set goals.

### Key Recommendations

1. **Introduce a National Guideline or Policies to Promote Full Condensing Wall-hung Boilers with Class 1 Energy Efficiency**

**Concern**

There is currently a lack of government support for encouraging highly efficient and low-emissions heating technologies, such as full condensing technologies, which has caused difficulties in controlling air pollution and improving energy efficiency in China.

**Assessment**

Wall-hung boilers are a crucial energy source for heating systems, using underfloor heating or last-generation radiators. These low-temperature heating systems provide very comfortable and healthy heating, by reducing the circulation of air and dust in buildings. In recent years, China’s regular wall-hung boiler market (excluding the market related to the coal-to-gas strategy) has grown rapidly because of the increase in spending power of Chinese consumers. This has led to a boom in sales of fully furnished homes, which require gas appliances to be installed before the units can be delivered.

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12 Ibid.
There are two main types of wall-hung boiler: conventional and condensing. Condensing wall-hung boilers increase efficiency and reduce pollutant emissions. In the Chinese market, customers tend to purchase conventional wall-hung boilers because they are cheaper. However, they cannot reach the highest levels of efficiency (class 2 energy efficiency, usually around 90 per cent). By comparison, condensing wall-hung boilers, especially the full-condensing models, are up to 20 per cent more efficient than their conventional counterparts, because they use latent heat from flue gases (class 1 energy efficiency, usually around 108 per cent). Condensing wall-hung boilers also emit far less NOx than older and non-condensing appliances. As a source of pollution, NOx emissions are a significant concern. A state-of-the-art condensing boiler reduces NOx emissions by up to 75 per cent, compared with non-condensing models.

A main priority of the working group is to encourage the use of condensing wall-hung boilers during the first installation. An example can be taken from a Beijing Municipality guideline prohibiting wall-hung boilers with class 2 energy efficiency and below from being used in new projects. As of 1st May 2015, boilers with class 2 energy efficiency were no longer permitted in the project planning phase; and as of 1st October 2015, they were not allowed to be installed. The benefit here is that customers who bought these apartments in Beijing pay 20 per cent less on their gas bills, and less pollution will be produced.

Where possible, it makes sense to promote the use of this technology from the first installation. Aside from energy efficiency and environmental reasons, there are also some practical considerations. If a conventional boiler is replaced by a condensing boiler, some small additional fittings may be required in the building. For example, produced condensates will need to be collected through a short, dedicated pipe, and transferred to a waste water pipe or sink in the building, where it is neutralised by the rest of the waste water. However, if a condensing wall-hung boiler is installed from the outset with the correct pipe, any future replacements will not have the same issues. The working group therefore suggests that relevant policymakers take condensing wall-hung boilers into consideration when formulating guidelines and policies on energy efficiency and pollution control in construction projects. Policies could be developed to promote the use of highly-efficient condensing boilers, and especially full-condensing models, similar to regulations promoting green energy vehicles.

**Recommendations**

- Extend to the whole country the pilot policies promoting condensing technology in the first installation.
- Introduce subsidy programmes for promoting highly efficient and low-emissions technologies, such as the full-condensing wall-hung boilers, in key cities and regions, and further expand the programmes to more areas.

2. **Establish Requirements for the Installation and Maintenance of Heating Products and Systems**

**Concern**

There is a lack of effective guidelines and standards on the installation and post-sales service of gas-fired, wall-hung boilers; installation issues may create disorder in the heating market and could pose safety problems.

**Assessment**

The sales of gas-fired heating and hot water combi-boilers in China grew rapidly in 2018, reaching 3.2 million units nationwide. Gas-fired heating and hot water combi-boilers use gas, water and electricity at the same time, providing users with heating and domestic hot water through one system.

When installing a complete system, it is necessary to choose highly-efficient and safe products for the heat source. The system also needs to be configured with reliable hydraulic and control devices. Finally, it is important for the whole system to periodically undergo professional maintenance in order to ensure efficient and safe operation in the long term.
The Chinese Government and other government-related agencies have issued some relevant national standards for gas-fired heating and hot water combi-boiler products and related industry standards for product application, including the following:

1. **Gas-fired Heating and Hot Water Combi-boiler GB 25034-2010.**
2. **Safety Management Regulation of Gas-fired Appliances for Domestic Use GB 17905-2000.**
3. **Specifications for the Installation and Acceptance of Domestic Gas-fired Appliances CJJ 12-2013.**

Despite existing standards, there is still a lack of effective monitoring and management of the efficiency of whole systems, as well as their operational status following installation and commissioning. The government previously managed gas-fired heating and hot water combi-boiler producers through regulation of production licences, though there was no specific regulation to manage installers of this equipment. The China Quality Supervising and Test Centre for Gas Appliances (CGAC) tested the quality and performance of products through sample inspections and market spot-checks. On 30th September 2018, the State Council adopted compulsory certification for gas appliances, replacing production permits. However, the procedure for obtaining compulsory certification for gas appliances is still vague and ambiguous, and more transparent guidelines are required.

European Union (EU) countries have a rich experience of gas-fired heating and hot water combi-boiler products usage for more than 50 years. More importantly, relevant EU standards, products, applications and services are mature and comprehensive. The EU issued the updated Regulation 813/814 in September 2015, which establishes new energy efficiency requirements for products and systems. Meanwhile, EU countries also have well-regulated and mature methods and systems for certifying the qualifications of service engineers and providers. Enterprises represented by the ECHI entered the Chinese market quite early, and therefore have a great deal of experience, from both China and Europe, to offer the Chinese Government on setting up rules on the installation and maintenance of heating products.

### Recommendations

- Introduce a system for qualifying heating products installation and for qualifying service engineers.
- Formulate and promote rules for the installation and servicing for heating products.
- Ensure the participation of foreign-invested enterprises (FIEs), to strengthen industry supervision of the installation and maintenance of heating products.

### 3. Strengthen Data Integration of Gas Equipment in Finished and Prefabricated Residential Buildings

**Concern**

Currently, the installation of gas appliances is not considered in the Chinese Government’s policy guideline on promoting prefabricated residential buildings, which has led to the waste of resources and buried potential safety hazards.

**Assessment**

In practice, the Chinese Government’s policy guideline on promoting prefabricated residential buildings only regulates structural components of a construction, but does not consider the following gas equipment-related elements:

1. Special requirements for the location of gas water heaters in a building.
2. The general impact on the building structure after the instalment of the gas appliance.


24 Prefabricated buildings are buildings that are assembled from prefabricated parts on site. The promotion process of the prefabricated residential buildings refers to the State Council’s guideline on promoting prefabricated buildings, especially residential buildings. MOHURD is the body of policy implementation. For more details please refer to footnotes 26 and 27.
3. The necessity to provide spaces through walls or beams for the appliance’s gas pipe, flue gas pipe and ventilation duct.

The working group therefore believes that taking gas equipment into consideration when formulating building plans, and during their construction, can guarantee the safety of the overall construction and increase the resource utilisation rate of building materials.

The Ministry of Housing and Urban-Rural Development (MOHURD) is promoting prefabricated residential buildings with the aim of encouraging both the transformation of the way the construction industry is managed and cooperation among enterprises in the industrial chain. Technology demonstration projects for prefabricated buildings are part of this campaign and play an important role in the whole process.

Compared with traditional methods of residential investment, development, design, construction, and after-sales service, residential industrialisation focusses on finished buildings. It emphasises the integration of related enterprises in the upstream and downstream sectors of the industrial chain into a complete system. For example, the planning of prefabricated building integrates both upstream and downstream sectors, including Building Information Module (BIM) and final construction. In this way, it simplifies and internalises complex production and trading processes, achieving optimal allocation of production factors, reducing transaction costs and increasing production efficiency. This can be achieved through an integrated approach that uses property rights and technology as a link, or through close collaboration between upstream and downstream companies.

The working group believes that engaging European heating manufacturers in the prefabricated building promotion process can accelerate policy implementation, improve the safety of the overall construction and reduce waste and emissions.

Recommendations

- Consider gas heating and hot water equipment in the planning of prefabricated buildings, including technical standards, BIM platform setup and building planning.
- Engage FIEs from the heating industry in policy consultations.

Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AQSIQ</td>
<td>Administration of Quality Supervision, Inspection and Quarantine</td>
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<td>BIM</td>
<td>Building Information Module</td>
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<tr>
<td>CECS</td>
<td>China Association for Engineering Construction Standardisation</td>
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<tr>
<td>CGAC</td>
<td>China Quality Supervising and Test Centre for Gas Appliances</td>
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<td>CGHC</td>
<td>China Gas Heating Speciality Committee</td>
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<tr>
<td>CO₂</td>
<td>Carbon Dioxide</td>
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<tr>
<td>ECHI</td>
<td>Europe China Heating Initiative (the Heating Sub-working Group)</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>FIEs</td>
<td>Foreign Invested Enterprises</td>
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<tr>
<td>MEE</td>
<td>Ministry of Ecology and Environment</td>
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<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
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<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
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<tr>
<td>MOHURD</td>
<td>Ministry of Housing and Urban-rural Development</td>
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<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>NGOA</td>
<td>National Government Offices Administration</td>
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<tr>
<td>NOₓ</td>
<td>Generic term for the various nitrogen oxides produced during combustion</td>
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<tr>
<td>SAC</td>
<td>State Administration for Market Regulation</td>
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<td>SAMR</td>
<td>State Administration for Market Regulation</td>
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27 Ibid.
28 Building Information Modeling (BIM) is a process supported by various tools and technologies involving the generation and management of digital representations of buildings.
Information and Communication Technology Key Recommendations

1. Further Open up China’s Value-added Telecoms Services (VATS) Sector to International Investment and Ease Internet Access
   - Further narrow down the Negative List and allow increased international participation in telecoms- and internet-related sectors.
   - Continue to open up the Telecoms Catalogue and allow international companies in China to obtain VATS licences, particularly for internet resources collaboration (IRC) services, information services and domestic internet protocol-virtual private network (IP-VPN) services.
   - Maintain international companies’ full access to the Software as a Service (SaaS) market, without excessive government intervention or unnecessary licensing requirements.
   - Maintain stable access to legitimate global internet resources that are critical for corporate business development, and ease restrictions on VPNs.

2. Develop an ICT Regulatory and Standardisation System that Benefits both the End-user and Industry Transformation as a Whole in Support of a Global Market and Shared Digital Economy
   - Ensure openness and transparency in the standardisation process, as well as full and equal membership rights for international companies in all information and communication technology (ICT)-related standards developing organisation (SDOs) in China, including social organisations and industrial alliances.
   - Encourage a non-discriminatory spectrum policy for various ICT technologies such as mobile broadband and lower-power wide-area networks (LPWAN), to ensure that early and globally-harmonised spectrum allocation contributes to social and economic transformation.
   - Ensure that local standards or other technical requirements do not unfairly mandate specific technologies.
   - Streamline the conformity assessment process in such a way that it:
     - clarifies how interested parties can implement it;
     - clarifies to what extent the complex and duplicative conformity assessment process for ICT products will become simple, transparent and unified; and
     - allows international testing, inspection and certification agencies to perform desired ICT product conformity assessment services in China.
   - Provide clarification on conformity assessment requirements well in advance of the implementation date and provide notification under the World Trade Organization/Technical Barriers to Trade (WTO/TBT) Agreement for any standard that is applicable to mandatory conformity assessment and market access.
   - Provide clear guidelines on the implementation of the Cybersecurity Law to create a regulatory environment that is conducive to digital business development.

3. Release a Cryptography Law and the Revised Commercial Cryptography Regulation with Rules that are Clear, Fair and Stable
   - Engage in a timely and meaningful consultation process with all relevant stakeholders well in
advance of the release of the Cryptography Law and the Commercial Cryptography Regulation.

- Formulate the Cryptography Law and the Commercial Cryptography Regulation in such a way that they are non-discriminatory towards imports/exports, operations, production or market access of international companies, and are in line with international best practices.
- Allow international companies to obtain licences for commercial cryptography products, including products used in critical information infrastructure (CII).

4. Ensure Equal Opportunities for International Companies in China under Chinese Industrial Policies

- Establish fair competition by reforming market access conditions, enhancing post-market supervision and strengthening IPR protection through concrete policy measures.
- Ensure China’s guiding industrial policies are conducive to innovation and fair competition and are not used for the short-term promotion of domestic industry.
- Encourage greater reciprocity in ICT innovation and engage in further collaboration between different EU organisations with the goal of developing mutually-beneficial international standards, by allowing international participation in Chinese R&D programmes.
- Streamline the application process for international companies applying for Chinese ICT research and development (R&D) programmes by removing unnecessary and overly burdensome documentation requirements and by increasing transparency in the process.
- Ensure equal access for international companies in China to state funding, R&D deductions and other policy incentives in support of China’s industrial policies.
- Ensure that government-guidance funds operate under market conditions.

Cybersecurity Sub-working Group Key Recommendations

1. Ensure that Cybersecurity Schemes Do Not Create Discriminatory Market Access Barriers

- Differentiate national security from commercial security in a clear manner, and refrain from broadening the scope of relevant cybersecurity schemes.
- Ensure a level playing field for all suppliers of ICT products and services, by developing clear and non-discriminatory cybersecurity rules and standards that are in line with global practices, instead of focusing on the nationality of ICT products and services.
- Improve transparency in relation to the development and implementation of cybersecurity schemes for ICT procurement in various industries and encourage inclusive stakeholder participation.

2. Eliminate Unnecessary Operational Burdens Created by Extensive and Ambiguous Cybersecurity Schemes and Potentially Intrusive Enforcement

- Ensure transparency and industry participation in the formulation of the Cybersecurity Law’s implementing regulations.
- Address openly any technical difficulties and operational burdens that companies face due to cybersecurity restrictions, by ensuring the timely review and improvement of released rules and encouraging international policy models that support China’s development.
- Ensure consistency between higher-level legislation and relevant implementing regulations and follow the least interference principle in the course of legitimate international business operations.
- Ensure that efforts to improve cybersecurity reflects the borderless, interconnected and global nature of today’s business environment, which is also beneficial for domestic companies.
Introduction to the Working Group

The term information and communication technology (ICT) can be taken to mean all devices, networking components, applications and systems that, when combined, allow people and organisations to interact in the digital world. ICT is leveraged for economic, societal and interpersonal transactions and interactions, and has drastically changed how people work, communicate, learn and live. Moreover, ICT continues to revolutionise all parts of the human experience as computers, and increasingly robots, carry out many of the tasks once handled by humans.

The ICT industry plays a fundamental role in economic and social developments that will benefit both Europe and China if both sides are committed to cooperate further. Advances in ICT enable an overall improved user experience, making peoples’ lives more convenient, and are essential for the successful transformation and upgrading of other industries such as manufacturing, mobility and financial services. This will be achieved through improved efficiency and guaranteed security. Additionally, ICT is essential for many new developmental areas, such as the Internet of things (IoT) and smart cities, to take off.

European ICT companies are among the largest investors in China and contribute to China’s development by transferring technology, creating jobs, contributing expertise, providing intellectual property (IP) and by training a new generation of Chinese engineers in the ICT field. A large percentage of European ICT companies have significant research and development (R&D) operations with well-established links to Chinese universities and research institutes that contribute significantly to ICT sectoral development in China.

As such, European ICT companies should receive equal treatment in the Chinese marketplace in key areas such as participation in standardisation, rule-making, government-funded national R&D projects and market access.

Formed in 2001, the Information and Communication Technology Working Group consists of major European telecommunications vendors, service providers, digital content providers and other companies that meet on a regular basis to assess reforms that can affect the ICT industry. The working group also serves as a platform for information exchange on developments in the ICT industry, including but not limited to standardisation and conformity assessment, services, technical regulations, research and innovation, interoperability and global harmonisation. The working group’s activities are intended to contribute to consultation and dialogue with all government agencies that are responsible for overseeing the ICT sector, as increased dialogue between Chinese decision-makers and the European
ICT industry would be beneficial to both parties. The Information and Communication Technology Working Group contains the Cybersecurity Sub-working Group.

**Recent Developments**

**5G**

China re-emphasised the importance of the fifth generation (5G) of mobile internet connectivity at the Central Economic Work Conference held from 19th to 21st December 2018, calling for accelerated 5G commercialisation.1 While the country originally expected to achieve 5G pre-commercialisation in 2019, and large-scale commercialisation in 2020, full-scale acceleration of the technology can now be expected: the first batch of four commercial licences for 5G were already issued to China Telecom, China Mobile, China Unicom and China Broadcasting Network in June 2019.2

Having defined 3,300–3,600 megahertz (MHz) and 4,800–5,000 MHz as 5G frequency bands,3 the Ministry of Industry and Information Technology (MIIT) also allocated in December 2018 low and medium-frequency bands to the country’s three-tier-one telecoms carriers for 5G testing: 3,500MHz for China Telecom and China Unicom, and 2,600MHz and 4,900MHz for China Mobile. Extensive 5G lab testing and trial activities in the field continue in 2019, with initiatives from both the Chinese Government and Chinese telecoms operators. European ICT companies have been closely engaged with, actively invested in and contributed to such activities in order to support China’s ambitious 5G roll-out by 2020.

On the international stage, China and the European Union (EU) expressed, in the 2019 EU-China Summit Joint Statement, that they welcome “progress and further exchanges in the EU-China dialogue and working mechanism on 5G based on the 5G Joint Declaration of 2015, including on technological cooperation between respective business communities.”4 China is also actively engaged in the International Telecommunication Union (ITU) and the Third Generation Partnership Project.

**Artificial Intelligence (AI)**

China’s top leadership sees AI as a strategic issue; key for the country to seize the opportunities in the next round of technological revolution and industrial transformation.5 Beijing is determined to leverage the country’s growing technological capacity, abundant data resources and strong domestic demands to become a global AI champion. Such an ambition is documented in the Next Generation AI Development Plan (Plan), released by the State Council in July 2017.6 In addition to detailing the policy objectives—creating an open and coordinated AI technological innovation system, a high-end and highly efficient intelligent economy, a safe and convenient intelligent society and intelligent infrastructure—the Plan also proposes a series of necessary supporting measures. These include: formulating laws, regulations and ethical norms relating to AI development; developing technical standards and IP safeguards for AI; and strengthening regulation and assessment of AI security. The MIIT later unveiled a detailed three-year action plan to advance AI development until 2020.7

These development goals underline China’s ambition to transform itself into an AI innovation centre and a world leader in AI technology and applications. The Information and Communication Technology Working Group believes there is room for the European ICT industry to take part in China’s AI development, if it is done in a fair, open, predictable and highly competitive market environment. For more information, please refer to Key Recommendation 4 of this paper.

**Telecommunications (Telecoms)**

On 30th June 2018, China released the Special Administrative Measures for Foreign Investment Access to Pilot Free Trade Zones (FTZ Negative List) (2018),8 with several changes that affect value-added telecoms  

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services (VATS). It expands the scope of the pilot VATS policy of the original China Shanghai Pilot Free Trade Zone (CSFPTZ) to all free trade zones (FTZs), by removing the foreign shareholding cap on store-and-forward, call centre, domestic multi-party communication and internet users’ internet access services. It also opened up domestic internet protocol–virtual private network (IP–VPN) services with a 50 per cent foreign shareholding cap on store-and-forward, call centre and domestic multi-party communication services nationwide.9

Internet Access

In January 2017, the MIIT published the Notice on Cleaning Up and Regulating the Internet Access Service Market,10 with the aim of further regulating Type I VATS under the Telecoms Catalogue,11 namely Internet data centre (IDC) services, content distribution network services, domestic IP–VPN services and Internet service provider services – prohibiting unlicensed operations, operations that go beyond the licensed scope and licence transfers.12 After an extension, the campaign finally ended on 31st March 2019.13

Further clarifications on VPN usage in China have also been issued since 2017. Multinationals have been allowed to have cross-border VPN connections on the condition that they directly lease international dedicated lines (including VPNs) provided by one of China’s three tier-one telecoms operators, or commission from abroad an overseas operator to do so. It has been made clear that while system integration, maintenance, management and other services may be outsourced to qualified third parties that have licences for domestic IP–VPN and fixed network domestic data transmission services, these third parties are prohibited from undertaking sales or leasing of international dedicated lines (including VPNs), or other telecom business activities.14 A China Cross-border Data Telecommunications Industry Alliance (CCDTIA) was established in March 2018, and has been tasked with further implementing the MIIT’s policies through industry self-regulation.15 However, cross-border VPN connectivity solutions that are currently available carry high costs, making them less affordable for small and medium-sized enterprises.

Cryptography

On 5th July 2019, the National People’s Congress (NPC) issued a public consultation on the Cryptography Law (Draft),16 a comprehensive piece of legislation governing the cryptography sector. Once implemented, the draft law will become the highest-level piece of legislation in the cryptography field. It defines cryptography as “products, technology and services using specific transformations to information to ensure encrypted protection or security authentication”, and divides it into ‘core’, ‘common’ and ‘commercial cryptography’. The draft law states that commercial cryptography may be used by citizens, legal persons and other organisations to ensure network and information security in accordance with the law, as long as state secrets are not involved. It also states that commercial cryptography-related development, production, sales, service, import and export activities are to be carried out in adherence to relevant laws, administrative regulations, mandatory national commercial cryptography standards and the technical specifications disclosed by companies.

In addition, sections of the draft law overlap with the Cybersecurity Law, the planned Export Control Law and other relevant laws. For example, commercial cryptography products which may affect national security, national economy, people’s livelihood and social and public interests, and are listed in the Catalogue on Critical Network Equipment and Specialised Network Security Products, are to be security certified by a qualified establishment or meet the requirements of a security testing before being sold or provided. Commercial cryptography services designated for critical network equipment

and specialised network security products must be security certified or meet the requirements of a security testing by a commercial cryptography testing establishment before being sold or provided. If laws, administrative regulations and other national provisions mandate the use of commercial cryptography for the protection of critical information infrastructure (CII), the CII operators must carry out a security assessment on commercial cryptography application and use commercial cryptography to ensure appropriate protection. If the purchase of network products and services by CII operators and state organs may affect national security, a joint national security review by the Cyberspace Administration of China together with the State Cryptography Administration (SCA) and other authorities will need to be carried out. Finally, the Ministry of Commerce and the SCA will implement an import licensing system for commercial cryptography involving national security and social and public interests, and have the function of encrypted protection. They will also implement an export control system for commercial cryptography involving national security and social and public interests, or in adherence to China’s international commitments. While the draft law exempts commercial cryptography used for mass consumption products from import and export restrictions, no definition has been given for ‘mass consumption products’.

Security-related Laws and Regulations
Following the promulgation of the Cybersecurity Law in November 2016, China has intensified its cybersecurity regulatory efforts. New rules regarding areas such as cybersecurity review, cross-border data transfer, the protection of personal information and critical information infrastructure (CII), a classified cybersecurity protection scheme, and the Cybersecurity Law’s sectoral application, have either been released or are in the process of being developed. These recent developments have left international companies concerned about China’s current regulatory environment. The working group urges the Chinese Government to openly address these concerns, actively engage in further dialogue with European industry and improve EU-China bilateral collaboration. For more information, please refer to the Cybersecurity Sub-working Group Position Paper.

Key Recommendations

1. Further Open up China’s Value-added Telecoms Services (VATS) Sector to International Investment and Ease Internet Access

Concern
China’s regulatory framework for ICT services can be further improved by allowing international companies greater market access and easing restrictions on access to legitimate sources of information.

Assessment
VATS
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, the Internet, consumer electronics and media industries are transforming the ICT industry and driving a shift away from basic connectivity towards richer forms of services, content and entertainment. These are areas where European companies are well positioned to offer value to China as the country seeks to further open up the market and encourage innovation. While European companies have played an important role in supplying ICT infrastructure, devices and services in China, creating a significant source of employment, they have, by and large, been excluded from new opportunities in the country’s ICT market.

According to China’s long-standing, telecoms-related market access restrictions, generally only companies that are less than 49 per cent foreign-invested can apply for a Basic Telecoms Services licence. Only companies that are less than 50 per cent foreign-invested can apply for a VATS licence, with the exception of limited areas such as online data processing and transaction processing services (operating e-commerce), domestic multi-party communications services, store-and-forward services and call centre services. Substantial changes are needed to open up the majority of VATS, which remain restricted, in order to better accommodate technological advancements.

Among the various VATS types under the Telecoms
Catalogue revised in 2015, internet resources collaboration (IRC) services constitute one of the services foreign players wish to be able to provide the most. These services are defined as a sub category of IDC services, and can be deemed as a combination of the Infrastructure as a Service (IaaS) and Platform as a Service (PaaS) models of cloud services. While China has issued numerous policies promoting cloud services domestically, international cloud service providers still find themselves confronted with unsurmountable market access barriers in the form of licensing, technical cooperation and data localisation requirements.

Information services are another VATS of particular interest to international companies operating in China, but remain regulated and difficult for them to apply for relevant licences. As mobile Internet and IoT continues to develop, relevant restrictions represent an increasingly burdensome obstacle to European businesses that wish to bring their expertise to the Chinese market.

Finally, international companies in China enjoy limited access to domestic IP-VPN services. Reduced access to information will inevitably negatively impact businesses and innovation in China—especially as R&D relies on research and information exchange—as well as cross-border transactions and, in the end, investments, as they are all underpinned by the free access to and flow of information. Further opening-up domestic IP-VPN services would help increase competition and bring more affordable solutions to SMEs.

Internet Access

Despite China’s pursuit of innovation-driven growth, the European Chamber’s European Business in China Business Confidence Survey 2019 revealed that 50 per cent of respondents believe China’s internet access restrictions have a negative economic impact on their business. Such restrictions have a deeply negative impact on the ability of domestic and international businesses to undertake research, conduct e-commerce transactions or even divert business from online vendors, hampering the development of China’s ICT sector, and more largely its entire business ecosystem.

European companies also state that unstable connections and access restrictions have severely impacted businesses in the following ways:

- 47 per cent report lower productivity in the office.
- 53 per cent also report difficulties in exchanging data and documents with their headquarters, partners and customers.
- 45 per cent highlight their inability to search for information and engage in research.
- 15 per cent report that it impacts their ability to attract and retain talent.
- 8 per cent say it has led to them deferring plans to establish R&D operations in China

Recommendations

- Further narrow down the Negative List and allow increased international participation in the telecoms- and internet-related sectors.
- Continue to open up the Telecoms Catalogue and allow international companies in China to obtain VATS licences, particularly for IRC services, information services and domestic IP-VPN services.
- Maintain international companies’ full access to the Software as a Service (SaaS) market, without excessive government intervention or unnecessary licensing requirements.
- Maintain stable access to legitimate global internet resources that are critical for corporate business development, and ease restrictions on VPNs.

2. Develop an ICT Regulatory and Standardisation System that Benefits both the End-user and Industry Transformation as a Whole in Support of a Global Market and Shared Digital Economy

Concern

Improvements need to be made to China’s ICT regulatory and standardisation system to ensure greater reciprocity, fairness, openness and transparency.

Assessment

Access to ICT Standards Developing Organisations (SDOs)

In 2015, China launched a new round of standardisation reforms, aiming to make its standardisation system and processes fairer, more transparent, reciprocal and

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18 Telecoms Catalogue, MIIT, 28th December 2015, viewed 4th May 2019, <http://www.miit.gov.cn/n1146285/n1146352/n3054355/n3057709/n3057714/c4564270/content.html>
open. A series of positive developments in the ICT field have been witnessed since, with international companies in China being granted full or greater access to key ICT SDOs, such as the China Communications Standardisation Association, the International Mobile Technology (IMT)-2020 Promotion Group and the National Information Security Standardisation Technical Committee (TC260). The working group is pleased to notice that TC260’s Working Group 3 on Cryptographic Solutions has also recently become open to international participation, and the ICT Working Group will continue to monitor the degree of such opening-up.

The working group looks forward to such positive momentum being expanded to all ICT SDOs at all levels, including social organisations and industrial alliances that are encouraged to develop their own social organisational standards as part of the reform plan, allowing international companies full and equal membership rights at both the technical committee and working group levels.

**International Harmonisation and Technology Neutrality**

Global cooperation on standardisation is the key to achieving economies of scale and bringing benefits to the end user in the form of affordable, high-quality products that utilise technological breakthroughs made around the world. As the global ICT market quickly advances towards 5G, AI, IoT, big data and cloud computing, it is important for China to have a globally-harmonised standardisation system. This would benefit stakeholders that are involved in both traditional and new areas of ICT, by avoiding market fragmentation due to the existence of local standards. For instance, in the field of cryptography, China is increasingly mandating the implementation of indigenous national algorithms. Despite positive steps taken over the past few years towards disclosing a number of these algorithms, international companies are still not granted the necessary licences to implement them.

In the process of developing new standards, the mandating of specific technologies that only serve the interests of certain companies should also be avoided. Technology neutrality is a well-tested concept that not only guarantees the best quality experience for the end user but also avoids unnecessary economic burdens. It is proven that the market can choose which technologies are competent enough to solve consumer issues. The working group urges China to avoid mandates that favour certain companies in order to create a stronger market. Enhancing dialogue with market players would be helpful to avoid setting forth requirements that are difficult to implement or that will jeopardise the business ecosystem.

**Transparency of Conformity Assessment Requirements**

The selection of standards for conformity assessment inclusion is often not transparent due to the lack of sufficient detail on requirements provided in writing. Of paramount concern to the industry are the following:

- Voluntary, non-World Trade Organization Agreement on Technical Barriers to Trade (WTO/TBT)-notified standards in mandatory conformity assessment requirements (particularly in the field of cybersecurity).
- Checking for black-listed technologies and configurations in a non-transparent process.
- Failing to file WTO/TBT notifications for changes in the conformity assessment criteria.

Providing clear, written requirements well in advance of the implementation date and notifying the WTO/TBT committee of conformity assessment criteria changes would ensure that the industry has sufficient time to ensure compliance, helping to avoid unnecessary technical barriers. Please see Key Recommendation 1 of the Standards and Conformity Assessment Working Group Position Paper for further discussion of this issue.

The working group would also like to underline that additional information unrelated to testing core product features—such as disclosure of source code and additional software or hardware information—should not be part of conformity assessment requirements, as these mainly relate to the exact implementation of standards and specific techniques. Understanding how each company implements standards does not add to test reliability, and instead requires companies to disclose sensitive commercial information.

**Operating Spectrum for Greater Service Efficiency and Global Harmonisation**

The working group has noticed some recent developments in China regarding 700 MHz, with regard...
to both mobile operators anticipating its use for IMT, and the broadcast camp that aims to better utilise the spectrum in the digital transformation of broadcast services. The working group believes that opening the 700 MHz band for IMT services in China will promote healthy and sustainable market growth in the IMT industry.

From a long-term perspective, the 5G spectrum is now an important topic for the global preparation of 5G commercialisation. The ITU World Radiocommunication Conference 2015 identified the potential new spectrum for 5G, including both below and above 6 gigahertz (GHz). China is an important stakeholder for global discussion and harmonisation, and close coordination with global and regional regulators is highly desired. Therefore, the working group urges China to implement an active plan of allocating more bandwidth to support IMT and 5G development, including the opening of incumbent bands (e.g. 700 MHz band) and studying new areas of the spectrum (e.g. bands above 6 GHz) to enhance China’s leadership in 4G and 5G ecosystem development. The working group would like to actively facilitate the exchange and coordination between China and the EU regarding spectrum regulation.

The working group welcomes the MIIT decision on the identification of 3,300–3,600 MHz and 4,800–5,000 MHz as 5G frequency bands, and the other 5G frequency developments outlined in the Recent Developments section of this paper. It is believed that active spectrum policies can play a fundamental role in boosting China’s digital economy. More importantly, harmonisation with global trends will enable the global ecosystem to achieve economy of scale, thus leading to the successful adoption of 5G and IoT and serving consumer needs around the globe.

In addition, there have also been some developments in China with regard to the lower-power wide-area network (LPWAN) IoT spectrum allocation and licensing. In June 2017, the MIIT published an announcement allowing IMT spectrum to be used for supporting narrowband (NB)-IoT deployment. In the same month, it also unveiled a national NB-IoT deployment plan, according to which 1.5 million NB-IoT base stations are to be deployed by 2020 to achieve nationwide coverage.

While the working group welcomes opportunities associated with NB-IoT development in China, with regard to non-cellular LPWAN technologies such as Sigfox and LoRa that are complementary with NB-IoT and other cellular technologies, the working group recommends to reference practices in other countries and ensure global spectrum harmonisation.

**Recommendations**

- Ensure openness and transparency in the standardisation process, as well as full and equal membership rights for international companies in all ICT-related SDOs in China, including social organisations and industrial alliances.
- Encourage a non-discriminatory spectrum policy for various ICT technologies such as mobile broadband and LPWAN, to ensure that early and globally-harmonised spectrum allocation contributes to social and economic transformation.
- Ensure that local standards or other technical requirements do not unfairly mandate specific technologies.
- Streamline the conformity assessment process in such a way that it:
  - clarifies how interested parties can implement it;
  - clarifies to what extent the complex and duplicative conformity assessment process for ICT products will become simple, transparent and unified; and
  - allows international testing, inspection and certification agencies to perform desired ICT product conformity assessment services in China.
- Provide clarification on conformity assessment requirements well in advance of the implementation date and provide notification under the WTO/TBT Agreement for any standard that is applicable to mandatory conformity assessment and market access.
- Provide clear guidelines on the implementation of the Cybersecurity Law to create a regulatory environment that is conducive to digital business development.

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22 Notice on Promoting the All-round Development of Narrow-band Internet of Things, MIIT, 16th June 2017, viewed 4th May 2019, [http://www.miit.gov.cn/n1/146285/n1/146352/n3054355/n3057674/n3057680/c5692515/content.html](http://www.miit.gov.cn/n1/146285/n1/146352/n3054355/n3057674/n3057680/c5692515/content.html)
3. Release a Cryptography Law and the Revised Commercial Cryptography Regulation with Rules that are Clear, Fair and Stable

Concern
The current cryptography regulatory framework places too much emphasis on administrative licensing, contains vague rules, and effectively excludes international companies from certain areas of the Chinese market.

Assessment
The Commercial Cryptography Regulation\textsuperscript{23} constitutes the overarching regulatory and certification framework for commercial cryptography products and technologies in China. Under these regulations, China has been implementing special control over scientific research into, and the production, sale and use of, commercial cryptography products. The Administrative Provisions for Production of Commercial Cryptography Products, the Administrative Provisions for Research and Development of Commercial Cryptography Products, the Administrative Provisions for Sale of Commercial Cryptography Products, and the Administrative Measures for Use of Commercial Cryptography Products by Overseas Organisations and Individuals in China, released from 2005 to 2007, set out licensing requirements for products that use cryptography technology.

On 29\textsuperscript{th} September 2017, the State Council announced the abolishment of four cryptography administrative approval items. This simplified, to a certain extent, the redundant administrative approval system and brought China further in line with international practices.\textsuperscript{24} However, this change is not an immediate market access improvement, as manufacturers of commercial cryptography products still need to obtain the Commercial Cryptography Product Type Certificate, which most international companies have to date been barred from obtaining.

Contrary to some of China’s practices, Europe believes in open markets and remains open to investment. Chinese companies receive all necessary licensing and authorisation when operating in Europe for the purpose of manufacturing and selling commercial cryptography products. So far, Europe has resisted calls to close markets. However, there is a real risk that such calls will escalate, and related fears will grow if China does not become more open and transparent.

In turn, the multilateral rules of the World Trade Organization (WTO) that have served to propel China’s economic growth over the last decade require the country to act upon the revision and implementation of the Commercial Cryptography Regulation:

- In terms of the revision process, as a technical regulation, China should ensure that the Commercial Cryptography Regulation is non-discriminatory and “shall not be more trade-restrictive than necessary to fulfil a legitimate objective”.\textsuperscript{25} In addition, China should also notify the WTO/TBT Committee of any technical regulations that are not based on international standards and that have a significant impact on trade.
- In terms of regulatory implementation, the Chinese Government should ensure its conformity assessment procedures grant access for suppliers of like products from other WTO members under conditions no less favourable than those accorded to domestic suppliers, including a supplier’s right to a conformity assessment. Furthermore, China should ensure that each applicant is given the information necessary to assess conformity and that the standard processing period of each conformity assessment procedure be published; or that the anticipated processing period is communicated to the applicant upon request. However, the SCA has not released this information to international suppliers of commercial cryptography products.

A draft Cryptography Law was released by the NPC in July 2019 for public consultation. China clarified in 2000, shortly after the release of the Commercial Cryptography Regulation, that the scope of ‘cryptography products and devices containing cryptographic technology’ as stated in the regulation is limited to special hardware and software, the core function of which is encryption and decryption, and does not include wireless cell phones, Windows software and browser software, known as the ‘core function test’. To the working group’s

\textsuperscript{23} Commercial Cryptography Regulation, SCA, 7\textsuperscript{th} October 1999, viewed 4\textsuperscript{th} May 2019, <http://www.std.gov.cn/gb/search/gbDetailed?id=676F270F33A21890E039FBE4A4A9DFE>

\textsuperscript{24} Decision on Removing a Batch of Administrative Approval Items, State Council, 29\textsuperscript{th} September 2017, viewed 4\textsuperscript{th} May 2019, <http://www.gov.cn/zhangca/content/2017-09/29/content_5228556.htm>

\textsuperscript{25} WTO/TBT, WTO, 1995, viewed 4\textsuperscript{th} May 2019, Article 2.2, <https://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm>
disappointment, no reference has been made in the draft law to the ‘core function test’, which will serve to effectively broaden the draft law’s scope of application.

Recommendations

• Engage in a timely and meaningful consultation process with all relevant stakeholders well in advance of the release of the Cryptography Law and the Commercial Cryptography Regulation.

• Formulate the Cryptography Law and the Commercial Cryptography Regulation in such a way that they are non-discriminatory towards imports/exports, operations, production or market access of international companies, and are in line with international best practices.

• Allow international companies to obtain licences for commercial cryptography products, including products used in CII.

4. Ensure Equal Opportunities for International Companies in China under Chinese Industrial Policies

Concern

China’s ambitious industrial policies have only provided limited benefits to international companies, as well as much of China’s private sector and economy at-large, as full play is not given to market forces.

Assessment

China has drawn up a wide variety of forward-looking industrial policies. National plans and initiatives including China Manufacturing 2025,26 the National Guidelines for the Development of the Integrated Circuit (IC) Industry27 and the Next Generation AI Development Plan28 underpin ambitions to master high-end technologies such as AI, robotics, semiconductor chips, IoT and big data analytics, among others.

Upgrading China’s industrial base and pursuing the development of next-generation technologies is a necessary undertaking – for the sake of both China’s environment and long-term economic sustainability. However, the working group cautions against preferential industrial policies, government funding and market access restrictions on international companies, as the resulting concerns among the business community have the potential to lead to trade disputes.

Restricted International Participation in China’s Industrial Plans

European ICT companies are well placed to play a supporting role in China’s forward-looking national industrial plans and boost China’s overall innovation capacity. Over the years, they have contributed to the local economy, participated in Chinese standardisation and R&D activities, and developed many patented technologies. Through investment and participation in the Chinese market, they have played a part in China’s innovation strategies and goals. However, due to the emphasis on reducing reliance on international technology and imports, China’s industrial plans disproportionately support domestic companies through state funding, R&D programmes and a series of other policy initiatives. The result is reduced international participation in crucial technology segments such as telecoms, cloud computing, IC, AI and IoT.

AI in particular is a crucial sector identified by the Chinese Government as a new, major economic growth engine that can transform traditional industries while solving societal problems. The working group welcomes the Chinese Government’s Next Generation AI Development Plan’s focus on R&D activities for basic science, as well as driving the application of AI technologies across a wide range of industries. The working group hopes that, as China develops into a global AI hub, it will welcome European ICT companies with valuable AI capabilities. The working group recommends that R&D deductions and other policy incentives be made available for both domestic and international AI companies, including start-ups, to fully tap into the commercial value of AI and support innovation.

Regarding R&D participation, the working group welcomes China’s progress in providing R&D funding to international companies in China through the Chinese National Significant Science and Technology Project and other national level R&D projects, such

as the 863 and 973 programmes. However, these companies are still restricted from making individual applications and are instead required to co-apply with a domestic partner. In addition, the process for applying for these funds is still overly burdensome and often requires the disclosure of private information and unnecessary documentation. This situation is further complicated by a lack of transparency in the application process and the opaque decision-making process of national key project planning. Furthermore, the policy that states intellectual property rights (IPR) ownership is a prerequisite for applying for R&D funds needs to be further clarified.

Restricting international involvement limits knowledge-sharing that is crucial for China if it wants to achieve its technological goals. It also runs counter to the inclusive practice of similar EU initiatives. The working group believes European companies—especially those with a research base in China—should be given equal access to Chinese research programmes and funds. The working group therefore encourages China to simplify the procedures for participating in funded programmes required of European ICT companies with R&D investments in China. Furthermore, the working group encourages China to study global best practices, such as the EU’s Seventh Framework Programme for Research and Technological Development, and incorporate such practices into its national R&D fund-application procedures.

Government Guidance Funds

Emblematic of China’s domestic favouritism are government guidance funds. Such funds work in theory much like venture capital funds. In practice however, they have emerged as a key government tool for achieving industrial policy objectives. Government guidance funds often seek to leverage state funds to attract as much social capital (i.e. non-government capital) as possible into the numerous government-backed projects that occupy China’s development landscape. Funds are commonly described as public-private partnerships, though in practice the major backers of industrial funds are either state-owned banks or state-owned enterprises (SOEs); in other words they represent a restructuring of public-sector money. These funds are having an increasingly distorting effect on China’s market conditions – it has been reported that by the middle of 2018, there were nearly 1,200 government guidance funds with a target to manage a total of Chinese yuan (CNY) 5.85 trillion.

Many of these established funds invest across a variety of sectors. For example, one of the largest is the Central SOE Guochuang Guidance Fund. This fund was set up to invest in “strategic emerging industries” such as aerospace, clean energy, high-speed rail, quantum communication and robotics. The National Integrated Circuit Fund (National IC Fund) is particularly influential due to its singular focus on the IC industry. The use of state funds through the National IC Fund to support the domestic IC industry risks creating overcapacity and other market distortions that could potentially lead to decreased profits and innovation capabilities across the entire industry and related value chains. The state-driven acquisition of overseas IC companies and technologies is likewise causing international concern and engendering mercantilist inclinations.

If allowed to operate on market principles, government guidance funds have the potential to facilitate innovation, necessary infrastructure development and sustainable economic development. The working group believes that China’s government guidance funds should follow market principles, rather than indigenous innovation targets. Allowing international companies in China to benefit equally from China’s state funding and other forms of support will best ensure the sustainable and healthy development of China’s ICT sector.

China’s ambitious industrial policies still represent an attractive opportunity for European ICT companies to play an important role in the short- and medium-term. Many companies have already established partnerships with domestic companies, to provide critical components, technology and management skills. The working group hopes that China follows through on its high-level commitments and allows European ICT companies to participate in its technology plans and compete as equals. Ultimately, resisting calls for ‘domestic substitution’ and the ‘security and controllability’ of products and services, and instead perfecting the market would do far more to ensure
China reaches its full potential in economic development and innovation.

Recommendations

• Establish fair competition by reforming market access conditions, enhancing post-market supervision and strengthening IPR protection through concrete policy measures.
• Ensure China’s guiding industrial policies are conducive to innovation and fair competition and are not used for the short-term promotion of domestic industry.
• Encourage greater reciprocity in ICT innovation and engage in further collaboration between different EU organisations with the goal of developing mutually-beneficial international standards, by allowing international participation in Chinese R&D programmes.
• Streamline the application process for international companies applying for Chinese ICT R&D programmes by removing unnecessary and overly burdensome documentation requirements and by increasing transparency in the process.
• Ensure equal access for international companies in China to state funding, R&D deductions and other policy incentives in support of China’s industrial policies.
• Ensure that government-guidance funds operate under market conditions.

Abbreviations

5G  Fifth Generation  IMT  International Mobile Technology
AI  Artificial Intelligence  IoT  Internet of Things
CAICT  China Academy of Information and IP  Intellectual Property
Communication Technology  IP  Internet Protocol
CCDTIA  China Cross-border Data IPR  Intellectual Property Rights
Telecommunications Industry Alliance IRC  Internet Resources Collaboration
CII  Critical Information Infrastructure ITU  International Telecommunication Union
CNY  Chinese Yuan LPWAN  Lower-power Wide-area Network
CSPFTZ  China Shanghai Pilot Free Trade Zone MHz  Megahertz
EU  European Union MIIT  Ministry of Industry and Information
FTZ  Free Trade Zone  Technology
GHz  Gigahertz NB  Narrowband
IC  Integrated Circuit NPC  National People’s Congress
ICP  Internet Content Provider PaaS  Platform as a Service
ICT  Information and Communication R&D  Research and Development
Technology  SaaS  Software as a Service
ICP  Internet Protocol SDO  Standards Developing Organisation
IPR  Intellectual Property Rights SOE  State-owned Enterprise
IRC  Internet Resources Collaboration TBT  Technical Barriers to Trade
ITU  International Telecommunication Union TC260  National Information Security
LPWAN  Lower-power Wide-area Network VATS  Value-added Telecoms Services
MHz  Megahertz MIIT  Ministry of Industry and Information
NB  Narrowband  Technology
NPC  National People’s Congress PaaS  Platform as a Service
PaaS  Platform as a Service R&D  Research and Development
R&D  Research and Development SaaS  Software as a Service
SaaS  Software as a Service SCA  State Cryptography Administration
SDO  Standards Developing Organisation SCA  State Cryptography Administration
SOE  State-owned Enterprise SDO  Standards Developing Organisation
TBT  Technical Barriers to Trade TC260  National Information Security
VATS  Value-added Telecoms Services  Standardisation Technical Committee
VPN  Virtual Private Network WTO  World Trade Organization
Cybersecurity Sub-working Group

Introduction to the Sub-working Group

Without cybersecurity legislation that strikes a proper balance between security and development, information and communication technology (ICT) cannot play the increasingly pivotal role in the economy and society that it needs to. This applies to both the procurement of network products and services, and the handling of data, which makes cybersecurity a top priority in today’s interconnected world.

China re-emphasised the importance of cybersecurity with its upgrade, in March 2018, of the Central Leading Group for Cybersecurity and Informatisation to the Office of the Central Cyberspace Affairs Commission, also known as the Cyberspace Administration of China (CAC).\(^1\) In view of the increasingly strengthened Chinese regulatory environment, the Cybersecurity Sub-working Group was established in February 2016 under the European Chamber’s Information and Communication Technology Working Group. The Cybersecurity Sub-working Group is comprised of world-leading European companies from a wide range of industries concerned about China’s cybersecurity policies.

The Cybersecurity Sub-working Group focuses on cybersecurity legislation, standardisation and enforcement that will impact a series of industries. It hopes to engage people on these subjects by issuing carefully crafted position papers, holding meetings with government agencies, and working increasingly with other stakeholders including industry associations, chambers of commerce, think tanks and independent experts.

Recent Developments

Cybersecurity Law and Implementation

Having taken effect on 1\(^{st}\) June 2017, the Cybersecurity Law\(^2\) outlines a series of general compliance requirements for network operators, as well as special obligations regarding critical information infrastructure (CII) protection, data localisation and cross-border data transfer security assessment, the Classified Cybersecurity Protection Scheme (CCPS),\(^3\) the promotion of ‘secure and trustworthy’ products and services,\(^4\) and a comprehensive certification and testing scheme for critical network equipment and specialised network security products, among others.

At the time of writing, China is still drafting regulations and standards necessary for the Cybersecurity Law’s roll-out, due to a combination of factors including: the complexity associated with bringing this far-reaching cybersecurity vision to life; the need for the CAC to align positions with other government authorities; and important developments in the European Union (EU), the United States and other major jurisdictions across the globe. Intensive legislative and regulatory developments have however been witnessed in mid-2019, bringing significant changes to the previously proposed regulatory framework. The lack of clear and consistent implementing regulations has generated a lot of uncertainty within the business community, and emboldened sectoral government authorities in cybersecurity rule-making. In the absence of general implementing regulations at the national level, various sectoral government authorities have proceeded with their own requirements.

Enforcement actions that have taken place within the first two years of the Cybersecurity Law’s entry into force have largely surrounded personal information protection, CCPS, illegal online content and real-name registration. With more implementing regulations being rolled out in 2019, the Cybersecurity Sub-working Group expects enforcement efforts to increase and their areas of focus to be expanded.

Personal Information and Important Data Protection

Data protection occupies a prominent place in China’s cybersecurity protection efforts. In addition to the

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\(^3\) The Classified Cybersecurity Protection Scheme was previously known as the Cybersecurity Multi-level Protection Scheme.

\(^4\) In recent years, the term ‘secure and trustworthy’ and similar phrases such as ‘secure and reliable’, ‘secure and controllable’ and ‘indigenous and controllable’ have appeared in a number of laws, regulations and policies. According to the CAC, there should be regulatory consistency.
Cybersecurity Law, a series of subsequent regulations and standards have also been released or are being formulated, mostly led by the CAC and the National Information Security Standardisation Technical Committee (TC260).

May and June 2019 witnessed the release of two important drafts, the Administrative Measures on Data Security (Draft for Comments) (Data Security Measures) and the Measures on the Security Assessment of Cross-border Transfer of Personal Information (Draft for Comments) (Personal Information Transfer Measures), both presenting discrepancies with their upper-level legislation by introducing burdensome requirements. They require network operators to conduct a record-filing with local cyberspace authorities when collecting personal sensitive information and ill-defined ‘important data’ for business purposes; perform a security assessment, of which the results should be reported to competent sectoral government authorities or provincial cyberspace authorities for approval before releasing, sharing or trading important data, or providing such data overseas; and to apply to provincial cyberspace authorities for a security assessment on cross-border personal information transfers. For more details, please refer to Key Recommendation 2 of this paper.

As a recommended national standard, the Personal Information Security Specification (Specification) released by TC260 and effective since mid-2018 has been widely referenced by companies in their efforts to comply with the Cybersecurity Law. Amendments to the Specification were released in February and June 2019, reflecting China’s intention to strengthen the protection of personal information of individual consumers by adding provisions relating to aspects such as personalisation, prohibiting forced personal information collection and the aggregation of personal information, as well as third-party access management. Besides TC260, the Cybersecurity Protection Bureau of the Ministry of Public Security (MPS), the Beijing Network Industry Association and the Third Research Institute of the MPS jointly released on 10th April 2019 the Guidelines on Internet Personal Information Security Protection. These guidelines contain inconsistencies with the Specification, and significantly broaden the scope of data localisation restrictions to all personal information holders, including those using private networks or in non-networked environments. The Cybersecurity Sub-working Group invites relevant government authorities to publicly clarify how the guidelines fit into China’s overall personal information protection regulatory and standards framework, as well as the roles and responsibilities of various government authorities with regard to personal information protection, and calls for a unified and coordinated approach.

In terms of enforcement actions, privacy clauses have been a recurring focus of recent government-led cybersecurity campaigns. Such efforts culminated with China’s announcement to launch a certification programme for applications (app) security, the impact of which still needs to be monitored.

CCPS

On 27th June 2018, the MPS issued a public consultation on the Regulation on Classified Cybersecurity Protection (Draft for Comments) (CCPS Regulation), which aims to implement Article 21 of the Cybersecurity Law requiring China to establish a CCPS. The draft CCPS Regulation sorts networks into five classified protection levels and specifies the corresponding security safeguards that should be adopted. It will be complemented by a series of cybersecurity standards that have been released or are currently being developed by TC260. On the basis of the previous Administrative Measures on the Classified Protection of Information Systems, the CCPS’s requirements will be expanded from mere information systems to new areas.
such as cloud computing, mobile Internet, Internet of things (IoT), and industrial control. The scope of level-three networks, which are subject to stricter compliance obligations, will also be significantly expanded. For more details, please refer to key recommendations 1 and 2 of this paper.

CII Protection Scheme
Built on the CCPS, the Cybersecurity Law contains a specific section on CII protection, underlining the importance of CII security to China’s overall cybersecurity agenda. The CII Protection Regulation (Draft for Comments), released by the CAC in July 2017, did little to narrow down the scope of CII or to clarify its identification procedures. Instead, it contains a number of provisions that are of concern to the sub-working group, for example those requiring the operation and maintenance of CII to be carried out within China and necessary remote maintenance be reported in advance to the sectoral government authorities, and those enabling government authorities to access and copy security-related files. TC260 is currently formulating the supporting standards, which include the Cybersecurity Protection Requirements of CII, and the Security Controls for CII. For more information, please refer to key recommendations 1 and 2 of this paper.

Cybersecurity Review
On 24th May 2019, the CAC released for public consultation the Cybersecurity Review Measures (Draft for Comments), which will supersede the existing Measures on the Security Review of Network Products and Services (For Trial Implementation). The draft requires reviews for network product and service purchases that will or may affect national security, along with supply chain assessments. In addition to a lack of transparency on the standards that will be used for the review’s purposes, the draft also significantly broadens the triggers and scope of the cybersecurity review, and introduces non-technical factors such as politics, diplomacy and trade, as the review’s areas of focus. For more information, please refer to Key Recommendation 1 of this paper.

Critical Network Equipment and Specialised Network Security Product Certification and Testing
Article 23 of the Cybersecurity Law requires critical network equipment and specialised network security products to follow the mandatory requirements of relevant national standards and be certified by a qualified establishment or meet the requirements of a security test, before being sold or provided to users. According to the CAC, the new scheme will not add an additional market entry requirement, and instead has been designed to improve coordination among the existing cybersecurity conformity assessment schemes, namely the Information Security China Compulsory Certification, the Network Access Licensing and the Sales Licensing for Specialised Computer Information System Security Products, managed by the Certification and Accreditation Administration of China (CNCA), the Ministry of Industry and Information Technology (MIIT) and the MPS respectively.

A series of rules have been released to implement this new scheme, including the Catalogue on Critical Network Equipment and Specialised Network Security Products (First Batch), the List of Entities Undertaking Security Certification and Testing of Critical Network Equipment and Specialised Network Security Products (First Batch), the Requirements for the Implementation of Security Certification of Critical Network Equipment and Specialised Network Security Products, the Rules for the Implementation of Security Certification of Critical Network Equipment and Specialised Network Security Products, and the Implementing Measures on Testing

of Critical Network Equipment (Draft for Comments).\textsuperscript{22} While TC260 is supposed to be responsible for overall cybersecurity standardisation, and has released for public consultation the recommended national standards against which the certification and testing activities are to be conducted,\textsuperscript{23} it is the National Technical Committee on Communications (TC485) under the MIIT which has been tasked with updating relevant security technical requirements and testing methods for routers and switchers, and transforming them into mandatory national standards. Further standards covering other product categories should be in the pipeline. This is because the revised Standardisation Law has stipulated that the formulation of mandatory national standards will fall under sectoral government authorities rather than the CAC.\textsuperscript{24} Such a situation creates further complexities for cybersecurity standardisation.

**Sectoral Regulations**

China has issued a number of sectoral regulations designed to enhance cybersecurity, and many more are still in the making. Sectoral government authorities will also have their say over the identification of CII and important data. The already-released regulations concern in particular key cybersecurity sectors such as financial services, aviation, automotive, healthcare, energy and logistics. Their common elements include the procurement of ‘secure and trustworthy’ ICT solutions, data security and the implementation of the CCPS, among others. In line with concerns about the Cybersecurity Law and other security-related pieces of legislation, these regulations leave European companies in China concerned about the current regulatory environment.

**Key Recommendations**

\textbf{1. Ensure that Cybersecurity Schemes Do Not Create Discriminatory Market Access Barriers}

**Concern**

Certain cybersecurity schemes may lead to the creation of a discriminatory environment for international businesses, where they are restricted or even prohibited from providing products and services to segments of the Chinese market – the lack of a clear definition or scope, as well as detailed procedures for such schemes, results in uncertainty and puts international businesses at an unfair disadvantage.

**Assessment**

The Foreign Investment Law, passed on 15\textsuperscript{th} March 2019,\textsuperscript{25} contains a number of positive provisions on building a level playing field for international investments in China. Provisions such as pre-entry national treatment, the use of a negative list, and equal access to government procurement and to the formulation of standards will help further remove market access barriers. However, in the field of cybersecurity, certain provisions as outlined below may still serve as de facto market access barriers for international businesses.

**Cybersecurity Review**

The draft Cybersecurity Review Measures released by the CAC in May 2019 mandates CII operators to proactively apply for a non-transparent cybersecurity review when their purchases of network products and services affect or may affect national security. By identifying cross-border transfer of large amounts of personal information and important data as a trigger for review, and identifying non-technical factors such as politics, diplomacy and trade, and whether network product and service providers are controlled by foreign governments as the review’s areas of focus, the draft risks pushing CII operators to ‘buy local’. Added to this concern is the fact that relevant government authorities are granted the potential power to review the purchases of network products and services, as well as the provision of information technology services, by non-CII operators. The sub-working group is concerned that, if left unamended, the draft Cybersecurity Review Measures will create a long-term environment that favours domestic companies over their international peers.

**CCPS and CII Protection Scheme**

Under the existing Classified Information Security Protection Scheme, a series of conditions must be met in order for a product to be sold for systems level three and above. These levels also require product research

\textsuperscript{22} Implementing Measures on Testing of Critical Network Equipment (Draft for Comments). MIIT, 5\textsuperscript{th} June 2019, viewed 30\textsuperscript{th} June 2019, <http://www.miit.gov.cn/newweb/n1146285/n1146352/n3057724/n3057728/c6991606/content.html>

\textsuperscript{23} Requirements of National Standards Relating to Critical Network Equipment and Specialised Network Security Products (Draft for Comments). TC260, 10\textsuperscript{th} May 2019, viewed 22\textsuperscript{nd} May 2019, <https://www.tc260.org.cn/front/postDetail.html?id=20190516203007>

\textsuperscript{24} Standardisation Law, Standardisation Administration of China, 4\textsuperscript{th} November 2017, viewed 22\textsuperscript{nd} May 2019, <http://www.sac.gov.cn/sbgs/flfg/f/zhf/201711/G20171108_318652.htm>

\textsuperscript{25} Foreign Investment Law, NPC, 15\textsuperscript{th} March 2019, viewed 4\textsuperscript{th} May 2019, <http://www.chinalaw.gov.cn/Department/content/2019-03/18/592_230773.html>
and development (R&D) and manufacturing to be carried out by Chinese-controlled enterprises, and the core technology and key components of the product to possess indigenous intellectual property (IP). In this sense, the release of the draft CCPS Regulation on 27th June 2018— which is expected to replace the existing Administrative Measures on the Classified Protection of Information Systems—constitutes a long-awaited and welcome development, as it proposes to remove the aforementioned restrictions that favour domestic products and enterprises. The sub-working group looks forward to this positive change being confirmed in the final version of the CCPS Regulation.

Nonetheless, to protect unclassified networks, the draft CCPS Regulation also requires networks above level three to use cryptography technology, products and services accredited by the State Cryptography Administration (SCA). Obtaining such accreditation has long remained an obstacle for many international companies in China, making it difficult for them to truly benefit from the removal of restrictions on equity and IP. Another notable provision of the draft CCPS Regulation is that the products and services purchased by the operators of networks above level three are required to pass a security review (the procedures and requirements of which remain unclear) when such purchases have the potential to impact national security. The CII protection scheme, introduced by the Cybersecurity Law on the basis of the CCPS, poses similar concerns, as CII should have a classified protection level no lower than level three, and a security review is mandated when national security may be at stake.

As the aim of the CCPS and the CII protection scheme is to safeguard security, a shift away from regulating supply-chains to the product itself, by removing the restrictions placed on international companies, would constitute a more desired approach. An ICT product should be permissible for inclusion under these schemes as long as it can improve security, irrespective of the IP’s origin and the nationality of the company that carried out the R&D and manufacturing of the product.

Cryptography
As explained in the Information and Communication Technology Working Group Position Paper, cryptography-related restrictions also exist at a more general level, as international companies that manufacture commercial cryptography products have been unable to implement domestic Chinese algorithms, or to obtain relevant licences from the SCA. This effectively limits international firms’ ability to compete with domestic Chinese companies on an equal footing. In this regard, the sub-working group noticed that, under the draft Cryptography Law, commercial cryptography is no longer classified as state secrets, and hopes that China will ease relevant market access restrictions accordingly.

Value-added Telecoms Services
China is upgrading its IT and internet infrastructure. The deployment of emerging and advanced technologies such as 5G, cloud computing and big data will significantly drive the country’s economic development and improve efficiency. Currently, as noted in the Information and Communication Technology Working Group Position Paper, it is still extremely difficult, or even impossible, for international companies to operate many value-added telecoms services—such as internet resources collaboration (IRC) services— as a result of a variety of restrictions introduced on security grounds, including limitations on investment, data localisation and cross-border data transfer. This has prevented international companies from offering their products and services in the China market in the same way as domestic Chinese firms, which also do not face the same stringent restrictions in Europe and other jurisdictions when it comes to operating telecoms services.

Taken together, certain elements of the abovementioned cybersecurity schemes may pose obstacles to international companies. If the nationality of a product or service—which is in itself difficult to define in ICT—is taken as the foundation for cybersecurity, international companies will face unsurmountable barriers across the entire market. China will incur problems if the most technologically-advanced and cyber-secure products and services are banned. Furthermore, conformity assessment requirements in China often differ from international standards, creating extra...

28 IRC services refer to the Infrastructure-as-a-Service and Platform-as-a-Service models of cloud computing.
costs for international companies to either re-certify or tailor products and services. Uncertainties linked to cybersecurity schemes also constitute a competitive disadvantage for international businesses as they plan their China market strategies. Foreign companies are concerned that such schemes will put their trade secrets in jeopardy and harm the market’s perception of them, while also negatively impacting their credit rating.

Recommendations

• Differentiate national security from commercial security in a clear manner, and refrain from broadening the scope of relevant cybersecurity schemes.

• Ensure a level playing field for all suppliers of ICT products and services, by developing clear and non-discriminatory cybersecurity rules and standards that are in line with global practices, instead of focusing on the nationality of ICT products and services.

• Improve transparency in relation to the development and implementation of cybersecurity schemes for ICT procurement in various industries and encourage inclusive stakeholder participation.

4. Eliminate Unnecessary Operational Burdens Created by Extensive and Ambiguous Cybersecurity Schemes and Potentially Intrusive Enforcement

Concern

The extensiveness of and ambiguities surrounding China’s cybersecurity schemes create significant administrative and operational costs and impede the development of China’s digital economy.

Assessment

Data Restrictions

The Cybersecurity Law requires personal information and important data collected and generated by CII operators to be stored within China, and a security assessment to be conducted when cross-border data transfers are warranted by business needs. While such measures already appear restrictive, the scope of China’s data restrictions have been significantly broadened by a series of released and planned implementing regulations, effectively increasing the operational costs of companies.

For example, the draft Data Security Measures and the draft Personal Information Transfer Measures—which constitute the CAC’s latest efforts to regulate cross-border data flows at the time of writing of this paper—expand the scope of cross-border data transfer restrictions as stipulated in the Cybersecurity Law in significant ways. All network operators are required to conduct a security assessment and report the results to competent sectoral government authorities or provincial cyberspace authorities for approval before releasing, sharing or trading important data, or providing such data overseas. They must also apply for a security assessment with provincial cyberspace authorities on their cross-border personal information transfers. Both of these requirements will bring about huge operational costs for international companies.

Furthermore, the draft Data Security Measures also states that network operators, when collecting important data or personal sensitive information for business purposes, should file such collection activities with local cyberspace authorities. The Cybersecurity Sub-working Group remains doubtful about the necessity for establishing such a broad filing system. Filing of data-processing activities was specifically omitted from the EU’s General Data Protection Regulation (GDPR), because the bloc’s many years of practical experience have shown that filing merely increases the costs and complexity of compliance without bringing tangible benefit to data subjects.

The compliance landscape was further complicated by the MPS Guidelines on Internet Personal Information Security Protection, according to which all personal information holders are to store within China the personal information they collect and generate within the country, including when hosting the data on a cloud platform. It also states that the cross-border transfer of the personal information should comply with relevant national rules. Compared to other rules, the MPS guidelines further broaden the scope of data localisation restrictions by covering both “companies providing services through the internet”, and “organisations and individuals that control and process personal information using private networks or in non-networked environments”. Although these guidelines remain advisory in nature, sub-working group members’ previous experience of cybersecurity law enforcement has demonstrated that they may become de facto mandatory.

Aside from general data restrictions derived from the
Cybersecurity Sub-working Group has observed a worrying trend for an increasing amount and severity of data localisation and cross-border data transfer restrictions in vertical sectors, such as in financial services, transport and health, among others. For example, in late 2018, the National Health Committee mandated personal health data to be stored in China. In early 2019, the China Banking and Insurance Regulatory Commission (CBIRC) released the Administrative Measures on Banking Financial Institutions Anti-money Laundering and Counter Terrorist Financing, which strictly prohibits cross-border transfers of customer identification information and transaction data.

The Cybersecurity Sub-working Group believes that setting up duplicate information technology infrastructure within China just to meet the localisation requirements and service local employees, customers and business partners, is not only a waste of resources, it can also be problematic for the following reasons: businesses will need to custom build and maintain interfaces to synchronise data for reporting, analysis and other normal business operations purposes; and they will need to hire staff with expertise to support the infrastructure (since the cross-border data transfer out of China may be restricted). This is not a scalable approach for running a global business. Moreover, restricting cross-border data flows may unintentionally hamper efforts to ensure that IT infrastructure is secure, as it would hamper the ‘follow the sun’ workflow strategy for monitoring and supporting mission critical systems, security audits and remedial actions for security incidents. Expert resources outside China may have to travel to China before appropriate actions can be taken. Eventually, every minute of delay would result in significant losses in the event of global security incidents, such as the Heartbleed bug, the WannaCry ransomware or the Petya virus. Finally, separating China’s domestic Internet from the rest of the world may prohibit the adoption of certain new technologies. For instance, global trading platforms or global electronic marketplaces need to bring buyers and sellers across the globe together in one place for transactions. Chinese buyers and sellers may not be able to participate in global trading platforms or e-marketplaces if data localisation is required or cross-border data flows are restricted. Big data, IoT and other innovative technologies (such as anti-money laundering monitoring systems) that have usage across jurisdictions may be severely impacted.

While China envisages a balance between assuring security and promoting the free flow of data, most of the aforementioned implementing regulations appear only to prescribe security obligations and leave unconsidered the equally important purpose of facilitating the free flow of data across borders. By analogy, an effective border control system should not only prevent illegal entry or exit but should also not deny entry or exit to legitimate travellers, i.e. it should not create a ‘false positive’ problem. The sub-working group therefore urges relevant government authorities to consider the impact of these restrictions on legitimate business operations, and prevent ‘false positive’ scenarios.

Cloud Service Market
The MIIT released the draft Notice on Regulating the Operational Behaviour in the Cloud Service Market (Cloud Service Notice) and the subsequent Notice on Cleaning Up and Regulating the Internet Access Service Market in 2016 and 2017 respectively. ‘Cloud’ is defined as IRC Services under the Classification Catalogue of Telecommunications Services (2015). The notices reiterate the restrictions on international companies participating in the IRC services market, underline server and data localisation, network security, personal information protection and restrictions on data flows, and clearly define the ‘not-to-do list’ for IRC services operators. For services provided to domestic users, IRC services operators are required to localise their service facilities and network data within Chinese territory and ensure that cross-border operations and data flows comply with relevant national regulations.

These abovementioned measures, together with existing licensing and foreign direct investment restrictions on international IRC services operators in China under the Classification Catalogue of Telecommunications Services (2015), MIIT, 29th November 2015, viewed 4th May 2019, http://www.miit.gov.cn/n1146295/n1165285/n1652930/n3757020/c5471946/content.html>
Services (2015), would require these operators to essentially turn over ownership and operations to a domestic partner, effectively impeding the normal operations of international IRC services companies in China.

The Cybersecurity Sub-working Group understands that cloud computing is the core infrastructure of the digital economy. However, besides areas listed in the draft Cloud Service Notice that require further clarification, the sub-working group believes that the abovementioned restrictions, if left unchanged, will unnecessarily burden both domestic and international companies operating in China, thereby greatly hindering innovation, and contradicting China’s objectives as stated in strategic plans such as Internet Plus and China Manufacturing 2025. As such, the sub-working group believes that the Cloud Service Notice should be strictly limited in its scope and only be used in areas, such as co-location services and infrastructure-as-a-service, to fulfil China’s policy interests while leaving more room for innovation in the higher layers of cloud computing services.

CCPS and CII Protection Scheme

The CCPS is based on the existing Administrative Measures for the Classified Protection of Information Systems, jointly issued by the MPS, the SCA, the Ministry of State Security (MSS) and the former State Council Information Office (SCIO) in July 2007, which has been central to China’s cybersecurity regime and predates the most recent cybersecurity initiatives. Compared to its predecessor, under the draft CCPS Regulation, the scope of the CCPS has been expanded from the protection of traditional information systems to new areas such as cloud computing, mobile Internet, IoT and industrial control.

In addition, the definition of level-three networks has also been widened by the CCPS. It now encompasses “networks, the damage of which will result in extremely serious harm to the lawful rights and interests of citizens, legal persons and other organisations”, a criterion which risks being interpreted in a liberal manner, possibly leading to a waste of scarce public resources and excessive intervention in the commercial market. The operators of these level-three networks will need to assume a series of intrusive and strict security protection requirements, including but not limited to connecting such networks with the public security organs’ systems, carrying out regular tests and evaluations, and localising operation and maintenance.

The CII protection scheme, which is to be established on the basis of the CCPS, also risks overburdening business. While CII protection is a common and justified practice in the face of heightened security risks worldwide, the Cybersecurity Sub-working Group would like to point out that the EU and most European countries take a risk-based and technology-neutral approach as part of their ongoing cybersecurity efforts. Industry concerns surrounding China’s CII protection regime mainly stem from its vague and overly-broad definition of CII, as well as certain obligations that CII operators should assume. These include but are not limited to strict data localisation and a non-transparent security review, in addition to other obligations that are applicable to all network operators. Furthermore, it is important to point out that stricter regulatory requirements stemming from CII operator categorisation should only be applied to the relevant networks meeting the respective criteria, not to all networks operated by the CII operator.

Although a unified scope of CII has yet to be released, China has already identified a series of ‘would-be’ CII sectors, many of which will not significantly impact national security, the national economy, people’s livelihoods or public interests, but will merely influence business continuity. This will divert attention from the focus on protection and will not be conducive to safeguarding national security.

Last but not least, the Cybersecurity Sub-working Group is concerned with broad and intrusive inspection requirements enforcing the Cybersecurity Law. For example, the MPS released the Provisions on Internet Security Supervision and Inspection by Public Security Organs, which empowers public security organs to conduct on-site or remote testing by connecting their inspection tools to corporate and business networks in the name of inspecting an Internet service provider and network-using unit’s compliance. This and other intrusive methods, such as penetration testing, could put the corporate and business networks that are critical to businesses’ service offerings at risk.
Cryptography and Interoperability

The digital economy is underpinned by interoperability between countries and their infrastructure, meaning that credit and debit cards issued in China should function in Europe and vice versa; that the industrial internet connecting production devices in China should be allowed to exchange data with other such devices in Europe and vice versa; and that mobile networks should be interoperable.

In all these examples, technical aspects to create end-to-end security, such as encryption and decryption of confidential data, must be interoperable. This can only be achieved by adopting a common set of international cryptography norms and standards, and developing clear and harmonised rules on the secure identification of connected devices, systems and services, secure communication and secure infrastructure. The Cybersecurity Sub-working Group therefore urges relevant government authorities to draft the Cryptography Law and any of its implementing regulations and standards in such a way that they will be conducive to ensuring interoperability and healthy industry development, instead of generating unnecessary costs and technical difficulties for businesses. Please refer to Key Recommendation 3 of the Information and Communication Technology Working Group Position Paper for more information.

Recommendations

• Ensure transparency and industry participation in the formulation of the Cybersecurity Law’s implementing regulations.
• Address openly any technical difficulties and operational burdens that companies face due to cybersecurity restrictions, by ensuring the timely review and improvement of released rules and encouraging international policy models that support China’s development.
• Ensure consistency between higher-level legislation and relevant implementing regulations and follow the least interference principle in the course of legitimate international business operations.
• Ensure that efforts to improve cybersecurity reflects the borderless, interconnected and global nature of today’s business environment, which is also beneficial for domestic companies.
• Ensure a coordinated and unified voice among various government authorities involved in cybersecurity.
• Ensure that cybersecurity enforcement is measured and does not risk businesses’ networks and proprietary information.
• Formulate cryptography regulations that are conducive to interoperability.

3. Ensure Transparency, Consistency, Non-discrimination and Proportionality in Cybersecurity Rule-making and Law Enforcement

Concern

Transparency, consistency, non-discrimination and proportionality are becoming increasingly important in order to create a healthy cybersecurity environment for domestic and international companies alike, but are not always ensured in current cybersecurity rule-making and law enforcement.

Assessment

China’s Cybersecurity Law has a significant impact on the operations of both domestic and international companies. It is so far-reaching that almost all sectors are now affected. Its vague provisions have generated uncertainty, requiring the development of supporting regulations and standards – which are currently topping the agenda of relevant government authorities, including sectoral government authorities and standards developing organisations. Many of these cybersecurity schemes are uncommon in other countries, either in terms of practice, or in terms of the stringency and scope of their application. According to a study conducted by the European Centre for International Political Economy (ECIPE), China ranks first in terms of digital trade restrictiveness, due to a series of regulatory measures governing trade in digital goods and services, ICT investments and data flows.\(^\text{36}\) To reassure companies that China’s cybersecurity environment will remain predictable and stable in the face of a rapidly evolving and constantly tightening regulatory framework, and to avoid unnecessarily compromising business confidence, it is of paramount importance when formulating and implementing any forthcoming laws, regulations and standards, that China ensures the following:

• Transparency: the sub-working group recognises and appreciates the efforts made by the CAC and other relevant government authorities to communicate with...

the industry, and hopes that transparency can be further improved by guaranteeing that a wider range of businesses are informed of the rule-making progress. EU experience also speaks to the importance of applying transparency during the entire cybersecurity rule-making process, and not simply retrospectively after a particular matter has been concluded. Such a perspective is also endorsed by the State Council in its Notice on Fully Listening to Opinions of Enterprises, Industry Associations and Chambers of Commerce in the Making of Administrative Measures, Provisions and Normative Documents.

- **Consistency:** The sub-working group underlines the need to ensure consistency between the Cybersecurity Law and its implementing regulations, for example by limiting the scope of data localisation and cross-border data transfer measures to CII operators as stated in the Cybersecurity Law. In addition, consistency should also be ensured between the cybersecurity regulations released and enforcement actions conducted by the CAC, the MPS and other government authorities.

- **Non-discrimination:** The sub-working group calls for China to eliminate any elements that risk discriminating against international companies. One example being that, it is currently impossible for international companies to implement domestic Chinese algorithms which are nonetheless mandated by an increasing number of Chinese government authorities. Also, in spite of the reassurances from the CAC that the emphasis on secure and trustworthy (and other similar terms) ICT products and services is not targeting international companies, in reality this term still has a close connotation with indigenous innovation.

- **Proportionality:** Cybersecurity regulations need to be technically credible and innovation friendly. Intervention at all levels, from national regulations to business security measures, should be appropriate to and commensurate with the risk, and not limit the opportunities offered by digital transformation nor creating unreasonable costs for businesses.

**Recommendations**
- Provide an open and transparent platform for EU industry to engage in cybersecurity rule-making.
- Provide clear and consistent guidance when implementing the Cybersecurity Law and ensure an effective two-way exchange over potential market access barriers.
- Respect the principles of technology neutrality, global harmonisation and proportionality.
- Publish laws, regulatory rules and standards on the security review regime in adherence with China's World Trade Organization/Technical Barriers to Trade (WTO/TBT) commitments and allow relevant stakeholders from the EU industry to comment in an effective and timely manner.

**Abbreviations**

- APP: Application
- CAC: Cyberspace Administration of China
- CBIRC: China Banking and Insurance Regulatory Commission
- CCPS: Classified Cybersecurity Protection Scheme
- CII: Critical Information Infrastructure
- CNCA: Certification and Accreditation Administration of China
- ECIPE: European Centre for International Political Economy
- EU: European Union
- GDPR: General Data Protection Regulation
- ICT: Information and Communication Technology
- IoT: Internet of Things
- IP: Intellectual Property
- IRC: Internet Resources Collaboration
- MIIT: Ministry of Industry and Information Technology
- MPS: Ministry of Public Security
- MSS: Ministry of State Security
- NPC: National People’s Congress
- R&D: Research and Development
- SCA: State Cryptography Administration
- SCIO: State Council Information Office
- TBT: Technical Barriers to Trade
- TC260: National Information Security Standardisation Technical Committee
- TC485: National Technical Committee on Communications
- WTO: World Trade Organization

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Logistics Working Group

Logistics Key Recommendations

1. Customs Issues
   1.1 Establish Detailed and Enforceable Implementation Guidelines for Voluntary Disclosure
      • Establish detailed and enforceable guidelines for voluntary disclosure.
   1.2 Optimise the Authorised Economic Operator (AEO) Programme
      • Simplify the AEO re-verification audit requirements.
      • Introduce penalty criteria for a downgraded AEO status that is proportional to the yearly actual value of import and export declarations.
      • Adopt international practice and allow companies to preserve their AEO status and customs rating without suspension or downgrading by paying extra duty and import taxes, except for non-compliance cases related to smuggling, when underpaid duty and import taxes do not exceed a defined threshold.
      • Grant more beneficial treatment to AEO companies.
      • Reach more AEO mutual recognition agreements with other countries.
   1.3 Promote the Reform of the ‘Two Steps’ Declaration
      • Simplify the number of required declaration elements and customs declaration documents for the ‘Step 1’ declaration.
      • Ensure the ‘Step 1’ declaration can be completed and released by customs authorities prior to the arrival of the shipment, so that the physical goods can be released immediately upon arrival at the airport or port.
      • Consider allowing all types of imports to be covered in the new ‘Two Steps’ model and eliminating the reconciliation requirement between the inbound declaration and outbound declaration so that Customs Special Supervision Areas (CSSAs) imports can benefit as well.
      • Waive the deposit for importation into CSSAs or bonded activities.
      • Allow enterprises to choose whether to declare using the old model or the new one.
      • Provide more flexibility or simplification for AEO enterprises.
   1.4 Enhance the Customs System and Improve System Stability
      • Engage with and get feedback from enterprises, and trial a pilot before rolling out the new systems.
      • Avoid maintaining and updating the customs system during peak hours of business.
      • Notify enterprises ahead of upcoming updates and maintenance.
      • Enable a manual customs clearance process for urgent shipments that are delivered during system maintenance to avoid disruption.
   1.5 Unify and Optimise Customs Special Supervision Areas (CSSAs) in China
      • Integrate and optimise existing and future CSSAs in terms of type, function, policy, treatment and supervision.
      • Simplify the processes and requirements of CSSAs.
      • Expand the trial of general value-added tax (VAT) taxpayer pilots in more CSSAs, but without jeopardising existing preferential customs and VAT treatments.
   1.6 Deepen Processing Trade Reform
      • Simplify reconciliation requirements and procedures.
• Use enterprises’ internal enterprise resource planning (ERP), control processes and business records for self-reconciliation or auto-reconciliation.
• Remove the Bill of Materials Reconciliation or the Work Order Reconciliation mechanism for AEO enterprises, especially if they are located in CSSAs.

1.7 Simplify the Requirements of Order No.56 (2017)
• Adjust compulsory fields in China’s Advanced Manifest System (AMS), for customer shipper and consignee IDs in particular, to optional fields.

1.8 Improve the Formulation and Implementation of Laws and Regulations
• Provide more clarity and visibility in the process of drafting customs legislation, along with roadmaps.
• Provide a suitable grace period for legislation changes that allows entities sufficient time to adjust and remain compliant.

2 Express Delivery Services
2.1 Improve the Safety Supervision of Express Delivery Services and Establish a Data-Sharing Platform
• Establish a data-sharing platform based on China Post’s current system, which will eliminate duplicate data requests from the various designated government bodies.

2.2 Facilitate Trade in the Express Delivery Service Industry
• Continue to simplify the normal express channel and adhere to guidelines based on the World Customs Organization’s (WCO) Immediate Release Guideline.
• Adopt a value-based clearance model instead of one based on types of goods.
• Establish an e-commerce Trusted Trader programme for qualified traders to enjoy simplified clearance treatment for low-value shipments.

3. International Hub
3.1 Establish a Clear Policy for International Hub Management
• Articulate clear regulations on the transit of shipments through established air express hubs in China.
• Clarify explicitly the procedures and responsible authorities for transited, regulated goods.
• Establish regulations to facilitate the movement of goods through hub locations and make a distinction between ‘imported goods’ and ‘transit goods’.

4. Dangerous Goods
4.1 Improve the Supervision and Management Level of Dangerous Goods’ Transportation and Storage
• Update the list of dangerous goods and establish a unified and specific management system for their transportation and storage.
• Guide and support the local implementation of regulations that pertain to the transportation and storage of dangerous goods.
• Unify the regulatory framework and enforcement methods related to affixing the Globally Harmonised System (GHS) label to International Standards Organisation (ISO) tanks.
International Liner Shipping Key Recommendations

1. Allow the Transport of International Cargo Between Chinese Ports (International Relay)
   - Support the development of more efficient Chinese shipping services by permitting international cargo relay.

2. Apply Nondiscriminatory Treatment in Chinese Free Trade Zones (FTZs)
   - Give all foreign-flagged vessels equal right to tranship in China’s FTZs, irrespective of the vessels’ nationality or ownership.

3. Ensure Effective Implementation of the Global Sulphur Cap 2020
   - Ensure the effective implementation of the Global Sulphur Cap 2020, starting 1st January 2020, by communicating its enforcement with other maritime nations.
   - Support the work being done at the International Maritime Organization (IMO) to help those affected by the Global Sulphur Cap 2020 and the global carriage ban on non-compliant fuels.
   - Clarify how the Global Sulphur Cap 2020 is going to be implemented in Chinese waters on all vessels that are foreign-flagged, as well as tonnage owned and operated by Chinese carriers, and those flying the Chinese flag.

4. Provide Clear Guidance on the Collection of Local Surcharges
   - Clarify the principles and scenarios in which shipping lines may collect surcharges.
   - Clarify that surcharges are determined by the market and that carriers and their customers enjoy freedom of contract in China.

5. Crack Down on Deliberate Misdeclarations of Container Weight and Contents
   - Draft and implement strict and enforceable regulations to punish companies and individuals who are intentionally mis-declaring the weight and contents of containers for commercial benefit, at great risk to the safety of personnel and assets.

6. Provide Guidance on the Application of China’s Cybersecurity Law for Shipping Lines
   - Clarify the detailed compliance requirements of the Chinese Cybersecurity Law to carriers operating in China.

Introduction to the Working Group

Logistics is an integral and vital part of global commercial activity, as it facilitates the distribution of products and services across the world according to customer demand. Today, logistics is no longer limited to just purchasing, storing or selling. In addition, a new trend has arisen in modern logistics with the emergence of e-commerce. By utilising online logistics, customers’ needs can be met at a lower cost, changing the core target of the industry. As it is responsible for transporting goods from supplier to receiver safely and efficiently, the logistics industry also plays a positive role in China’s economic development. The country’s ongoing efforts to develop its high-end manufacturing sector and increase consumption are set to further increase demand for safe, efficient and affordable logistics services.

The Logistics Working Group was founded in 2003, and represents a diverse spectrum of logistics service providers in freight forwarding, including sea, air, land and express delivery, as well as warehousing and distribution.
At present, more than 200 member companies participate in the working group. As such, it is one of the largest working groups within the European Chamber, reflecting the important role that transport and logistics play in society and international trade.

The working group provides a platform for companies to discuss and share best practices, experiences and recommendations, and to exchange views on the regulatory framework of the logistics industry. It also maintains a constructive dialogue between relevant governments and industry stakeholders to discuss and provide comments on regulations and standards.

The Logistics Working Group is also composed of the International Liner Shipping Sub-working Group, with core members from leading international maritime transport enterprises. Through regular dialogue with Chinese and European government officials, the International Liner Shipping Sub-working Group is dedicated to working towards a more effective and competitive maritime transport environment in China.

Recent Developments

Industry Development

In 2018, China's logistics industry saw steady growth. According to the National Development and Reform Commission (NDRC), the total value of logistics in 2018 grew to Chinese yuan (CNY) 13.3 trillion, a 0.7 per cent year-on-year increase. Total revenue in the logistics industry increased from CNY 8.8 trillion in 2017, to CNY 10.1 trillion in 2018, a 14.5 per cent increase.¹

Regulatory Environment

Trade facilitation plays an extremely important role in cross-border transportation. On 5th March 2018, the General Administration of Customs (GAC) issued the Measures for Improving Cross-border Trade Facilitation,² in order to reduce customs clearance costs and enhance efficiency. On 21st May, during a visit to the GAC, Premier Li Keqiang urged for further improvements in the functionality of customs clearance.³ The executive meetings of the State Council on 18th and 26th September discussed how to optimise the port business environment and promote the work of cross-border trade facilitation, which clearly demonstrates how important this is to the government. On 13th October, the State Council published the Working Plan for Optimising the Port Business Environment and Promoting Cross-border Trade Facilitation,⁴ which lists twenty specific measures aimed at deepening the reform of the regulation and services systems, aligning national standards with international ones, innovating oversight methods, improving customs clearance procedures and efficiency and reducing customs clearance costs. These measures are in order to create a stable, fair, transparent and predictable business environment.

In addition, on 28th March 2019, the State Council Information Office held a press conference on ‘Improving the Efficiency of the Comprehensive Transportation Network and Reducing the Cost of Logistics’. The Ministry of Transportation (MOT) announced its intention to reduce logistics costs by CNY 120.9 billion in 2019. Over the past three years, quantifiable measures have reduced logistics costs by 55.8 billion yuan, 88.2 billion yuan and 98.1 billion yuan respectively. The MOT has formulated a work plan aimed at reducing the cost of transportation in logistics through four major measures.⁵ The Logistics Working Group welcomes China’s efforts to improve trade facilitation and transportation efficiency.

With China’s e-commerce market taking off, express delivery has been one of the fastest growing sectors in the logistics industry. On 23rd January 2018, the General Office of the State Council issued the Guiding Opinions on Advancing the Collaborative Development of E-commerce and Express Logistics,⁶ and the E-commerce Law came into force on 1st January 2019.⁷ The State Council has agreed to set up comprehensive pilot zones for cross-border e-commerce in 22 cities, including Beijing.⁸ The Logistics Working Group supports

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5 Logistics Costs Projected to be Reduced by 120.9 Billion Yuan in 2019, SCIO, 28th March 2018, viewed 19th April 2019, <http://www.gov.cn/xinwen/2018-03/28/content_5377861.htm>


these efforts by the Chinese Government to ensure the smooth and healthy development of the express delivery sector.

Key Recommendations

1. Customs Issues

1.1 Establish Detailed and Enforceable Implementation Guidelines for Voluntary Disclosure

Concern

The current Customs Voluntary Disclosure rule in China is very general, lacking actionable guidance and process.

Assessment

Customs Voluntary Disclosure was first regulated in the Decision of the State Council on Amending the Regulations of the People’s Republic of China on Customs Inspection,9 which was published in 2016. It states that enterprises and units directly concerned with the import and export of goods, who actively report to customs that they have violated the provisions of customs regulations and are subject to customs treatment, shall receive lenient or reduced administrative penalties. The regulation is very general and lacks enforceable guidance for implementation, resulting in challenges for both enterprises and local customs authorities in practice. Enterprises are more than willing to undertake voluntary disclosure, and yet the uncertainty and inconsistency of enforcement and enterprises’ voluntary disclosure being declined without reasons being provided prevent them from doing so, which impacts their compliance management as well.

Recommendation

- Establish detailed and enforceable guidelines for voluntary disclosure.

1.2 Optimise the Authorised Economic Operator (AEO) Programme

Concern

Despite investing a lot of resources in obtaining and maintaining the AEO qualification, many enterprises do not enjoy much more preferential treatment than those without it, which restricts the operational efficiency of enterprises.

Assessment

An AEO is defined in the WCO’s Framework of Standards to Secure and Facilitate Global Trade (SAFE Framework)10 as “a party involved in the international movement of goods in whatever function that has been approved by or on behalf of a national customs administration when complying with WCO or equivalent supply chain security standards”. This concept, which originally appeared in the Community Customs Code,11 is one of the core concepts in the SAFE Framework. In the AEO system, customs authorities work with qualified business partners to gain additional competitiveness and effectiveness in the facilitation of international supply chains by reducing customs clearance lead time and cost. The AEO certification system is an important part of the national credit system and customs authorities could use it to reduce any conflict that may arise between customs supervision and trade facilitation.

The working group welcomes the efforts of the GAC to enhance China’s AEO programme in recent years, and recommends it continues its efforts to provide more benefits for enterprises in the future. Based on the current AEO rules of GAC, AEO enterprises need to be re-verified by customs authorities every three years to maintain the qualification, which brings great costs for enterprises in terms of money, manpower, time, and resources. In order to reduce the burden on enterprises and improve efficiency, it is recommended that some of the re-verification requirements or processes be simplified. The internal policies, systems or structure of most multinational companies (MNCs) do not change very frequently. During the re-verification audit, it is therefore a waste of time to repeat certain processes each time.

Furthermore, the AEO rules also clearly state that any enterprise will be downgraded and lose its AEO qualification after being penalised with a single fine over CNY 30,000 or fines that exceed CNY 50,000 within a year. In other words, a relatively small fine imposed as a consequence of minor non-compliance can result in the loss of AEO qualification for MNCs and significantly impact their daily operations.


In addition, AEO enterprises that have demonstrated considerable internal control and compliance capabilities should be eligible to enjoy more preferential treatment. The working group recommends that the GAC grants this to such enterprises.\footnote{Regarding the suggestions for AEO enterprises’ beneficial treatment, please refer to Key Recommendation 1.3 and 1.6.}

It is very encouraging to see China has made good progress in signing AEO mutual recognition agreements with other countries. China should continue to establish more of these, as it will be very beneficial in improving the efficiency and reducing the expense of cross-border activities.

**Recommendations**

- Simplify the AEO re-verification audit requirements.
- Introduce penalty criteria for a downgraded AEO status that is proportional to the yearly actual value of import and export declarations.
- Adopt international practice and allow companies to preserve their AEO status and customs rating without suspension or downgrading by paying extra duty and import taxes, except for non-compliance cases related to smuggling, when underpaid duty and import taxes do not exceed a defined threshold.
- Grant more beneficial treatment to AEO companies.
- Establish more AEO mutual recognition agreements with other countries.

### 1.3 Promote the Reform of the ‘Two Steps’ Declaration

**Concern**

China Customs has made progress in driving the ‘Two Steps’ declaration model, which will be helpful for improving import customs clearance efficiency, however it still has some issues that need to be fixed before it can be implemented nationwide.

**Assessment**

As a global best practice, the ‘Two Steps’ declaration model has been widely implemented in several countries, including the United States and EU Member States. The model has largely enhanced the efficiency of import customs clearance and reduced the burden of enterprises. It is therefore very encouraging to see the GAC working on the ‘Two Steps’ declaration model in mid-2019. To ensure success, the working group suggests the GAC engage with and collect feedback from enterprises while piloting the new model, as some of the model’s key elements restrict it from fulfilling its full potential. For instance, the majority of the elements of the ‘Step 1’ declaration should be based on the manifest or airway billing (bill of lading). The number of both the required declaration elements and customs declaration documents should be minimised.

Furthermore, ensuring that the ‘step 1’ declaration can be completed prior to the arrival of the shipment is one of the critical areas to ensuring the success of the ‘Two Steps’ model. Without this, the lead time for customs clearance would still be too long.

Additionally, the design of the ‘Two Steps’ declaration model should also take CSSAs and AEO enterprises into consideration in order to maximise its efficiency, with deposits for CSSAs importation being waived. The current reconciliation requirement between inbound declaration and outbound declaration is also limiting its application in CSSA zones.

Since the ‘Two Steps’ model is brand new, the working group also recommends the GAC leaves the application of the new model for enterprises’ discretion to begin with, so that companies can determine which model supports their business the best. This will help optimise business operations.

**Recommendations**

- Simplify the number of required declaration elements and customs declaration documents for the ‘Step 1’ declaration.
- Ensure the ‘Step 1’ declaration can be completed and released by customs authorities prior to the arrival of the shipment, so that the physical goods can be released immediately upon arrival at the airport or port.
- Consider allowing all types of imports to be covered in the new ‘Two Steps’ model and eliminating the reconciliation requirement between the inbound declaration and outbound declaration so that CSSAs imports can benefit as well.
- Waive the deposit for importation into CSSAs or bonded activities.
- Allow enterprises to choose whether to declare in the old model or the new one.
- Provide more flexibility or simplification for AEO enterprises.
1.4 Enhance the Customs System and Improve System Stability

Concern
System changes or integrations create an extra burden for enterprises and disturb normal daily operations.

Assessment
China Customs has made a great effort with its customs declaration system reforms in recent years. In 2018, launched the Golden Customs Phase 2, which largely improved the existing H2010 customs system capability. This was followed by the H2018 system, an updated version of the H2010 system for customs clearance. System maintenance, changes and integration usually have a significant impact on the business operations of a company, as they need to invest a lot to prepare for any changes. Many enterprises have encountered customs system stability issues from time to time due to various reasons. These issues can result in delays to customs clearance, ranging from a couple of hours to days. They can also lead to significant disruptions to daily operations, which impacts the efficiency of clearance as well as the predictability of enterprises’ supply chains.

Recommendations
• Engage with and get feedback from enterprises and trial a pilot before rolling out the new systems.
• Avoid maintaining and updating the customs system during peak hours of business.
• Notify enterprises ahead of upcoming updates and maintenance.
• Enable a manual customs clearance process for urgent shipments that are delivered during system maintenance to avoid disruption.

1.5 Unify and Optimise Customs Special Supervision Areas (CSSAs) in China

Concern
The regulations and policies related to different types of CSSAs are not unified, resulting in challenges for enterprises.

Assessment
Since the establishment of the Shanghai Waigaoqiao Free Trade Zone in 1990, the State Council has approved the set-up of over 160 CSSAs in terms of bonded zones, export processing zones, bonded logistic parks, bonded ports, comprehensive bonded zones and cross-border industrial zones. Each of these areas enjoys different preferential benefits, is regulated by different policies or rules and runs different processes, resulting in challenges and additional burdens for MNCs that operate in different CSSAs across China.

Several processes within CSSAs are still complicated and tedious, and enterprises in CSSAs sometimes even feel more restricted than those that are not. For example, cargo moving in and out of the zones needs to go through the customs formality as well as extra procedures at the entry of the zones. In many cases, the requirements at the zones’ entry points are unnecessarily strict. From the enterprises’ perspective, this means less flexibility and longer lead times for moving goods. There are also other opportunities to simplify CSSAs’ processes. For example, importation into some of the inland zones would be further streamlined if a direct transfer process could be enabled at the port.

With regards to value-added tax (VAT) treatment, CSSAs enjoy varying customs and VAT treatment based on their respective rules. For example, the VAT treatment of bonded areas and other CSSAs are different. Chinese domestic suppliers that export to companies registered in bonded zones cannot enjoy an export VAT refund, even when the goods exported have been delivered in order to perform customs export or import declaration formalities. However, if such a company was incorporated in CSSAs other than bonded zones, the export VAT could be refunded to the Chinese domestic supplier. In addition, enterprises located in the selected trial CSSAs may lose their existing tax benefits to conduct bonded business once selected as a general VAT taxpayer. These differing standards of treatment and the pre-set scope of CSSAs have restricted companies registered there from carrying out newly-emerging business in newly-emerging industry sectors related to international trade and goods in transit trade, weakening their competitiveness.

Recommendations
• Integrate and optimise existing and future CSSAs in terms of type, function, policy, treatment and supervision.
• Simplify the processes and requirements of CSSAs.
• Expand the trial of general VAT taxpayer pilots in more CSSAs, but without jeopardising existing preferential customs and VAT treatments.
1.6 Deepen Processing Trade Reform

Concern

The existing requirements and procedures of processing trade create a huge compliance burden for enterprises in reconciling the customs handbook.

Assessment

The GAC has made progress in processing trade reform in recent years. It is very encouraging for enterprises to see the GAC’s efforts in exploring new models such as self-reconciliation and credit reconciliation.

However, there is currently still quite a high compliance burden for enterprises to operate and reconcile the customs handbook issued by local customs authorities. Ensuring zero variance among the inventory in the customs authorities’ record, in the enterprise’s record and the physical inventory is the key regulatory requirement. Processing trade enterprises therefore have to invest significant manpower, materials and financial resources to manage the customs handbook to ensure that it complies with this requirement. Considering the features of processing trade, even if there is no leakage to the domestic market and no other kind of wrongdoing, it is still possible that enterprises could encounter variance in the handbook. If there is any variance among above-mentioned items, enterprises will likely have to pay back the duty and VAT, or even penalties. This results in challenges for enterprises in terms of risk and compliance management, and it hinders business operations.

The working group encourages the GAC to continue to explore new models, leveraging enterprises’ internal systems and control processes for self-reconciliation and auto-reconciliation. And, for AEO enterprises that have demonstrated high compliance capability—especially for those located in CSSA zones—the working group suggests the GAC optimise efficiency by providing some flexibility and simplifying the reconciliation requirements; for instance, removing the Bill of Materials or the Work Order Reconciliation mechanisms.

Recommendations

• Simplify reconciliation requirements and procedures.
• Use enterprises’ internal enterprise resource planning (ERP), control processes and business records for self-reconciliation or auto-reconciliation.
• Remove the Bill of Materials Reconciliation or the Work Order Reconciliation mechanism for AEO enterprises, especially if they are located in CSSAs.

1.7 Simplify the Requirements of Order No.56 (2017)

Concern

Order No.56 (2017), published by the GAC, adjusted the China Customs Advanced Manifest (CCAM) rules, which has increased the operational costs of enterprises.

Assessment

Order No.56 (2017),13 which regulates requirements for China’s AMS, came into force on 1st June 2018. It requires manifests for exports to be submitted four hours prior to aircraft departure. For imports transported on flights longer than four hours, the manifests have to be submitted four hours prior to aircraft arrival. Both shipper and consignee IDs must also be entered into the AMS system in order to generate an import or export declaration that will get a shipment released by customs. There are several concerns raised by delivery enterprises regarding the Order’s full enforcement, which include the inability of companies to provide all customer shipper and consignee IDs as required and challenges associated with laws and the regulation of privacy protection.

Recommendation

• Adjust compulsory fields in the AMS system, for shipper ID and consignee ID in particular, to optional.

1.8 Improve the Formulation and Implementation of Customs Laws and Regulations

Concern

Customs laws and regulations lack clarity, visibility and consistency, and enterprises do not have a sufficient grace period to adjust and cope with legislation changes.

Assessment

The local customs authorities’ enforcement of the national customs regulations is not transparent, which in some cases has been attributed to local protectionism. This lack of transparency, including a lack of stakeholder consultation, prevents effective implementation and compliance by operators and their customers alike. For instance, according to the public consultation history record on the GAC’s website, Order No.56 (2017)—which has had significant impact on the industry and has now

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been applied to all imports and exports and all modes of transport—was not submitted for public consultation.\(^{14}\) Additionally, Order No. 61 (2018) was published on 21\(^{st}\) June 2018 and came into force on 1\(^{st}\) August 2018.\(^{15}\) This order revised the import and export goods customs declaration documentation and left a very short grace period for enterprises to adjust to these changes. The opaqueness left enterprises scrambling to update their systems in order to ensure compliance with the laws and regulations.

Recommendations

- Provide more clarity and transparency during the process of drafting customs legislation, along with roadmaps.
- Provide a suitable grace period for legislation changes that allows entities sufficient time to adjust and remain compliant.

2 Express Delivery Services

2.1 Improve the Safety Supervision of Express Delivery Services and Establish a Data-sharing Platform

Concern

Inconsistent regulatory measures and technical standards implemented by different designated government bodies, along with duplicate requirements, impose a huge burden on enterprises.

Assessment

Various government bodies have been designated to supervise safety issues in the express delivery service industry, and regulatory measures across the country are not unified. Meanwhile, local postal or public security regulators in some cities have imposed mandatory requirements locally, which require express delivery services companies to readjust their national or global operations to connect to local regulators’ data systems. Considering that all express delivery services companies have already connected their operations’ systems to the postal regulator for shipment data submission, the Logistics Working Group recommends that the data be shared internally among different government authorities or regulators, to reduce the administrative costs being imposed on companies. In addition, there is a variance in the technical standards recognised by the relevant government bodies, including standards for security equipment, which impacts the operational efficiency of enterprises.

Recommendation

- Establish a data-sharing platform based on China Post’s current system, which will eliminate duplicate data requests from the various designated government bodies.

2.2 Facilitate Trade in the Express Delivery Service Industry

Concern

The tedious and burdensome requirements and procedures for customs clearance limit the development of the express delivery service industry.

Assessment

Border clearance is a major challenge for express companies operating in China. This is not only due to the sheer volume of trade, but also because of the underdeveloped risk management regime and highly regulated inspection and quarantine regime applicable to imported goods. In 2016, China ratified the Trade Facilitation Agreement of the World Trade Organization (WTO), and is working towards reforming its customs regime in line with international best practices. While clearance is expected to become more efficient, the current regulatory framework results in complex and tedious processes.

China’s current import clearance regime unnecessarily complicates trade and prevents low-value shipments—from small business related to e-commerce in particular—from enjoying the expedited shipments treatment stipulated by the WTO Trade Facilitation Agreement. In addition, many procedures are burdensome, such as the highly complex import duty and tax structures. To illustrate this point, imports can be cleared through either the normal channel, the e-commerce channel or the postal/personal shipments channel. The e-commerce channel is the preferred system for efficient clearance, as it takes less than half a day. However, due to tedious requirements such as details on the retailer, payments and delivery logistics, access to the e-commerce channel is limited. In addition, only currently operating e-commerce platforms and payment companies are allowed to use this channel, which restricts business operations and trade facilitation.

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Recommendations
• Continue to simplify the normal express channel and adhere to guidelines based on the WCO Immediate Release Guideline.
• Adopt a value-based clearance model instead of one based on types of goods.
• Establish an e-commerce Trusted Trader programme for qualified traders to enjoy simplified clearance treatment for low-value shipments.

3. International Hub

3.1 Establish a Clear Policy for International Hub Management

Concern
The current transit regulatory framework reduces the efficiency of enterprises and holds back hub development.

Assessment
Efficient functioning of air hubs requires policies that facilitate the movement of aircraft and shipments between origin and destination via China. However, the country lacks developed customs transit policies. Transit regulated goods, including strategic goods and biological substances, are treated as imports. They require import permits and approvals from the relevant regulators even if just being transferred between aircraft in airport secured zones. For instance, the transit of clinical trials and biological substances requires the approval of the Chinese health authorities, which greatly impacts operational efficiency. Additionally, if goods are prohibited for import into China, they can be confiscated in Chinese airports even if just in transit for third destinations where they can be legally imported. It is worth noting that express carriers are held liable for this category of goods.

Recommendations
• Articulate clear regulations on the transit of shipments through established air express hubs in China.
• Clarify explicitly the procedures and responsible authorities for transited, regulated goods.
• Establish regulations to facilitate the movement of goods through hub locations and make a distinction between ‘imported goods’ and ‘transit goods’.

4. Dangerous Goods

4.1 Improve the Supervision and Management Level of Dangerous Goods’ Transportation and Storage

Concerns
China’s classification of ‘dangerous goods’ is outdated, and its transportation and storage systems lag behind international standards, which impacts transport efficiency as well as storage and handling requirements.

Assessment
As China continues to upgrade its industries, it has an increasing need for various dangerous materials. However, the classification of ‘dangerous goods’ in China is outdated, and the local government lacks experience in the supervision and management of the transportation and storage of such goods.

Additionally, the legal basis for transporting dangerous goods by rail in China is immature and local rail terminals have little experience in handling such cargo. These limitations make it difficult for suppliers to compete and provide sustainable solutions for clients in the long term.

Furthermore, the Globally Harmonised System of Classification and Labelling of Chemicals, a system developed by the United Nations for standardising and harmonising the classification and labelling of chemicals globally, does not require the Globally Harmonised System (GHS) label to be placed on International Organization for standardization (ISO) tanks. Yet enterprises have been required by local customs authorities to affix the GHS label on ISO tanks from time to time. This discrepancy, which is also not in line with international practice, results in challenges for enterprises when going through import and export procedures.

Recommendations
• Update the list of dangerous goods and establish a unified and specific management system for their transportation and storage.
• Guide and support the local implementation of regulations that pertain to the transportation and storage of dangerous goods.
• Unify the regulatory framework and enforcement methods related to affixing the GHS label to ISO tanks.
Abbreviations

AEO   Authorised Economic Operator
AMS   Advanced Manifest System
CCAM  China Customs Advanced Manifest
CNY   Chinese Yuan
CSSA  Customs Special Supervision Areas
ERP   Enterprise Resource Planning
GAC   General Administration of Customs
GHS   Globally Harmonised System
ISO   International Organization for Standardization
MNC   Multinational Company
MOT   Ministry of Transportation
NDRC  National Development and Reform Commission
VAT   Value-added Tax
WCO   World Customs Organization
WTO   World Trade Organization
SAFE Framework Framework of Standards to Secure and Facilitate Global Trade
International Liner Shipping Sub-working Group

Introduction to the Sub-working Group

Ships transport more than 80 per cent of global trade. Shipping is the most efficient and cost-effective method of international transportation for most goods, and helps to create prosperity among nations and peoples. The maritime industry has been a key enabler of economic growth in, and an indispensable partner for, China as it has developed into the world’s largest trading nation. The importance of the maritime industry to China has been further highlighted by the Belt and Road Initiative, under which the so-called ‘Maritime Silk Road’ plays a key role. As such, the Chinese and global economy is dependent on a well-functioning and healthy maritime transport industry.

The International Liner Shipping Sub-working Group—originally the Maritime Transport Working Group—was established in 2000 to represent international maritime transport enterprises operating in China. The objective of the working group is to work towards a more efficient and competitive China maritime transport environment. To accomplish this, the working group engages in dialogue with relevant government institutions to contribute to the healthy development of the international transportation industry in China.

Recent Developments

While the international liner shipping industry saw moderate growth in 2018, uncertainty remains as demand in key markets is low and protectionist sentiments are gaining ground around the world. Protectionism is poison for trade, and by extension for the maritime industry. Moreover, uneven market access is creating unfair advantages as some companies are benefitting from both a protected home market and open markets in key overseas locations. With this in mind, the maritime industry welcomes the recent improvements to China’s regulatory environment for the maritime industry. As a result of these changes, two of the recommendations raised in the working group’s 2018/2019 position paper (i.e. “Standardise the Paperless Process for Non-vessel Operating Common Carrier (NVOCC) Applications” and “Update Vessel Dimensions in the Port Design Standards and Norms to Allow for the Introduction of New Generations of Container Vessel that Call at Chinese Ports”) have been effectively resolved and are thus no longer a concern to the maritime industry.

The International Liner Shipping Sub-working Group values the annual EU-China Maritime Dialogue between the European Commission and the Chinese Ministry of Transport. The dialogue is a ‘best practice’ of government-to-government communication, giving the opportunity for industries to provide input where possible and exchange views on a series of difficult and wide-ranging topics. This model has proven successful and should be replicated in other industries and geographies.

Key Recommendations

1. Allow the Transport of International Cargo Between Chinese Ports (International Relay)

Concern

International relay may only be carried out by Chinese-flagged vessels operated by wholly-owned Chinese companies, a market access barrier that remains an issue of the highest priority for the EU liner shipping community in China.

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Assessment
International relay refers to the practice of a company carrying cargo from China to an overseas destination on its own vessels, and then transferring the cargo from one vessel to another vessel owned by the same company in a Chinese port. For example, a container to be transported from Dalian to Africa is loaded on a vessel in Dalian servicing Europe. When this vessel, en route to Europe, arrives in Shanghai, the container is moved to another vessel on an Africa-bound service. However, EU shipping lines currently are forced to route cargo originating in China via overseas ports.

Permitting international relay will create flexibility for shipping lines, allowing them to optimise route networks, leading to shorter transit times, lower transport costs and less pollution. As a major shipping nation, China should take responsibility for optimising the global efficiency of sea freight. Alongside supporting China’s domestic economic situation, permitting international relay would bring significant benefits to the EU as well.

Economic Benefits for China
• International relay could produce more revenue for Chinese ports. A high volume of goods currently transhipped overseas, for example in Korea and Singapore, could potentially be transhipped in China.
• It could more effectively utilise Chinese ports since they have excess handling capacity. This could lead to the development of international hub ports in China and the full utilisation of their terminal capacity.
• It could create a competitive advantage for the Chinese economy. Transit times and transportation costs to and from China would be reduced, encouraging the establishment of more direct maritime services and contributing to the success of the ‘Maritime Silk Road’.

Permitting international relay would only have a marginal effect on domestic Chinese shipping lines. International shipping liners currently choose to transship containers outside of China rather than use a domestic feeder service, which increases costs. This is in direct contrast to Chinese carriers, which freely transport containers between EU ports.

Recommendation
• Support the development of more efficient Chinese shipping services by permitting international cargo relay.

2. Apply Nondiscriminatory Treatment in Chinese Free Trade Zones (FTZs)

Concern
Foreign-flagged vessels owned by a Chinese company may engage in international relay in China’s FTZs, while foreign-flagged vessels owned by foreign companies may not, thus creating unfair competition.

Assessment
The establishment of China’s FTZs was greeted with excitement by the EU shipping community, as it appeared to be a step in the right direction, shifting from a trade facilitation policy to a market-access perspective. Hopes were high when it was announced that foreign-flagged vessels would be allowed to engage in international relay in the FTZs.

To the disappointment of the EU shipping community, the Chinese Government went on to clarify that foreign-flagged vessels would only be allowed to conduct international relay in Shanghai if the vessels were ultimately owned by a Chinese company. This diverges from the international rule of having the flag status, not the nationality of the ship owner, determine market access. The Chinese practice allows Chinese shipowners with vessels under foreign flags to enjoy both the benefits of a foreign flag (usually lower tax) as well as the benefits of a domestic Chinese flag, i.e. permission to conduct international relay.

While China’s FTZs have helped to improve a number of shipping-related issues, the International Liner Shipping Sub-working Group regrets that they have also placed EU companies at a further disadvantage to Chinese companies. This may cause frictions in international trade and lead to reciprocal actions being taken.

Recommendation
• Give all foreign-flagged vessels equal right to tranship in China’s FTZs, irrespective of the vessels’ nationality or ownership.

3. Ensure Effective Implementation of the Global Sulphur Cap 2020

Concern
It is of utmost importance that the Global Sulphur Cap 2020 is followed by effective and global implementation and enforcement to ensure a level playing field.
Assessment
In October 2016, the IMO decided that the Global Sulphur Cap 2020 for ships would enter into force on 1st January 2020. This new international regulation reduces the content of sulphur in marine fuel from 3.5 per cent mass-by-mass (m/m) to 0.5 per cent m/m, which will raise costs significantly for shipping companies. The price of low-sulphur compliant fuel will be significantly higher than the ordinary high-sulphur fuel that is currently widely used, and shipping companies that comply with the regulation will be at a significant disadvantage to any companies that choose not to. It is therefore essential that enforcement is robust, both in national and international waters, and that penalties are both proportionate to the offences committed and have a proper deterrent effect. This is a matter of global concern and is not only applicable to China.

Recommendations
• Ensure the effective implementation of the Global Sulphur Cap 2020, starting 1st January 2020, by communicating its enforcement with other maritime nations.
• Support the work being done at the IMO to help those affected by the Global Sulphur Cap 2020 and the global carriage ban on non-compliant fuels.
• Clarify how the Global Sulphur Cap 2020 is going to be implemented in Chinese waters on all vessels that are foreign-flagged vessels, as well as on tonnage owned and operated by Chinese carriers, and ships flying the Chinese flag.

4. Provide Clear Guidance on the Collection of Local Surcharges

Concern
The regulations related to surcharge collection in the maritime transportation industry remain vague, unclear and seemingly arbitrary, which makes it difficult for carriers to achieve compliance.

Assessment
A lack of clear guidelines makes it impossible for shipping lines to know what criteria must be fulfilled for a local surcharge filing to be compliant with regulations. This creates a legal risk for carriers. Authorities have

Recommendations
• Clarify the principles and scenarios in which shipping lines may collect surcharges.
• Clarify that surcharges are determined by the market and that carriers and their customers enjoy freedom of contract in China.

5. Crack Down on Deliberate Misdeclaration of Container Weight and Contents

Concern
A significant number of containers originating in China are found to have an inaccurate weight or content declaration.

Assessment
Working group members have communicated that the contents and weight of a significant number of containers originating in China are intentionally wrongly declared by companies and individuals in order to save on cost – for example, to avoid the extra cost associated with shipping dangerous cargoes because they require special handling. This results in significant risks of vessel damage, additional costs, terminal operation failures, container damage, and most importantly, increased risk of injury and even death of seamen and terminal workers.

Recommendation
• Draft and implement strict and enforceable regulations
to punish companies and individuals who intentionally mis-declare the weight and contents of containers for commercial benefit, at great risk to the safety of personnel and assets.

6. Provide Guidance on the Application of China’s Cybersecurity Law for Shipping Lines

Concern
Shipping companies are unclear about the detailed compliance requirements of the Chinese Cybersecurity Law, which are potentially demanding and costly.

Assessment
More guidance is required in relation to the enforcement of China’s Cybersecurity Law and the steps that international carriers need to undertake in order to ensure their compliance. This is especially the case with regard to data localisation and log-keeping, as the Cybersecurity Law could potentially have significant implications in terms of increased complexity and cost.

Being international by nature, international shipping should be regarded as a part of the global system of trade rather than part of the infrastructure of any particular country. The industry is concerned that it may lead to significant added costs and other burdens if individual nations each begin to make the facilitators of international trade, such as shipping lines, subject to nation-state specific requirements like data localisation, which is on the opposite direction for support of free trade and necessary information flow between countries.

Recommendation
• Clarify the detailed compliance requirements of the Chinese Cybersecurity Law to carriers operating in China.

Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>FTZ</td>
<td>Free Trade Zone</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>IMO</td>
<td>International Maritime Organization</td>
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<tr>
<td>m/m</td>
<td>mass-by-mass</td>
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<tr>
<td>NVOCC</td>
<td>Non-vessel Operating Common Carrier</td>
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<tr>
<td>THC</td>
<td>Terminal Handling Charge</td>
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4 For more analysis on China’s Cybersecurity Law, see Recent Developments in the Cybersecurity Working Group Position Paper.
Section Five
Financial Services
The European Chamber has three separate working groups that cover the financial services sector:

- Banking and Securities
- Consumer Finance and Non-banking Financial Institutions
- Insurance

In the last few years, the Chinese financial system has undergone significant reforms. In November 2017, it was announced that ownership limits for foreign banks in China—20 per cent ownership limit on any single foreign investor in a Chinese bank (with a cap of total foreign ownership at 25 per cent)—will be removed, and that the ceiling for foreign ownership in joint venture (JV) securities and futures brokerages and fund management companies will be raised from 49 to 51 per cent and lifted completely in 2021. The ceiling for foreign ownership of insurance JVs will be raised to 51 per cent in 2021 and lifted completely in 2023. In July 2019, Chinese Premier Li Keqiang announced that this timeline will be brought forward to 2020 as per a set of 11 measures for increased opening up.

Some significant efforts have been made to internationalise China’s capital markets, notably through inclusion of Chinese bonds and equities into global indices. In June 2017, it was originally announced that Chinese A-shares would be included in the MSCI indices. Just 18 months later on 31st January 2019, it was confirmed that Chinese renminbi (RMB)-denominated government and policy bank securities would be added to the Bloomberg Barclays Global Aggregate Index, a process that started in April 2019, providing a transition period of 20 months.

These steps towards the full opening of China’s financial sector are welcomed by the European financial community, yet they come at a late stage. Foreign investors are now looking for timely implementation of said measures and comprehensive complimentary reforms, including providing full transparency, access to licences and a reformed bankruptcy code. The European Chamber also continues to monitor to what extent European financial services firms will be able to buy out their Sino-foreign JVs and obtain licences to enter all business lines. In this regard, it is noteworthy that, according to respondents to the European Chamber’s European Business in China Business Confidence Survey 2019 (BCS 2019), state-owned enterprises (SOEs) hold over 50 per cent of the market share in financial services.

Some progress was made in 2019 regarding the EU-China Comprehensive Agreement on Investment (CAI). Bilateral negotiations between the EU and China on a CAI started at the end of 2013, and the 22nd

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2. Ibid.
6. Please note: neither the European Chamber nor its Banking and Securities Working Group have a position on the index providers mentioned or any other index providers. Their mention in this paper is only intended for informational purposes.
round of talks took place in July 2019. Encouragingly, a joint statement was signed at the 21st EU-China Summit on 9th April 2019, which included a commitment to conclude CAI negotiations by 2020. Further positive signs could be seen in the statement released after the 22nd round, which stated that discussions on specific disciplines related to the financial services and national treatment-related commitments have also advanced. It is generally hoped that a successfully concluded CAI will significantly improve market access in China for European financial services companies.

The financial services working groups believe that China’s financial system has the potential to play an even greater part in the country’s economic development and the well-being of its people. Through the financial services working groups’ observations and detailed recommendations in the following papers, they hope to make meaningful and significant contributions to this end.

Key Recommendations

1. Lift Restrictions on Business Conduct

**Foreign Bank Branches**
- Remove the two-times operative capital borrowing quota in the online interbank market.
- Allow banks to convert funds borrowed from overseas under the new Scheme for Macro Prudential Management of Cross Border Financing.
- Allow foreign bank branches to establish sub-branches.
- Apply the *China Banking Regulatory Commission (CBRC) Measures for the Management of Liquidity Risk for Commercial Banks (Draft)* only at the group level.
- Exempt foreign bank branches from the *CBRC Measures for the Administration of Large Risk Exposures for Commercial Banks*.

**Foreign Incorporated Banks**
- Increase access to the bond underwriting market.
- Grant European banks the same rights as local banks.
- Grant European financial companies/banks custodian licences for cross-border and onshore activities.

**Securities Joint Ventures (SJVs)**
- Award securities licences to European banks.
- Allow locally-incorporated international banks to act as sub-holding entities in China and to directly own equity stakes in Chinese financial institutions and their Chinese JVs.

2. Lift Restraints Affecting Organic Growth

2.1 Grant Full Exemption to Intragroup Risk Exposures
- Exempt foreign banks from the 25 per cent limit on interbank exposure, so as to support international banks' growth and development in China.

2.2 Review Prudential Ratios
- Remove the net of long-term borrowings from current liabilities for overseas branches when calculating liquidity ratios, in order to compare assets and liabilities in the same tenor and ensure equal treatment for Chinese and foreign banks.

2.3 Address Funding Limitations for Foreign Banks
- Remove the two times capital limitation for all banks in China.
- Allow foreign banks to borrow money overseas and swap directly to renminbi (RMB) to fund themselves or their loan portfolio.

2.4 Lift Restrictions on Business Scope to Create more Opportunities for Foreign Banks’ Organic Growth
- Allow foreign banks, futures brokers and securities firms to set up 100-per-cent-owned securities subsidiaries in China with a full futures licence and a full securities licence, comparable to that of local Chinese securities firms.
- Allow foreign banks and fund management firms to set up 100-per-cent-owned fund management subsidiaries in China with a full fund management licence, comparable to local Chinese fund management firms.
2.5 Allow Easier Branch and Sub-branch Business Expansion for Locally-incorporated Banks

- Enable locally-incorporated banks to provide annual master plans for branch and sub-branch expansion that will then be pre-agreed to in principle.
- Allow multiple, simultaneous branch and sub-branch expansion submissions.

2.6 Remove the Long-term Foreign Debt Quota

- Remove the long-term foreign debt quota and guarantee quotas for foreign financial institutions in China.

2.7 Allow Financial Institutions Flexibility in the Adaptation of their Local Set-up, making it Possible to Downsize or Exit Some Activities or Unprofitable Segments/Locations

- Publish comprehensive, systematic guidelines for selling/closing a business, reducing a product offering in an orderly fashion.

2.8 Make it Easier for Subsidiaries and Branches of Foreign Banks to Issue RMB-denominated Bonds for Funding Purposes, and to Help Their Clients to Do So

- Simplify the procedures for foreign banks to issue RMB-denominated bonds (panda bonds), ‘Chinese yuan (CNY) bonds’ and Asset-backed Securities (ABSs) for funding purposes.
- Permit foreign bank branches to issue ‘CNY bonds’.
- Authorise foreign banks to underwrite corporate bonds issued in the interbank bond market.

3. Limit the Requirements for Banks to Localise Data and those Related to Critical Information Infrastructure (CII)

- Refrain from mandating banks to localise their data or their entire IT system by moving it to China.
- Exclude foreign banks from the scope of CII and therefore the requirement to localise data, servers, etc.

4. Allow for the Development of the Shanghai Clearinghouse as a Qualifying Central Counterparty (QCCP) and Provide for an Equivalent System of Recognition of Foreign Central Counterparties (CCPs)

- Continue with the development of the Shanghai clearinghouse as an internationally recognised QCCP.
- Provide for an equivalent system of recognition of foreign CCPs.

5. Refrain from the Introduction of Quotas and Window Guidance

- Refrain from using loan growth quotas.
- Refrain from using window guidance for deposit rates.
- Promulgate all regulations publicly in writing.

6. Develop a Proper Ecosystem for Financial Services in China

- Set up a clearer and tighter market governance framework.
- Overhaul China’s Bankruptcy Law and ensure that subsequently the bankruptcy mechanism is enforced.
- Allow more international rating agencies into the market to ensure that risk is priced more accurately.
- Implement better and tougher auditing regulations.
Introduction to the Working Group

The banking industry and capital markets play a key role in helping the economy allocate money efficiently. Banks operate payment systems, offer loans, take deposits, and help companies and private individuals with investments. However, in order for banks to function properly, they need to be able to assess credit risk correctly and have access to a liquid and well-functioning interbank market underpinned by the central bank’s policy rate. Banks are vital for a modern economy to function properly, but also for ordinary citizens to live a normal life, which is why the banking industry is so heavily regulated. Since banks cannot cover all the credit needed in an economy, debt capital markets—such as the bond market—also play an important role. The importance of the banking market and debt capital markets differs significantly depending on the country they are based in, but both are necessary in order to create an efficient and vibrant economy.

Recent Developments

Since it was announced in November 2017 that ownership limits for foreign banks in China—20 per cent ownership limit on any single foreign investor in a Chinese bank (with a cap of total foreign ownership at 25 per cent)—would be removed, China’s financial system has undergone significant reforms. Also announced in November 2017 was the decision to raise the ceiling for foreign ownership in joint venture (JV) securities and futures brokerages from 49 to 51 per cent. Previous investment limitations had restricted foreign banks’ capacity to grow in the Chinese market ever since being introduced in China’s World Trade Organization accession agreement in 2001. These limitations are one of the chief reasons—besides the slow approval process for expanding and awarding new branch licences—why the total market share of foreign banks was only 1.28 per cent by the end of 2017, the last year for which official records are available, a further decrease from 1.6 per cent in 2014.

Key Recommendations

1. Lift Restrictions on Business Conduct

Concern

Foreign banks, whether operating as branches, locally incorporated or in a Sino-foreign JV, still face various constraints on conducting business in the Chinese market.

Assessment

Foreign Bank Branches

Borrowing quota of two times operative capital

Foreign bank branches are only allowed to borrow two times their operative capital in the People’s Bank of China (PBOC)-operated online interbank market. Also, many Chinese banks have been advised to limit their bilateral offline funding agreements. These factors have severely restricted foreign bank branches’ ability to fund their business in China. Furthermore, offline funding tends to be more expensive and normally involves more complex processes for ‘know your customer’ (KYC) procedures and renminbi (RMB) account opening.

Converting funds borrowed from overseas

Foreign banks constrained by limited RMB funding avenues have previously partly relied on currency

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2 Ibid.


swaps to gain stable RMB funding onshore – a standard derivative product under the China Banking and Insurance Regulatory Commission’s (CBIRC’s) regulations. This is no longer a reliable funding option, as the State Administration of Foreign Exchange (SAFE) stopped approving the conversion of short-term funds borrowed from overseas sources under the new Scheme for Macro Prudential Management of Cross-border Financing, introduced by the PBOC in Circular No. 9 [2017]. SAFE also retroactively revoked already approved conversions under this scheme. While there is no ‘hard limit’ on the amount of short-term foreign currency funds that can be borrowed from overseas sources, foreign bank branches should still be allowed to convert these funds into RMB, as most branches need local currency funding.

Foreign bank branches setting up sub-branches
When a foreign bank establishes a branch in China, it is not permitted to subsequently establish sub-branches in the country. Instead it has to establish other branches. This adds considerable overheads and creates unnecessary financial burdens. Meanwhile, Chinese banks that establish a branch in Europe are allowed to then establish a sub-branch in any country in Europe.

Management of liquidity risk
On 25th May 2018, the Bank of China Insurance Supervision and Management Commission issued the Measures for the Management of Liquidity Risks of Commercial Banks. The Working Group expressed concern about the vague wording of the approach and was also concerned about whether these measures could be applied to branches of foreign banks. As far as the working group is aware, these liquidity measures are implemented only at the group level.7 The working group is concerned both by the vague wording of the draft, and the fact that these measures may be applied to foreign branches. As far as the working group understands, these liquidity measures will only be imposed at group level, and suggests that this be explicitly clarified in the final version.

Foreign Incorporated Banks
Increase Access to the Bond Underwriting Market
European banks’ access to the bond underwriting market in China is still constrained. In February 2016, the China Interbank Bond Market (CIBM) was opened up to foreign institutional investors with the PBOC promulgation of Announcement No. 3,8 which complemented the Qualified Foreign Institutional Investor (QFII) and Retail Qualified Foreign Institutional Investor (RQFII) schemes. Yet to date, only three locally-incorporated foreign banks have been allowed to underwrite corporate bonds as lead underwriters.9

Chinese Government Bond (CGB) underwriting falls under the joint scope of the Ministry of Finance (MOF), the PBOC and the China Securities Regulatory Commission (CSRC). The PBOC bills underwriting market is only available to players with primary dealer (PD) certification. It has been stated that the total number of PDs would not change, as the current number is already large by international standards. There are strict requirements to become a qualified PD,10 and, in practice—according to anecdotal evidence—the actual requirements are stricter than those provided in written form. Out of the current 49 PDs, only four are foreign banks.11

Onshore and cross-border custodian business licences
European banks are seeking to be among the first banks in China to obtain cross-border and onshore custodian licences. There are two types of custodian licences:

1. A cross-border licence that has a capital requirement of Chinese yuan (CNY) 8 billion.
2. An onshore licence with a capital requirement of CNY 40 billion, which is excessive according to the industry.

The difficulty in receiving a licence for cross-border activities arises from the fact it is managed by two different authorities, the CSRC and the CBIRC, before being ultimately granted by the CSRC. Coordination between these two authorities needs to improve, and the process needs to be streamlined.

The main difficulty in receiving a licence for onshore activities is the high capital requirement. While it may be targeted at smaller Chinese banks, the CNY 40 billion requirement also effectively excludes foreign banks, as their overseas balance sheet cannot be included in this calculation. The working group recommends the CBIRC and the CSRC allow European banks to apply for onshore licences based on their overall size instead of the local capital requirement of CNY 40 billion.

As of June 2019, no foreign bank has been awarded an onshore licence (although one is in the final stages of the application process), while several foreign banks from the USA, the United Kingdom and continental Europe have obtained cross-border licences.

Chinese banks find it easy to access these licences in the EU, so the working group calls for European banks to be granted the same, reciprocal rights in China.

Securities Joint Ventures (SJVs)

Securities licences

European banks need to get licences in order to access business lines in the securities business. In April 2018, the CSRC released the Administrative Measures for Foreign-invested Securities Companies, which effectively enabled the opening up of the securities sector. It not only lifted the foreign ownership cap but also expanded the scope of SJVs and simplified relevant requirements. Several locally-incorporated European banks are preparing their applications for establishing SJVs as well.

Holding structures

Currently, European locally-incorporated banks cannot act as a sub-holding entity in China and directly own equity stakes in Chinese financial institutions, or in their Chinese JVs (banks, securities, asset management, among others). However, Chinese banks can do the equivalent in Europe.

Recommendations

Foreign Bank Branches

- Remove the two-times operative capital borrowing quota in the online interbank market.
- Allow banks to convert funds borrowed from overseas under the new Scheme for Macro Prudential Management of Cross Border Financing.
- Allow foreign bank branches to establish sub-branches.
- Apply the CBRC Measures for the Management of Liquidity Risk for Commercial Banks (Draft) only at the group level.
- Exempt foreign bank branches from the CBRC Measures for the Administration of Large Risk Exposures for Commercial Banks.

Foreign Incorporated Banks

- Increase access to the bond underwriting market.
- Grant European banks the same rights as local banks.
- Grant European financial companies/banks custodian licences for cross-border and onshore activities.

SJVs

- Award securities licences to European banks.
- Allow locally-incorporated international banks to act as sub-holding entities in China and to directly own equity stakes in Chinese financial institutions and their Chinese JVs.

2. Lift Restraints Affecting Organic Growth

2.1 Grant Full Exemption to Intragroup Risk Exposures

Concern

Measures promulgated by the CBIRC stipulating that “interbank exposure shall not exceed 25 per cent of first-tier net capital” could have a substantial negative impact on the ability of international banks to do business in China.

Assessment

In April 2018, the CBIRC then promulgated the Measures for the Administration of Large Risk Exposures for Commercial Banks (Risk Exposure Measures). The working group is concerned by a point in Article 9 of the Risk Exposure Measures, which states “interbank exposure shall not exceed 25 per cent of first-tier net capital”. The working group believes that intra-group funding/placement ought to be excluded from the risk exposure calculation. This is because it is normal practice for a China-based branch or subsidiary of an international banking group to receive/place funding within its own international corporate group, and the size of this funding may vary according to market conditions.
Recommendation
• Exempt foreign banks from the 25 per cent limit on interbank exposure, so as to support international banks’ growth and development in China.

2.2 Review Prudential Ratios

Concern
The net amount of long-term borrowings financed from overseas branches is treated as current liabilities, which unnecessarily reduces a bank’s liquidity ratio, as current assets often only cover short-term lending.

Assessment
Even though it falls under the long-term foreign debt quota of the National Development and Reform Commission (NDRC), the net amount of long-term borrowings from overseas branches is treated as a current liability in China. The purpose of liquidity ratios is to ensure a bank’s ability to pay short-term obligations. Therefore, it is essential that the ratio captures actual solvency. It is international practice to compare assets and liabilities in the same tenor. In the absence of large retail customer deposits, foreign banks—especially smaller branches—rely on overseas intragroup funding, including long-term borrowing. The current Chinese practice reduces the liquidity ratio in an unfair way for such foreign banks.

Recommendation
• Remove the net of long-term borrowings from current liabilities for overseas branches when calculating liquidity ratios, in order to compare assets and liabilities in the same tenor and ensure equal treatment for Chinese and foreign banks.

2.3 Address Funding Limitations for Foreign Banks

Concern
Foreign banks face funding restrictions due to SAFE regulatory approvals and have limited access to the China Foreign Exchange Trade System (CFETS) interbank market.

Assessment
Access to the CFETS interbank market is limited to two times the RMB capital of banks in China, which heavily impacts foreign bank branches, as these have limited RMB capital. Lifting this restriction would result in a more active and liquid RMB interbank market that will benefit all banks.

Besides the two-times capital restriction, the working group sees further funding restrictions on international banks, because without regulatory approval from the SAFE, the foreign debt of financial institutions cannot be exchanged to RMB or sold on through a swap deal.

Recommendations
• Remove the two times capital limitation for all banks in China.
• Allow foreign banks to borrow money overseas and swap directly to RMB to fund themselves or their loan portfolio.

2.4 Lift Restrictions on Business Scope to Create more Opportunities for Foreign Banks’ Organic Growth

Concern
Foreign banks, futures brokers, securities houses and fund management companies are currently still prevented from obtaining licences comparable to those of local Chinese firms, which inhibits their organic growth.

Assessment
Since June 2016, wholly foreign-owned private fund managers have been allowed to register with the Asset Management Association of China (AMAC).14 A total of 18 foreign asset management companies have done so and obtained a private fund management licence,15 which enables them to trade in the secondary markets without the need for a Chinese majority JV partner. However, due to various reasons, European banks are still constrained from obtaining licences for their wholly foreign-owned subsidiary futures brokers, securities houses and fund management companies. The working group hopes that more foreign futures brokers, securities houses and fund asset management companies will be allowed to obtain such licences. Also, according to the expedited schedule announced

by Premier Li Keqiang on 2nd July 2019, 16 100 per cent foreign ownership of a JV will be allowed in 202017 – a year early. The working group hopes it will be possible for foreign investors to inherit and hold on to all licences.

Recommendations
- Allow foreign banks, futures brokers and securities firms to set up 100-per-cent-owned securities subsidiaries in China with a full futures licence and a full securities licence, comparable to that of local Chinese securities firms.
- Allow foreign banks and fund management firms to set up 100-per-cent-owned fund management subsidiaries in China with a full fund management licence, comparable to local Chinese fund management firms.

2.5 Allow Easier Branch and Sub-branch Business Expansion for Locally-incorporated Banks

Concern
Locally-incorporated foreign banks face difficulties in business planning and resource management due to the complex system of submissions required to expand their branch and sub-branch network.

Assessment
A locally-incorporated bank needs to go through several complex and often unnecessary submissions to regulators in order to expand their branch and sub-branch network. While the working group understands the need for detailed submissions, it recommends a planned strategic approach, whereby multiple branch and sub-branch applications are allowed on an annual basis to facilitate the locally-incorporated bank’s branch network expansion strategies in a more transparent and planned manner. By comparison, there are few obstacles for Chinese banks to open a branch network within the European Union (EU).

Recommendations
- Enable locally-incorporated banks to provide annual master plans for branch and sub-branch expansion that will then be pre-agreed to in principle.
- Allow multiple, simultaneous branch and sub-branch expansion submissions.

2.6 Remove the Long-term Foreign Debt Quota

Concern
The limitations imposed by the long-term foreign debt quota are an obstacle to banks that want to service businesses with genuine financing needs.

Assessment
While China has now moved to a new ‘macro-prudential framework’ and abandoned the short-term debt quota, the long-term debt quota still maintains strict limits under the administration of the NDRC. These limitations make foreign currency funding unnecessarily expensive for foreign and Chinese enterprises. No similar restrictions are imposed on Chinese banks operating in Europe, highlighting the unequal treatment of European banks in China. The working group is concerned about the following rules:

- Direct financing through foreign shareholder loans is restricted through the foreign debt quota for foreign-invested enterprises (FIEs). This quota is consumed if the financing in foreign exchange has a term longer than one year or is currently consumed by any foreign loan in RMB. Once the foreign debt quota is consumed, it cannot be renewed under the current regulations.
- Financing for FIEs, especially small and medium-sized enterprises within China, often depends on collaterals by guarantee of foreign banks or their parent companies. Since foreign guarantees to secure financing would be eventually capped by two times the borrower’s net assets, the methods of local financing are also extremely limited. This makes it impossible for FIEs that have already used up their foreign debt quota to obtain local financing with a foreign guarantee.

Recommendation
- Remove the long-term foreign debt quota and guarantee quotas for foreign financial institutions in China.
2.7 Allow Financial Institutions Flexibility in the Adaptation of their Local Set-up, making it Possible to Downsize or Exit Some Activities or Unprofitable Segments/Locations

Concern
The process of exiting certain business activities is complex and lacks clear rules, which results in financial institutions often being forced to continue providing banking services even when there is no more group support.

Assessment
Below are two areas where foreign market participants encounter problems in exiting:

• After having obtained a licence for a branch in a local province, it is almost impossible to close it, even if it has not become profitable after several years. Financial institutions are expected to demonstrate to the province their long-term commitment and maintain an overly-large, minimum set-up – usually around 10 people, including branch manager, deputy branch manager, and operations, compliance, finance and relationship managers.

• The same applies at the provincial level to new products or client segments. Exit barriers are significant, with financial institutions being prohibited from selling some portfolio (client consent is required, and a tripartite agreement needs to be signed), transferring some assets to other institutions or ceasing certain activities for which a licence has been obtained.

Exit barriers are resulting in foreign institutions being considered non-performing in China and are reducing institutions’ risk appetite to explore opportunities in new locations, clients or products. The working group suggests therefore that the CBIRC and regional authorities should provide detailed guidelines on how foreign banks can exit the market or dispense with product offerings.

Recommendation
• Publish comprehensive, systematic guidelines for selling/closing a business, reducing a product offering in an orderly fashion.

2.8 Make it Easier for Subsidiaries and Branches of Foreign Banks to Issue RMB-denominated Bonds for Funding Purposes, and to Help Their Clients to Do So

Concern
Subsidiaries and branches of foreign banks face several problems associated with the issuance of RMB-denominated debt instruments in China—be it theirs or that of their clients—which stifle their growth.

Assessment
Foreign banks—depending on whether they are incorporated in China or operating as a branch—face problems associated with the issuance of any of the three distinct types of RMB-denominated debt securities: onshore bonds issued by onshore Mainland based issuers; onshore bonds issued by offshore (i.e. outside Mainland China) issuers (the so-called ’panda bonds’); and bonds issued offshore (i.e. outside Mainland China) by both onshore and offshore issuers (e.g. Dim Sum, Lion City).18

CNY Bonds
Locally-incorporated foreign banks are legally allowed to issue debt securities and onshore asset-backed securities (ABS) in the Chinese interbank bond market for funding purposes — as long as they can meet regulatory requirements and receive pre-approval from the CBIRC and the PBOC.19,20 However, it is currently still impossible for foreign banks’ branches to do so.

Underwriting Panda Bonds
In 2018, the PBOC and the MOF jointly published new interim administrative rules for bond issuance by non Mainland-China (i.e. panda bonds),21 which clarify and simplify a number of issues. At present, the relevant rules do not list specific requirements on the use of proceeds from a panda bond issuance, and—as far as account openings and foreign remittances are concerned—instead refer to relevant regulations by the

18 Emerging Market Focus – Panda: From Zero to a USD 2trn Market in Ten Years [Client Note], Credit Agricole Corporate & Investment Bank, 3rd May 2016, viewed 24th June 2019. Please note, this was a non-public client note courtesy of Credit Agricole.
PBOC and the SAFE.\textsuperscript{22} That said, while the remittance of panda bond proceeds is in principle allowed, there is apparently still a strong preference for the onshore use of said funds.\textsuperscript{23} To date, only six locally-incorporated foreign banks are allowed to underwrite corporate bonds – among which three have Type B senior underwriting licence.\textsuperscript{24}

Asset-backed Securities (ABS)

When issuing an ABS, the commercial bank—as the originator—first has to obtain from the CBIRC a qualification to issue different types of ABS, which it then has to file with the CBIRC for each subsequent ABS issuance. Similarly, the trustee of the ABS needs to obtain the approval of the PBOC and the CSRC for the issuance of an ABS in the interbank bond market. In addition, the originator can only securitise assets that comply with the PBOC’s requirements.\textsuperscript{25}

T+1 and T+2 Settlement Methods

China settles transactions on the following working day—the trade date plus one day ‘T+1’ method of settlement—whereas the international standard is ‘T+2’. This mismatch creates problems.

Recommendations

- Simplify the procedures for foreign banks to issue RMB-denominated bonds (panda bonds), ‘CNY bonds’ and ABS for funding purposes.
- Permit foreign bank branches to issue ‘CNY bonds’.
- Authorise foreign banks to underwrite corporate bonds issued in the interbank bond market.

4. 3. Limit the Requirements for Banks to Localise Data and those Related to Critical Information Infrastructure (CII)

Concern

The way that Chinese regulators deal with cybersecurity in the financial sector, in particular with regard to CII protection, data localisation and cross-border transfer, serves to increase foreign banks’ operational risks and associated costs.

Assessment

European banks continue to encounter a host of problems in relation to the Cybersecurity Law and associated legislation, such as the Measures on the Security Review of Network Products and Service,\textsuperscript{26} issued by the Cyberspace Administration of China (CAC) in May 2017, and the draft Administrative Measures on the Security Assessment of the Overseas Transfer of Personal Information and Important Data, issued in April 2017.\textsuperscript{27} For more information on these measures, please refer to the Cybersecurity Working Group Position Paper.

Cybersecurity Law and CII

The Cybersecurity Law\textsuperscript{28} requires CII operators to keep the personal information and important data they collect in China within the country, and to carry out a security assessment where cross-border transfers are warranted by their business needs. The second draft of the Measures on the Security Assessment of Cross-border Transfer of Personal Information and Important Data further scaled down the security assessment burden, with CII operators subject to stricter security assessment requirements only when the transfer of data involves network security information.\textsuperscript{29} No additional burdens should apply to CII operators transferring other types of data.

Data Localisation

Data localisation complicates banks’ normal operations and has an adverse effect on cybersecurity. International banks usually deploy their cybersecurity solutions group-wide under a 24/7 ‘follow-the-sun’ model, i.e. in which responsibility for cybersecurity threat monitoring is transferred to an entity in progressively more westward countries as the day progresses. Cross-
border data flow is an essential element of this. In particular, the CBIRC’s Banking Financial Institutions Anti-Money Laundering and Counter Terrorist Financing Management Measures, which strictly prohibit cross-border transfers of customer identification information and transaction data, have created a significant compliance burden and operational risks.

Cybersecurity Inspections and Penetration Testing
The working group is concerned about the possibility of mandated penetration testing of banks’ information technology (IT) systems, and thus advocates that bank-led penetration testing be recognised as sufficient by regulators. The working group recommends that the CSRC and other regulators remove penetration testing and system scanning requirements from regulations, such as CSRC Order No. 152, and the Ministry of Public Security’s (MPS’s) Provisions on Internet Security Supervision and Inspection by Public Security Organs, and initiate an open dialogue with industry stakeholders on this topic.

Recommendations
• Refrain from mandating banks to localise their data or their entire IT system by moving it to China.
• Exclude foreign banks from the scope of CII and therefore the requirement to localise data, servers, etc.

4. Allow for the Development of the Shanghai Clearinghouse as a Qualifying Central Counterparty (QCCP) and Provide for an Equivalent System of Recognition of Foreign Central Counterparties (CCPs)

Concern
Chinese authorities need to do more to facilitate the setting-up of the Shanghai clearinghouse, specifically by implementing an equivalent system of recognition of foreign CCPs.

Assessment
Recognition of the Shanghai clearinghouse as a QCCP would aide European banks in China with dealing in derivatives. The PBOC is trying to ensure that the Shanghai clearinghouse is recognised internationally as a QCCP, i.e. an entity that has a licence to function as a central counterparty (CCP) and that has the permission to clear transactions in financial products. Yet for the European Commission to act, Chinese authorities need to first provide for an equivalent system of recognition of foreign CCPs. Only then can the European Commission adopt an equivalence decision for Chinese CCPs, which would enable the European Securities and Markets Authority (ESMA) to recognise the Shanghai clearinghouse as a QCCP. The European Commission and ESMA are bound here by the European Market Infrastructure Regulation (EMIR).

Specifically, Article 25(2)(a) in connection with Article 25(6) of the EMIR are important here, as according to Article 25(2)(a):

“2. ESMA, after consulting the authorities referred to in paragraph 3, may recognise a CCP established in a third country that has applied for recognition to provide certain clearing services or activities where:

(a) the Commission has adopted an implementing act in accordance with paragraph 6;”

Furthermore, according to Article 25(6):

“6. The Commission may adopt an implementing act under Article 5 of Regulation (EU) No 182/2011, determining that the legal and supervisory arrangements of a third country ensure that CCPs authorised in that third country comply with legally binding requirements which are equivalent to the requirements laid down in Title IV of this Regulation, that those CCPs are subject to effective supervision and enforcement in that third country on an ongoing basis and that the legal framework of that third

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35 Ibid.

36 Ibid.
country provides for an effective equivalent system for the recognition of CCPs authorised under third-country legal regimes."

Recommendations
• Continue with the development of the Shanghai clearinghouse as an internationally recognised QCCP.
• Provide for an equivalent system of recognition of foreign CCPs.

5. Refrain from the Introduction of Quotas and Window Guidance

Concern
Instances of window guidance and quotas have been highly disruptive to the day-to-day operations of European banks and companies alike.

Assessment
The practice of window guidance and the stipulation of quotas by various regulators is disruptive to the operations of European banks and, as such, should not be applied to regulate the market.

Window Guidance by the SAFE
In the past, window guidance as well as inflow/outflow quotas stipulated by the SAFE have caused problems for European banks. While not an acute problem, the working group remains vigilant to ensure that this does not happen again.

Loan Growth Quotas by the PBOC
Ad hoc loan growth quotas make business unpredictable for banks, resulting in some banks being unable to extend loans to clients.

Recommendations
• Refrain from using loan growth quotas.
• Refrain from using window guidance for deposit rates.
• Promulgate all regulations publicly in writing.

6. Develop a Proper Ecosystem for Financial Services in China

Concern
The development of China’s financial sector is constrained by various issues, which in turn limits the further expansion of European banks in China.

Assessment
China’s financial sector has come to a point where it is increasingly necessary for regulators to take a systemic approach, which will require implementing many essential reforms.

China’s Bankruptcy Law
Chinese authorities need to ensure that the bankruptcy mechanism is enforced. In late March 2019, it was announced that China’s Bankruptcy Law—which dates from 2007—will be overhauled. This is a good step forward, as over the years the bankruptcy mechanism had rarely been invoked for companies, leading to a great mispricing of risk and the rise of ‘zombie firms’.  

Rating Agencies and Ratings
The quality of credit ratings in China is still woefully inadequate. In January 2019, China opened the market to foreign rating agencies. This was an important yet overdue step in improving the quality of China’s financial services sector. Greater opening-up will improve the quality of credit ratings and thus ensure that bonds are priced more accurately.

Auditing
Chinese regulators need to implement better and tougher regulations regarding auditing. The working group regards it as essential to impose tighter regulations on information transparency and place more emphasis on the duties of audit firms and rating agencies.

Recommendations
• Set up a clearer and tighter market governance framework.

37 The Banking and Securities Working Group would define ‘window guidance’ as regulations and orders given by regulatory agencies to banks in an informal way, such as verbally over the phone, as a way of persuading banks and other financial institutions to adhere to official guidelines. A key concern is that these regulations and orders are never promulgated in official legislation.


39 For example, the Bank for International Settlements (BIS) defines ‘zombie firms’ as ‘firms that are unable to cover debt servicing costs from current profits over an extended period’; Banerjee, Ryan Niladri and Boris Hofmann, The rise of zombie firms: causes and consequences, BIS Quarterly Review, 23rd September 2018, viewed 26th June 2019, <https://www.bis.org/publ/qtdiskr_qt1809q.htm>

• Overhaul China’s Bankruptcy Law and ensure that subsequently the bankruptcy mechanism is enforced.
• Allow more international rating agencies into the market to ensure that risk is priced more accurately.
• Implement better and tougher auditing regulations.

Abbreviations

ABS   Asset-backed Security
AMAC  Asset Management Association of China
BIS   Bank for International Settlements
CAC   Cyberspace Administration of China
CBIRC China Banking and Insurance Regulatory Commission
CBRC  China Banking Regulatory Commission
CCP   Central Counterparty
CFETS China Foreign Exchange Trade System
CGB   Chinese Government Bond
CIBM  China Interbank Bond Market
CII   Critical Information Infrastructure
CIRC  China Insurance Regulatory Commission
CNY   Chinese Yuan
CSRC  China Securities Regulatory Commission
EMIR  European Market Infrastructure Regulation
ESMA  European Securities and Markets Authority
EU    European Union
FIE   Foreign-invested Enterprise
IT    Information Technology
JV    Joint Venture
KYC   Know Your Customer
MOF   Ministry of Finance
MPS   Ministry of Public Security
NDRC  National Development and Reform Commission
PBOC  People’s Bank of China
PD    Primary Dealer
QCCP  Qualifying Central Counterparty
QFII  Qualified Foreign Institutional Investor
RMB   Renminbi
RQFII Retail Qualified Foreign Institutional Investor
SAFE  State Administration of Foreign Exchange
SAT   State Administration of Taxation
SJV   Securities Joint Venture
T+1   Trade Date Plus One Day
T+2   Trade Date Plus Two Days
Consumer Finance and Non-banking Financial Institutions Working Group

Key Recommendations

1. Non-performing Loans (NPLs)
   1.1 Keep NPL Logic (90 days past due) as it is or Lower Provisioning Requirements
   • Maintain the existing 90DPD criteria for classifying non-performing loans.
   • Consider decreasing provisioning requirements from the current 150 per cent to at least 120 per cent for qualified non-banking financial institutions if the NPL classification is changed from 90DPD to 60DPD.

2. Provide a Clear Mechanism for Consumer Finance Companies (CFCs) to Sell Delinquent Assets in Larger Batches to Asset Management Companies (AMCs)
   • Lift restrictions on batch transfers of NPLs in the consumer finance industry; allow compliant CFCs to pilot NPL sale under the framework of selected Free Trade Zones.
   • Lower the qualification threshold for NPL assignees and open the primary bad assets market up to more qualified participants.

3. Broaden CFCs’ Funding Channels
   • Allow CFCs to take large-sum deposits of Chinese yuan (CNY) 300,000 and above from individuals and CNY 10 million and above from institutional investors by way of issuing large-denomination certificates of deposits (LDCDs).
   • Allow CFCs to issue asset-backed securities (ABS) on securities markets and explicitly allow CFCs access to the Yindeng market, considering the nature of the consumer finance business.
   • Stipulate clearly in the relevant regulations on CFCs that they are also allowed to borrow from abroad.

4. Allow Auto Finance Companies (AFCs) to Take Deposits from their Non-fully-owned Affiliates
   • Revise the current AFC rules to allow wholly foreign-owned AFCs to take deposits from their Chinese joint ventures (JVs).

5. Lower the Capital Adequacy Ratio (CAR) Requirement Placed on AFCs in a Macro Prudential Assessment (MPA)
   • Lower the MPA-CAR requirement for AFCs by increasing the corresponding tolerance scale.

6. Implement Homogeneous Regulation of the Individual Loan Market
   • Continue implementation of homogenous regulations and their equal enforcement in the consumption loan market.
   • Interpret and enforce all the regulatory requirements equally throughout the country.
Introduction to the Working Group

Consumer credit empowers individuals to both achieve their dreams and to face everyday challenges with ease, as it provides them with a reasonable and fair solution to afford what they want when they need it, as well as to respond to contingencies in a timely manner. Consumer credit gives the many full access to what would be otherwise only affordable to the few. Thus, it is an essential engine in the realisation of the Chinese plan to develop a consumer-based society while adding to the well-being of the nation.

European consumer credit firms are active and essential players in the implementation of the State Council’s Plan for Advancing the Development of Financial Inclusion (2016–2020), which aims to improve “the availability, uptake, and quality of financial products and services in China, with a clear emphasis on expanding and deepening financial inclusion for historically unserved and underserved population segments, including micro and small enterprises (MSEs), rural residents, low-income urban groups, the poor, the disabled, and the elderly.”

Regulated by the China Banking and Insurance Regulatory Commission (CBIRC), consumer finance companies (CFCs) are allowed to operate nationwide and provide consumption-purpose loans, excluding car loans and mortgages, up to Chinese yuan (CNY) 200,000.

The Consumer Finance and Non-banking Financial Institutions (NBFIs) Working Group was established in 2008. It includes leading European consumer finance specialists who operate CFCs, auto finance companies (AFCs), small loan companies and other entities engaged in consumer finance services in cooperation with third parties (e.g. guarantee companies) in China. The establishment of this working group is a reflection of the importance attached to the emerging consumer finance industry in China, its relevance to the State Council’s major policy objectives and the attention European players pay to this agenda.

Recent Developments

Since the G20 Hangzhou Summit of September 2016, the consumer finance and non-banking institution industry has been rightly recognised as a fundamental engine of financial inclusion in China. In fact, companies in the sector have for some time been allowing a significant portion of the Chinese population to enjoy financial services, and prior to the G20 Summit the State Council had issued the Plan for Promoting the Development of Financial Inclusion (2016–2020).

Consumer finance has become a part of China’s economic system and is an important catalyst for promoting China’s transition to a consumption-driven economy, rather than relying purely on investments and exports. Consumer finance helps to meet consumers’ needs, promotes the upgrading of consumption, increases consumption awareness and boosts the economy overall.

During the 2018 ‘Two Sessions’, Premier Li Keqiang mentioned in his government work report that China would “vigorously expand consumption and promote effective investment”. It is therefore expected that consumer finance will continue to develop rapidly over the next few years. “The scale of the consumer finance market at the end of 2017 was between CNY 8 and 9 trillion, an increase of around CNY 2 trillion compared with 2016, with a year-on-year rise of 30 per cent,” according to Zeng Gang, deputy director of the National Financial and Development Laboratory.

According to Research on China’s Consumer Credit Market 2017, customers of consumer credit services mainly consist of people between the ages of 18–29, are highly educated and receive what is considered a low income (70 per cent of them have a monthly income of CNY 2,000–5,000). When selecting a consumer credit service, they consider the companies’ scale, business transparency level, and degree of compliance and convenience.
Updates on Individual Loan Regulatory Framework

The development of peer-to-peer (P2P) lending started in 2007 when PPDAI, China’s first P2P platform, was established. The sector experienced rapid development in 2011, when interest rates were finally liberalised. At first, regulators adopted a gentle approach that consisted of the introduction of several ‘remedial measures’ while abstaining from issuing any specialised law or regulation. Among those measures is the China Banking Regulatory Commission’s (CBRC’s) Notice of the General Office of the CBRC on Warning on Risks Associated with Peer-to-Peer Lending (August 2011), the State Council’s Notice on Issues Concerning Strengthening the Supervision of Shadow Banking (Document No.107) (February 2014) and the CBRC’s Ten Principles for P2P Lending Regulation (January 2015).7,8,9

Given the absence of stringent regulations, from 2011 to 2015 the industry boomed with the number of P2P lenders going from 50 to nearly 3,500.10 As a result, in July 2015, the People’s Bank of China (PBOC), together with nine other ministries, released the Guiding Opinions on Promoting the Sound Development of Internet Finance.11 The document, which served as the sector’s basic law, was followed by the Interim Measures for the Administration of Business Activities of Online Lending Intermediary Institutions (Interim Measures), issued by the CBRC, the Ministry of Industry and Information Technology, the Ministry of Public Security and the Cyberspace Administration of China.12 The Interim Measures reaffirmed the importance of P2P lending for the financial market, while defining the sector’s scope and boundaries.

Despite China’s effort to make the sector’s growth more orderly, the industry kept ballooning with the total number of lenders reaching 4,000 units in early 2017. On the top of that, a study by the PBOC published in late 2016 showed that nearly 40 per cent of the P2P companies were in fact Ponzi schemes.13

Nonetheless, it is essential to note that P2P platforms do play a crucial role in China’s credit system as they provide access to loans to certain kind of borrowers, and the ability to lend to lenders, that would be otherwise excluded. From the consumer point of view, P2P represents in most cases a valid investment opportunity. In fact, given the extreme volatility of the Chinese stock market, especially after the 2015 crash, and the high entry barriers to the real estate market, P2P offered a valid alternative for investing small sums of savings. On the other hand, in a landscape dominated by state-owned banks that direct 60 per cent of their loans to other state-owned enterprises (SOEs) and 30 per cent of the remaining 40 per cent to large domestic companies or individuals willing to buy their first house, P2P and individual loans often constituted the only way for small and medium-sized enterprises (SMEs) and consumers to access credit.14

As a result, when it comes to evaluating the stricter regulatory environment that policy-makers started to enforce from mid-2017, it is essential to keep in mind the fact that P2P constituted, and still constitutes, a vital tool to assure financial inclusion in China. On the top of that, despite the many distortions that characterise the sector, when the industry peaked in 2016, all the P2P players combined accounted for only 0.5 per cent of the loans in China, worth a total of CNY 1 trillion.15 Therefore, when regulators started to implement new policies to reform the industry, the main goal was not preventing systemic risks, rather consumer protection. This is how the following regulations should be interpreted:

- On 7th April 2017, the CBRC released the Guiding Opinions on Risk Prevention and Control of the Banking Sector, which continually improves the

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6 Peer-to-peer lending, also known as social lending, enables individuals to obtain loans directly from other individuals, cutting out the financial institution. P2P usually takes place through websites that directly connect borrowers to investors.
risk management of P2P platforms and rectifies the problems found in cash loan businesses as well.16
• On 14th April 2017, the Office of the Leading Group for the Special Campaign against Peer-to-Peer Lending Risks issued the Notice on Carrying out the Clearance and Rectification of Cash Loan Business, along with its supplementary explanation.17
• On 23rd August 2017, the General Office of the CBRC released the Guidelines for the Disclosure of Information on the Business Activities of Online Lending Information Intermediary Institutions, which establishes the ‘1+3’ regulatory framework of the internet loan industry (See Chart 1).18

‘1+3’ Regulatory Framework of the Internet Loan Industry19

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<td>2</td>
<td>Guidelines for the Online Lending Fund Depository Business</td>
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• On 1st December 2017, the Office of the Leading Group for the Special Campaign against Internet Financial Risks and the Office of the Leading Group for the Special Campaign against Peer-to-peer Lending Risks jointly released the Notice on the Regulation and Rectification of the ‘Cash Loan’ Business, specifying the principles for carrying out cash loan business and implementing pertinent clearance and rectification measures.20 It provides comprehensive guidance for regulating and rectifying cash loan business in the following six areas: implementation principles, internet small loan clearance and rectification, regulating banking financial institutions, improving the administration of online lending information intermediary institutions, intensifying disposal efforts toward illegal acts and paying attention to implementation.

• On 7th December 2017, the Non-banking Department of the CBRC issued the Letter on Forwarding the Notice on the Regulation and Rectification of the ‘Cash Loan’ Business,21 requiring local offices to regulate and rectify the cash loan business of CFCs within their jurisdiction. Before its issuance, there were four sources of cash loan business: internet small loan companies, banking financial institutions, P2P internet loan information intermediary institutions and CFCs. In fact, the PBOC and the CBRC referenced how the rapid development of the cash-loan industry had created problems, such as overlending, repeated borrowing, improper debt collection, abnormally high interest rates and privacy violations. These concerns escalated after the high-profile initial public offerings of several major Chinese micro-loan and P2P lenders in the United States. Moreover, there were reports that some of these microloans were channelled through the property market, contributing to the soaring house prices.22

• On 17th August 2018, the Office of the Leading Group for the Special Campaign against Peer-to-peer Lending Risks released the Notice on Conducting Compliance Checks for P2P Network Lending Organisations.23 It requires P2P companies to conduct a regular self-examination process that consists of a survey articulating ten main questions

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20 Notice on the Regulation and Rectification of the ‘Cash Loan’ Business, baika, 3rd December 2017, viewed 4th July 2019, <https://baike.baidu.com/item/%E5%8B%83%E4%BA%8E%E6%8A%A1%E7%91%9E%E8%84%B8%E7%94%A8%E9%A1%B8%20%E5%9B%BE%E7%9A%84%E9%9A%90%E7%9F%9F%E5%8A%A62223975>
22 Microlenders Choose Flight over Fight, Caixin, 7th December 2017, viewed 4th July 2019, <https://www.caixinglobal.com/2017-12-07/microlenders-choose-flight-over-fight-101182038.html>
aimed at determining the nature of the company. A report should then be submitted to provincial authorities that will verify it.

- On 21st January 2019, the Office of the Leading Group for the Special Campaign against Peer-to-peer Lending Risks and the Office of the Leading Group for the Special Campaign against Internet Financial Risks jointly issued the Opinions on the Optimal Classification of Online Lending Institutions and Risk Prevention Measures (No. 175) (Opinions). The Opinions are aimed at reducing risk by establishing a classification system for P2P companies. More specifically, the ‘high-risk’ category was introduced for companies that have more than 10 per cent of overdue loans in their portfolio.

- On 25th January 2019, the Office of the Leading Group for the Special Campaign against Peer-to-peer Lending Risks released the Notice on Further Implementation of P2P Network Lending Compliance Inspection and Follow-up Operations (No. 1). It requires P2P companies to grant complete and real-time access to transaction data to provincial authorities as well as to send statistical monitoring data to the National Internet Financial Registration and Disclosure Platform. More importantly, the document has been widely interpreted by the market as a clear and official answer to the idea that regulators wanted to completely shut down the P2P market. In fact, the notice listed the procedures and steps that P2P companies have to follow to legally operate under the new regime.

- On 8th April 2019, the Office of the Leading Group for the Special Campaign against Peer-to-peer Lending Risks and the Office of the Leading Group for the Special Campaign against Internet Financial Risks jointly issued the Working Plan for the Conditional Recording of Internet Lending Intermediaries, which contains three main elements. First, it clarifies that P2P institutions should keep working on the compliance system established in documents numbers 175 and 1. Second, the plan provides a clear timeline for the registration process of P2P institutions. Finally, the plan indicates 11 conditions under which P2P institutions can register in the new system. Among them the most relevant are the amount of capital, the risk reserve and the risk compensation.

As result of the new regulatory environment, more than 90 per cent of existing P2P companies in China will be forced out of the market, according to a report released by Fitch in March 2019. This seems to be in line with the intention expressed by the regulator that clearly aims to allow only the biggest companies to remain in the market so as to increase overall consumer protection.

Key Recommendations

1. Non-performing Loans

1.1 Allow Consumer Finance Companies (CFCs) to Keep Determining the Non-performing Status of a Consumer Loan on a Period of 90 Days or Less, or Lower to 120 Per Cent the Loan Loss Provision CFCs are Required to Reserve as Allowance for Uncollected Loans and Loan Payments

Concern
Recently, the working group learned that the regulatory authorities intend to require some financial institutions to classify loans that are more than 60 days past due (DPD) as an NPL. In the working group’s opinion, such a development, if introduced without further consultation, might have several ramifications for affected non-banking financial companies.

Assessment
The regulators intend to require some NBFIs to book 60DPD+ portfolios as non-performing loans. The working group suggests that the existing non-


performing loan classification criteria (90DPD) be kept in accordance with international practices.

The working group estimates that, under the proposed change, affected companies might face negative consequences such as: decreases in net profit; decreases in the capital adequacy ratio (CAR), which will trigger covenants and may result in requests from funding partners for early repayment; an increase in NPLs, making it more difficult to get funding; and costly adjustments to back-office systems. Fluctuation of affected companies’ operating performance may also lead to significant and negative reputational damage.

The working group also understands that this proposed change is based on a more prudent regulatory philosophy. However, it could have a direct impact on affected businesses, resulting in a change of some companies’ financial positions from profit-making to breakeven or even slightly loss-making. As a result, NPLs could start to climb, jeopardising funding partners’ confidence and draining liquidity. Affected companies would have a hard time raising funds, lowering costs and offering financially inclusive products on a wider scale. It is therefore recommended that, on the premise of sufficient provisioning, adequate capital and excellent risk control, the existing 90DPD criteria for classifying non-performing loans should be maintained.

If the regulators decide to proceed with the change, the working group recommends that the requirement of provisioning should be prudently lowered under certain conditions to 120 per cent in order to avoid an extremely negative impact on companies’ net profit and CAR.

There is a regulatory precedent in the market. The regulator might consider setting a non-banking-institutions provisioning policy similar to that for banks. In February 2018, the CBIRC issued Notice regarding the Adjustment of Regulatory Requirements on Commercial Banks’ Loan Loss Reserves (Yin Jian Fa [2018] No.7) (Notice).28 According to the Notice, provision coverage may be dropped from a mandatory 150 per cent to 120–150 per cent, and loan loss reserves from 2.5 to 1.5 per cent for banking institutions that meet regulatory indicators such as loans classification accuracy, initiative for disposing of NPLs and capital adequacy, among others. At the local level, regional regulatory branches can decide individually for each bank under their jurisdiction on an appropriate level of provisioning. Regulators can consider a similar approach to be implemented for NBFIs.

Recommendations

- Maintain the existing 90DPD criteria for classifying non-performing loans.
- Consider decreasing provisioning requirements from the current 150 per cent to at least 120 per cent for qualifying NBFIs if the NPL classification is changed from 90DPD to 60DPD.

3.1.2 Provide a Clear Mechanism for CFCs to Sell Delinquent Assets in Larger Batches to Asset Management Companies (AMCs)

Concern

According to the current regulations, it is not feasible for CFCs to sell NPLs. Individual loans (including all kinds of loans with individuals as the main borrowers, such as housing, automobile or student loans, credit card debts) cannot be transferred in batches (equal to 10 or more NPLs). Other NPLs sold in a batch can only be assigned to AMCs or a local recognised AMC.

Assessment

CFCs’ business particularity is to grant small ticket loans to multiple individual borrowers. Considering this, it is not practical to dispose of NPLs in batches of less than ten loans. With the development of the CFC industry, a large amount of NPLs accumulated, with CFCs left to dispose of by writing them off. The current regulation regarding NPL batch transfers, the Administrative Measures on Non-Performing Assets Batch Transferring of Financial Enterprises, Ministry of Finance and the CBRC, 2012, mainly aims to prevent the loss of state-owned assets. It does refer to foreign-funded financial enterprises or CFCs.29 Therefore, the working group recommends that these measures apply to foreign-funded financial enterprises, as well as to CFCs. Also, currently batches of NPLs are only allowed to be transferred to financial AMCs and local AMCs. However, in the working group’s opinion, more assignee participants in the market would be beneficial in terms of fair pricing for selling NPLs.

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Recommendations

- Lift restrictions on batch transfers of NPLs in the consumer finance industry; allow compliant CFCs to pilot NPL sales under the framework of selected Free Trade Zones.
- Lower the qualification threshold for NPL assignees and open the primary bad assets market up to additional qualified participants.

2. Broaden Consumer Finance Companies’ (CFCs’) Funding Channels

Concern

For the consumer finance industry, funding has a comprehensive impact on daily operations, but CFCs’ current access to funding remains limited and there is no level playing field among various consumer finance providers in terms of funding channels that are available.

Assessment

From a prudential regulatory viewpoint, it is important that CFCs have an appropriate and diversified funding strategy with strong asset/liability management.

Certificate of Deposits

The working group recommends that CFCs be permitted to take large-sum deposits of CNY 300,000 and above from individuals, and CNY 10 million and above from institutional investors by way of issuing large-denomination certificates of deposits (LDCDs) under the same system that was introduced for commercial banks.

The only purpose of CFCs’ deposit taking and issuance of LDCDs should be to attract direct funds as a source of liquidity for disbursing consumer loans to customers. CFCs should not be given a variety of options on how to use these funds; instead, they should be explicitly restricted to using them only for consumer finance purposes.

Asset-backed Securities (ABS) Market

CFCs are not encouraged to issue ABS on the Yideng platform, and not permitted to issue ABS on securities markets.\(^3\) There is no regulation that specifically prohibits CFCs from issuing ABS on these markets, and CBIRC’s guidance on these issues remains vague. The working group would like to recommend specifying the relevant regulations regarding individual loan assets transfer on the Yindeng platform and reclassifying the nature of Yindeng ABS transactions as beneficiary rights transfers, not credit asset transfers. In terms of CFCs’ access to the securities market, the working group recommends allowing CFCs to issue ABS on the securities market with no restrictions.

Borrowing from Overseas Financial Institutions

The Administrative Measures for the Pilot Scheme for Consumer Finance Companies has specific requirements with regards to the business scope, which stipulates that CFCs are only allowed to borrow money from domestic institutions. At the same time, there is no restriction on such activity by the State Administration of Foreign Exchange (SAFE) and the PBOC. Also, other market players (e.g. financial leasing companies and AFCs) are allowed to enjoy overseas sources of funding. There do not seem to be any substantial reasons for denying the same privilege to CFCs, which by now have become well established and experienced players in China’s domestic funding market.

As an additional measure to improve funding opportunities for CFCs, and to enable those whose main shareholders are based overseas to fully utilise the negotiating strength of their parent groups with international lenders, the working group proposes that CFCs be permitted to borrow from overseas lenders. This will also further remove some differences in regulatory treatment of the various domestic NBFIs with respect to overseas borrowing.

Recommendations

- Allow CFCs to take large-sum deposits 300,000 and above from individuals and CNY 10 million and above from institutional investors by way of issuing LDCDs.
- Stipulate clearly in the relevant regulations on consumer finance companies that CFCs are also allowed to borrow from abroad.
- Allow CFCs to issue ABSs on securities markets and explicitly allow CFCs access to the Yindeng market, considering the nature of the consumer finance business.

3. Allow Auto Finance Companies (AFCs) to Take Deposits from their Non-fully-owned Affiliates

Concern
According to prevailing rules, AFCs are only allowed to take deposits from affiliates that belong 100 per cent to the same group, whereas group finance companies—the main competitors of AFCs—are not restricted in the same way.

Assessment
The current rules hinder AFCs from taking deposits from their joint venture (JV) partners in which they hold equity. This has resulted in wholly foreign-owned AFCs being treated unfairly in comparison to their Chinese partners, especially in terms of equal access to JV liquidity.

Recommendation
• Revise the current AFC rules to allow wholly foreign-owned AFCs to take deposits from their Chinese JVs.

4. Lower the Capital Adequacy ratio (CAR) Requirement Placed on AFCs in a Macro Prudential Assessment (MPA)

Concern
The MPA imposes stricter loan growth restrictions and higher CAR requirements on AFCs, which undermines AFCs’ capability to serve car buyers, dealers and manufacturers.

Assessment
The MPA is a comprehensive regulatory assessment index system with 14 key indicators covering several areas, such as capital and leverage, asset and liability, liquidity, and credit policy implementation. It was introduced by the PBOC in 2016. MPAs are applied to commercial banks, rural banks, financial companies, financial leasing companies, trust companies and AFCs.

China’s auto finance industry witnessed an annual growth rate of more than 30 per cent over the past five years, which is significantly higher than commercial banks’ 13 per cent. In this regard, the auto finance market has huge potential, something that is reflected by its current penetration rate of approximately 35–40 per cent in China compared to 60–80 per cent in other mature automotive markets. Although there is some slight differentiation in the assessment, depending on the type of financial institution, it still does not fully reflect the situation in the auto finance industry.

Considering the potential positive effects of auto financing on both upgrading domestic consumption and supporting the automotive industry, such restrictions may undermine the potential of AFCs to serve the real economy.

By the end of 2017, the stock value of automotive loans by AFCs accounted for approximately 0.7 per cent of the total loan balance of all commercial banks. Since the automotive finance industry is of relatively low systemic importance, the working group believes that appropriate loosening of loan growth restrictions for AFCs would have no negative impact on the whole financial system.

Recommendation
• Lower the MPA-CAR requirement for AFCs by increasing the corresponding tolerance scale.

5. Implement Homogeneous Regulation of the Individual Loan Market

Concern
There are currently a large variety of online and offline consumption loan providers that are all subject to different regulatory treatment, which creates an unlevel playing field and promotes unfair competition, while also raising concerns from a consumer rights protection point of view.

Assessment
At present, the various types of consumption loan providers follow different regulatory rules, which is not conducive to maintaining a fair market environment. The working group would like to suggest that all consumer loan providers should operate within the same regulatory framework. This framework should cover factors such as pricing, provisions, capital adequacy ratios, risk control, loan approvals, corporate governance, credit records management, funding channels and registered capital. The working group suggests that all relevant institutions should abide by The Interim Measures for the Administration of
Consumer Finance Companies issued by the former CBRC. At the same time, we would like to suggest that the regulators continue their recent impressive work on inspecting all types of lenders and punishing non-compliant and illegal acts, so as to ensure that all lenders are properly licensed and operate in accordance with the law. The working group would like to further recommend that all existing regulatory requirements are interpreted and enforced consistently throughout the country.

Recommendations

• Continue implementation of homogenous regulations and their equal enforcement in the consumption loan market.

• Interpret and enforce all regulatory requirements consistently throughout the country.

Abbreviations

ABS  Asset-backed Security
AFC  Auto Finance Company
AMC  Asset Management Company
CAR  Capital Adequacy Ratio
CBIRC China Banking and Insurance Regulatory Commission
CBRC China Banking Regulatory Commission
CFC Consumer Finance Company
CNY Chinese Yuan
DPD Days Past Due
FIE Foreign-invested Enterprise
JV Joint Venture
LDCD Large-denominated Certificate of Deposit
MPA Macro Prudential Assessment
MSE Micro and Small Enterprises
NBFI Non-banking Financial Institution
NPL Non-performing Loan
P2P Peer-to-peer
PBOC People’s Bank of China
SAFE State Administration of Foreign Exchange
SME Small and Medium-sized Enterprise
SOE State-owned Enterprise
Key Recommendations

1. Allow Foreign Insurers to Apply for Branch Licences in More than One Province Per Time Per Year
   - Allow foreign-invested insurance companies to apply at any time for approval licences to open new branches in as many provinces as they believe is necessary.
   - Provide a clear timeline with a clear deadline—ideally within three months—for the approval of new branch registrations.

2. Update and Expand the Existing Regulations on Licences
   - Introduce policies and administrative measures to facilitate the investment of qualified foreign insurers in China’s health insurance industry.
   - Introduce a platform to support the expansion of foreign health insurers to the health provision sector, leveraging their international expertise in integrated healthcare.
   - Increase the maximum amount of premiums that are eligible for tax deductions to realise the growth potential of tax-deductible health insurance products.

3. Clarify the Rules of Foreign Ownership in Insurance Services
   - Exempt domestic shareholders in current 50-50 joint ventures (JVs) from being subject to the Administrative Measures for Equity Interests in Insurance Companies.

4. Create More Opportunities for Foreign Insurers to Contribute to China’s Pension Reform
   - Create more opportunities for foreign insurers to contribute proposals for China’s pension reform.
   - Grant licences for pension insurers or enterprise annuity trustees to select foreign insurers (even on a trial basis) for new pension schemes.
   - Expand the investment scope of enterprise annuity progressively to the offshore market, which will allow foreign insurers and asset managers to participate.

5. Clarify Internet Insurance Business
   - Allow foreign insurance players to set up internet insurance companies.
   - Ensure the equitable and prudent supervision of insurance and technology companies that establish insurance businesses.
Introduction to the Working Group

The Insurance Working Group is the voice of Europe’s insurance industry in China. It represents leading European insurers, brokers and other service providers engaged in life, non-life, reinsurance and speciality insurance. Their services provide peace of mind to both families and businesses across China, and they actively promote the health and security of the economy and the business environment.

Insurance is a form of safety in an unpredictable world – it shields families, individuals and businesses alike from all kinds of risks that may arise from our modern and complex society. Insurance is therefore a force for freedom, as it enables companies and households to spend their resources without having to worry about unforeseen events. Insurance is also a formidable engine of local and regional economic growth because it enables trade, innovation and risk protection.

The insurance industry therefore plays a vital role in improving the livelihoods and wellbeing of all people, which is a key focus of the Chinese leadership.¹

While members of the insurance working group have different operational structures, all of them consider China a long-term priority market. They are fully committed to contributing towards the sustainable growth of the Chinese insurance market and are aware of the crucial role commercial insurance plays in China’s economy and society. To this end, they want to provide added value to the industry by introducing best practices and technical know-how.

Recent Developments

In 2018, foreign-invested insurance and reinsurance companies operating in China saw some significant changes in their industry. As 2017 faded out with its not-yet implemented, high-level announcements on further opening up the market, China’s policy-makers started to issue a series of new regulations and policies the industry had been waiting a long time for. Notable examples are the Measures on Facilitating the Further

Opening Up of the Banking and Insurance Sector,² the Notice on Widening the Business Scope of Foreign-funded Insurance Brokerage Companies,³ both issued on 27th April 2018, and the Notice on Allowing Overseas Investors to Operate Insurance Agencies in China, issued on 19th May 2018. Furthermore, for the first time in recent history, the Chinese authorities granted a full-operating licence to two European insurance companies.⁴⁵

The Insurance Working Group welcomes those developments and appreciates the fact that the China Banking and Insurances Regulatory Commission (CBIRC)⁶ listened to and cooperatively engaged with the industry and its representatives throughout the process that led to the first steps aimed at opening up the sector. The working group believes that continuing along this path of win-win engagement and cooperation will be beneficial for both China and foreign-invested companies.

At the opening ceremony of the 19th National Congress of the Communist Party of China in October 2017, President Xi declared that by 2049—the 100th anniversary of the founding of the nation—China should become “the world’s leading country in terms of national power and international influence.”⁷ If this goal is to be achieved, China needs to truly open up its market to allow world-leading companies enter and compete on an equal footing with its national champions. In order to be a global champion, China must first become a “champion of economic openness”, as President Xi declared in his speech in January

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⁶ The China Banking and Insurance Regulatory Commission (CBIRC) was formed in April 2018, when the former China Insurance Regulatory Commission (CIRC) and the China Banking Regulatory Commission (CBRC) were merged. Thus, this paper will refer to the CIRC for everything that took place before April 2018 and to the CBIRC for all the events that happened after that.

2017 at Davos. Currently, the combined market share of China’s four biggest insurance companies—People’s Insurance Company of China (PICC), Ping An Insurance, China Pacific Insurance Company (CPIC) and China Life Insurance—stands at a painfully conspicuous 60 per cent, against the combined two per cent share of foreign-invested companies. For this reason, the Insurance Working Group advocates for a comprehensive, ongoing dialogue with the CBIRC, with the aim of contributing towards meaningful industry reforms that will finally allow foreign-invested companies to bring their know-how and best practices into China.

In this regard, the new Foreign Investment Law the National People’s Congress (NPC) approved on 15th March 2019 has the potential to initiate a new deal in the financial services sector. According to Li Fei, director of the NPC Constitution and Law Committee, the vague language of the law is due to the fact that it “only sets principles […] and public consultations will not only give foreign businesses the opportunity to comment but will also serve to push the relevant departments to adhere to the original intention of the legislation.” As a result, the working group hopes that, if this is the case, the CBIRC will continue to engage with industry representatives throughout the drafting process and that it will be receptive to recommendations aimed at realising complete and meaningful market opening.

A New Organisation for Industry Regulation
Overall, China’s insurance sector remained focused throughout 2018 on fending off risks and strengthening the regulatory environment, as the industry became increasingly mature and sophisticated. The CBIRC’s focus on risks can be traced back to 2012, when the regulatory body eased licensing requirements and allowed insurers to make high-risk investments and sell high-risk wealth management products. As a result of this reform, Chinese insurance companies became dependent on wealth management products, in particular on universal life products. The main reasons behind the appeal of these products were their flexible surrender terms, high guaranteed annual returns and minimal benefits in case of the death of the insured. However, those flexible surrender terms were also incompatible with the high returns insurance companies had promised to investors. To match investors’ expectations, insurance companies would often invest the income coming from premiums in longer-term, high-risk and illiquid assets. As a result of the duration mismatch between insurance plans and high-risk investments, most of the players in the sector were constantly on the brink of a liquidity crisis.

To stabilise the sector as well as to foster long-term stable growth, the Central Government restructured the regulatory system of the financial sector. More specifically:

• In November 2017, the Central Committee of the Chinese Communist Party, under the auspices of the State Council, established the Financial Stability Development Committee (FSDC). Headed by one of China’s four vice premiers, Ma Kai, the FSDC is intended to be more powerful than a government ministry and to have an influence comparable to the National Development and Reform Commission.

• In March 2018, the China Insurance Regulatory Commission (CIRC) and the China Banking Regulatory Commission (CBRC) were merged to become the CBIRC, which ceded a relevant portion of its former powers to the People’s Bank of China (PBOC) (now responsible for drafting key regulations).

The working group has noticed that the merger between the CIRC and the CBRC is already producing positive results in terms of better supervision of insurance companies, especially regarding fending off risks, compliance and products’ adequacy for clients. Nonetheless, the Insurance Working Group hopes that the regulator can create a new regulatory framework under which all insurance companies—life and non-life insurance companies on one side and banks, consumer finance companies and auto finance companies on the other—can better cooperate and offer new products and services of benefit to the Chinese population, as well as improving their own risk management.

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The ‘General Plan’
In order to solve the issue of excessive risks, the FSDC kicked off a complete restructuring of the financial sector, a process the then CIRC, later CBIRC, declared would last for more than three years in January 2018. The cornerstone of this new deal is the General Plan for Risk Reduction and Reform of the Insurance Industry (General Plan) that was made public on 2nd January 2018. Rather than a law, the General Plan is more of a high-level policy document, which contains all the general principles and policy directives that, since its publication, have shaped a long round of still-ongoing new regulation drafting. The plan seeks to target the solvency of insurers through a stricter enforcement of new and existing regulations.

Stemming from the General Plan are a long list of regulations that are completely reshaping the industry, particularly with regards to three main categories: solvency and use of funds; corporate governance; and consumer protection. For each, the former CIRC and its predecessor, the CBIRC, have released a wide set of policies, and more are expected up until 2021.

Solvency and Use of Funds
As mentioned above, solvency and the use of funds were among the main issues affecting the industry due to the liquidity crisis many companies were facing. For instance, at the end of 2016, roughly 10 per cent of insurance companies in China had solvency levels dangerously close to 100 per cent. As a result, in order to improve the solvency regulatory system and, above all, to prevent the risk of an asset-liability mismatch, on 28th February 2018, the CIRC issued the Notice on Printing and Distributing the Insurance Asset and Liabilities Management Regulations (Nos. 1–5) and Matters Related to their Trial Operation. To increase coordination with the China Risk Orientated Solvency System (C-ROSS) and to tighten the rules on liability management and reporting requirements, the regulatory commission also issued the Notice on Adjusting the Frequency of Submitting Insurance Regulators Including ‘Insured Amount’ and ‘Number of Issued Policies’ on 17th January 2018.

Finally, to prevent insurance companies from investing premiums in high-risk investments or in ‘irrational acquisitions’, on 1st April 2018, the CBIRC implemented the Measures for the Administration of the Utilisation of Insurance Funds.

Corporate Governance and Shareholders’ Qualifications
Another area the CBIRC has targeted to reduce risks is corporate governance. In this regard, the Anbang Insurance Group Co Ltd (Anbang) case is one of the main events that prompted regulators to take action, and a showcase of the CBIRC’s new attitude towards financial risk. Anbang ranked 139th on the Global Fortune 500 list in 2017, and was China’s second biggest insurer, with assets of Chinese yuan (CNY) 1.97 trillion. The company engaged in bold acquisitions abroad, such as the Waldorf Astoria hotel in New York, was characterised by an opaque shareholding structure and, according to the CBIRC, repeatedly violated “laws and regulations which may seriously endanger the solvency of the company.” For this reason, on 22nd February 2018, in an unprecedented move, the CBIRC took over the company and arrested its founder and CEO, Wu Xiaohui, who was sentenced to 18 years in jail.

To prevent other companies from running the same risks, the CBIRC focused its efforts in two areas: independent directors and shareholder qualifications. More specifically, the Notice on Issuing the Administrative Measures for Independent Directors in Insurance Institutions, issued on 30th June 2018, aims to strengthen the role of independent directors in the governance of the company. Furthermore, to ensure the soundness of their judging abilities, independent directors are also

13 Notice on Printing and Distributing the Insurance Asset and Liabilities Management Regulations (Nos. 1–5) and Matters Related to their Trial Operation, CIRC, 28th February 2018, viewed 13th May 2019, <http://bxjg.circ.gov.cn/web/site0/tab5225/info4100777.htm>
15 ‘Irrational acquisitions’ in this instance refers to high-profile investments in foreign countries.
19 ‘Independent directors’ refers to managers that do not hold any post within the insurance firm and have no relationship with the shareholders.
required to have a university education in actuarial science or law and to have relevant professional experience in their field. The measure also specifies that independent directors have to account for at least one third of the board of directors, or for half of it in cases where a shareholder holds 50 per cent or more of the company’s equity. The CBIRC wields great powers to enforce this regulation, including the faculty to nominate its own independent directors if a company refuses to comply.

To further reduce risk in insurance governance, the CBIRC paired the new regulation on independent directors with the *Administrative Measures for Equity Interests in Insurance Companies,* which came into effect from 10th April 2018. By preventing any single shareholder from retaining more than one third of an insurance equity, these measures are aimed at countering the possibility of insurance companies being used as platforms for high-risk investments. Despite the fact that foreign insurance companies are already regulated through the *Regulation on the Administration of Foreign-invested Insurance Companies,* the CBIRC said the *Administrative Measures for Equity Interests in Insurance Companies* will also be applied to these firms, and that its provisions will be considered in their examination and review processes.

**Consumer Protection**

Finally, the CBIRC also released a series of regulations aimed at ensuring a better protection of consumers. To this end, it encouraged the introduction and use of standardised products throughout the industry and vowed to curb illegal fund raising, subsequently issuing the following:

- **Notice on Issuing Basic Rules for Insurance Adjusting (2nd May 2018)**

These measures distort the market, and limit foreign-invested companies' ability to expand within China and compete on an equal footing with their Chinese rivals.

**Key Recommendations**

1. **Allow Foreign Insurers to Apply for Branch Licences in More than One Province Per Time Per Year**

**Concern**

Because foreign insurers are restricted to applying for licences one province at a time—and generally the CBIRC only approves one such application per insurance company per year—their operational capabilities are severely limited, particularly because the procedure lacks a precise timeline.

**Assessment**

The CBIRC’s *Detailed Rules for Implementation of Regulations of the People’s Republic of China on the Administration of Foreign-funded Insurance Companies* limits foreign-invested insurers who wish to apply for licences in China to do so one province at a time. Furthermore, working group members report that the CBIRC generally only approves one such application per insurance company per year. Chinese insurance companies, however, have in the past had no such restrictions, with the big four Chinese insurance companies (China Life, China Pacific, PICC and Ping An) achieving complete penetration in all Chinese provinces. In addition, when a foreign-invested insurance company applies to register a new branch in a new province, its operational capabilities are severely limited by the fact that the procedure lacks a precise timeline.

There are no signs that such intensive regulatory activity will come to an end in the short-term. On the contrary, as announced by the Commission in January 2018, it will continue until 2021.


competitors. Because Mainland China’s territory is so vast, based on the current situation it would take around thirty years for a market entrant to achieve full country coverage if it applies for establishment of provincial branches one by one. Chinese companies, meanwhile, were able to build their branch networks in China at a time when such restrictions were not in place. Such constraints do not exist in Europe, where insurance licences are granted by national regulators for the entire territory of one Member State. Companies approved in one Member State can provide services in all other Member States by way of the ‘European passport’ system, as a result of the freedom of establishment and the freedom to provide services under the Treaty on the Functioning of the European Union. This means that a Chinese insurance company with valid registration in Portugal, for example, can freely provide services in all the other countries of the EU without the need to apply for additional approval.

Recently the CBIRC expressed its intention to limit the ‘blind expansion’ of Chinese insurers wishing to open new branches in new provinces. Nonetheless, the working group believes that, as the big four have already built their networks throughout China, this development will not change anything and will not make the regulatory environment any fairer.

Recommendations
• Allow foreign-invested insurance companies to apply at any time for approval licences to open new branches in as many provinces as they believe is necessary.
• Provide a clear timeline with a clear deadline—ideally within three months—for the approval of new branch registrations.

2. Update and Expand the Existing Regulations on Licences

Concern
Currently, the CBIRC only recognises two types of licences, which negatively impacts the operations of European insurance companies.

Assessment
The Chinese Government has highlighted the importance of the commercial health insurance industry for realising health objectives put forth in the *Healthy China 2030 Planning Outline* (*Outline*). The *Outline* calls for the implementation of preferential policies that encourage consumers to acquire commercial health insurance, and promotes cooperation between commercial insurance companies and medical institutions. Within this context, a series of policies have been put in place to support the sector’s development.

European specialist health insurers have a strong track record of not only offering well-designed products to hundreds of millions of customers around the world, but also empowering them to manage their health via the services they provide. The working group is very keen to bring this expertise and experience to China in order to benefit local consumers.

However, members of the working group have been facing various difficulties after entering the market due to the complexity of the licensing process and the restrictions on foreign ownership. According to previous practices, health insurance companies fall into the same category as personal insurance companies, where the 50 per cent limit on foreign ownership applies. With the relaxation/removal of this restriction, the working group encourages the Chinese Government to also introduce supporting policies and administrative measures to simplify the licensing/approval process of foreign companies’ investments in China’s health insurance sector.

Offering integrated healthcare to local consumers is the working group’s long-term vision for China. Many successful international health insurance companies have established a footprint in health provision businesses to coordinate care for customers. This is also a rising trend among health insurance companies in China. The working group encourages the Chinese Government to introduce a platform for supporting the expansion of foreign health insurance companies into the health provision sector, so that members can leverage their international expertise to provide enhanced care for Chinese consumers.

As one of the major measures that promotes the uptake of commercial health insurance, the Chinese Government launched tax-deductible health insurance

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products nationwide in July 2017. While widely supported by the public, the products’ uptake ratio appears to be below expectations, with one of main causes for this being the relatively low deduction limit of CNY 2,400 per year. Therefore, the working group recommends that the Chinese Government raise the deduction limit to realise its growth potential.

**Recommendations**

- Introduce policies and administrative measures to facilitate the investment of qualified foreign insurers in China’s health insurance industry.
- Introduce a platform to support the expansion of foreign health insurers to the health provision sector, leveraging their international expertise in integrated healthcare.
- Increase the maximum amount of premiums that are eligible for tax deductions to realise the growth potential of tax-deductible health insurance products.

3. **Clarify the Rules of Foreign Ownership in Insurance Services**

**Concern**
Because the *Administrative Measures for Equity Interests in Insurance Companies*—which limits the maximum shareholding percentage to one third for any single shareholder—also apply to a foreign insurer’s JV partner, it has created a conflict with the latest opening up policy announced by the CBIRC, which allows a foreign insurance investor to become the controlling shareholder in a JV by increasing the maximum shareholding from 50 per cent to 51 per cent.

**Assessment**
The *Administrative Measures for Equity Interests in Insurance Companies (Measures)*, 30 released in March 2018, limit the maximum shareholding percentage to one third for any single shareholder. The *Measures* are also applicable to Chinese shareholders in current 50/50 foreign insurance JVs, whenever a change to a minor shareholding occurs in an insurance JV. This means that while a foreign company is now allowed by the CBIRC to increase its shareholding from 50 to 51 per cent, the domestic shareholder will then have to reduce its stake from 50 per cent to one third and sell the rest to a third-party investor. The working group believes that artificially introducing a third party into a JV will create more complexities in shareholder relationships for both Chinese and foreign shareholders, as the stability of the shareholder relationship is very important to the sound development of foreign insurance JVs.

**Recommendation**
- Exempt domestic shareholders in current 50-50 JVs from being subject to the *Administrative Measures for Equity Interests in Insurance Companies*.

4. **Create More Opportunities for Foreign Insurers to Contribute to China’s Pension Reform**

**Concern**
China’s three-pillar pension system—conceptually similar to many European countries but far more imbalanced, with low coverage and insufficient benefit adequacy—is not equipped to cater to China’s rapidly ageing society.

**Assessment**
Since 2014, the Chinese Government and the CBIRC have shown that they are firmly resolved to reform the existing pension system, with a focus on the development of non-public pillars – this includes the second pillar (enterprise annuity) and the third pillar (private pension insurance). Life and pension insurers are expected to benefit from these reforms and to expand their pension businesses accordingly.

However, non-public pillars are still underdeveloped. Enterprise annuity only covered less than 10 per cent of urban employees in 2018, not to mention private pension insurance, the volume of which is negligible. Furthermore, virtually no foreign insurers (including those in JVs with Chinese partners) are actively engaged in China’s pension system.

As many European countries are already confronting the challenges that come with an ageing society, their experience using the three-pillar pension system is more mature and balanced. The central government plays a vital role in building up such a system and facilitating the development of the second and the third pillars by offering tax breaks and subsidies to the insured. Moreover, in some countries, such as Germany, the government leads the establishment of special...

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private pension schemes with rigid criteria for qualified pension providers and prudent risk management. This has greatly encouraged insurers to participate in these schemes and has proven effective in improving the non-public pillars.

The Insurance Working Group believes that European life insurers can play a proactive role in supporting China’s pension system reforms, by leveraging their experience and expertise gained in Europe. The members of the working group support the top-down design of a new pension system and the introduction of more mature pension product concepts and schemes into China, which they believe will eventually benefit the development of the non-public pillars.

**Recommendations**

- Create more opportunities for foreign insurers to contribute proposals for China’s pension reform.
- Grant licences for pension insurers or enterprise annuity trustees to select foreign insurers (even on a trial basis) for new pension schemes.
- Expand the investment scope of enterprise annuity progressively to the offshore market, which will allow foreign insurers and asset managers to participate.

**5. Clarify Internet Insurance Business**

**Concerns**

The licensing criteria for internet insurance companies are not clear due to the lack of policies and regulations in this area, and there is a considerable gap between the supervision of insurance and technology companies.

**Assessment**

Since the launch of a pilot project for internet insurance companies in 2014, few licences have been granted.  

In fact, since 2015, the internet insurance business has been regulated by the CIRC’s *Interim Measures for Regulating the Internet Insurance Business* that allow approved companies to sell online the following insurance products countrywide: accidental personal injury, fixed-term life, life-long, home property and liability insurance.

The *Measures* also allow approved companies to sell their products online either on their own website—the so-called ‘Self-owned Website Model’—or on third parties’ platforms—the ‘Third-party Platform Model’. The *Measures* list as “potential requirements” the fact that to sell insurance products online, companies have to obtain an Internet Content Provider (ICP) licence or, alternatively, conduct “record-filling with the Ministry of Industry and Information Technology (MIIT)”. The main difference between those two potential requirements is that—according to feedback from working group members—ICP licences have rarely, if ever, been granted to foreign companies. Moreover, the practice of “record-filling” with the MIIT has so far only been allowed for websites not aimed at making profit.

Since the *Measures* do not clearly specify in what case and how those potential requirements will be applied, no licence has as yet been granted to any foreign player, many of which have the capability to combine international underwriting and risk management techniques with locally developed and fast-developing information technologies. One application, which involves a foreign player aiming to set up an internet insurance company, has been pending approval for almost four years.

The working group is concerned about future regulatory developments in this field, particularly in relation to the setting-up of an internet insurance company and the reluctance of regulators to allow foreign investment to enter this sector. The Insurance Working Group strongly advocates that both domestic and foreign entities be treated equally with respect to licensing for internet insurance companies, and that foreign insurance companies also be approved, in the ongoing pilot, to set up internet insurance companies in China.

The objective of improving clients’ protection, as expressed in government documents such as the 13th Five-year Plan, requires quality underwriting and risk management techniques, which need to be encouraged and fostered in China. China-licensed foreign players, many of them having over 30 years of international operational experience, possess some of the most advanced systems and know-how regarding distribution and client protection. Moreover, their well-disciplined and mature risk management expertise deserves to be evaluated equally with domestic entities when establishing licensing.
criteria and supporting the expansion of traditional offline business.

The Chinese Government is also promoting protection-orientated insurance as a sound instrument for solving societal and economic issues, along with facilitating wealth management. Meanwhile, technology companies and technology-based service providers, with their large number of clients including private customers and small and medium-sized enterprises, are looking to enter the insurance business. Their ability to collect large amounts of data allows them to set more competitive prices for their insurance products.

The progressively closer integration between insurance and technology is a clear trend and insurance companies and online platforms are currently in a serious competition to control the sector. Nonetheless, this competition is clearly uneven, given that internet companies entering the insurance business do not face the same regulations that limit the growth of traditional players. This is even worse for foreign-invested companies that, after struggling to obtain licenses to expand their operations throughout China, have never been granted any to operate online. Thus, the working group considers it necessary for the financial and technology authorities to align regulations. This would ensure equal treatment of all parties engaged in insurance operations and the establishment of a risk prevention mechanism for all insurance operations.

Recommendations
• Allow foreign insurance players to set up internet insurance companies.
• Ensure the equitable and prudent supervision of insurance and technology companies that establish insurance businesses.

Abbreviations
CBIRC  China Banking and Insurance Regulatory Commission
CBRC  China Banking Regulatory Commission
CIRC  China Insurance Regulatory Commission
CNY  Chinese Yuan
CPI  Creditor Protection Insurance
CPIC  China Pacific Insurance Company
C-ROSS  China Risk Orientated Solvency System
EU  European Union
FSDC  Financial Stability Development Committee
ICP  Internet Content Provider
MIIT  Ministry of Industry and Information Technology
NPC  National People’s Congress
PBOC  People’s Bank of China
PICC  People’s Insurance Company of China
WTO  World Trade Organization
Section Six

Forums
Corporate Social Responsibility Forum

The Corporate Social Responsibility (CSR) Forum is an event-driven platform that regularly organises meetings, training courses and events of interest to all European Chamber members. Established in 2005, it is now comprised of more than 250 member companies that cover a wide range of corporate functions, such as sustainability/CSR, marketing and communications, public relations, government relations, corporate governance and compliance, human resources, the environment, and health and safety.

The CSR Forum promotes best practices already established by European companies and emphasises the importance of a strategic and innovative approach to CSR. The forum fosters CSR collaboration and co-innovation between the European Chamber, Chinese government agencies, professional organisations and local non-governmental organisations.

In 2018/2019, the forum held 25 activities including meetings, seminars, round tables and conferences at locations in both Beijing and Shanghai. Regular forum meetings covered a wide range of topics including corporate sustainability strategy planning, CSR transparency initiatives, corporate volunteerism, the positive impact of CSR programmes on access to education, corporate inclusion employment, environment risk assessment and management, and internal communications on corporate sustainability.

The European Chamber held its second Sustainable Business Awards in 2018, and continues to host dialogues on topics related to CSR through its Corporate Social Profitability CEO/VIP Talk series. The goal of this series is to bring together corporate leaders for high-level discussions on the importance of incorporating sustainability and innovation into strategic decision-making to improve companies’ bottom lines.

The European Chamber established partnerships with governmental stakeholders such as the Dutch Embassy, Swedish Embassy and German Embassy to help promote CSR in the business community. To better promote sustainable trade in China, a Sustainable Trade Task Force was also launched under the CSR Forum. The task force aims to contribute to the development of responsible, competitive and sustainable businesses, by sharing observations and providing recommendations to members of the European Chamber and their supply chain partners who support activities focusing on compliant logistic networks, tackling CSR risks, and greater workplace safety.

In 2019/2020, the Corporate Social Responsibility Forum will continue to foster dialogue between European Chamber member companies and Chinese stakeholders in order to promote best European CSR practices and explore new, innovative ways to act sustainably.
Government Affairs Forum

Established in 2011, the Government Affairs Forum consists of government affairs (GA) professionals from member companies that represent a wide range of industries. Most of the forum’s participants have a great deal of experience in GA and policy advocacy at the local and national level in both Europe and China. This forum is open to all members of the European Chamber.

The overall aim of the Government Affairs Forum is to promote a fair business environment in China, by helping member companies to understand and navigate China’s challenging regulatory landscape, an area that lacks transparency and predictability.

The forum hosts quarterly meetings that feature speakers from academia, industry and the Chinese Government, and has established itself as a platform for sharing best practices and where members can learn more about recently enacted policies and the latest GA trends.

Over the past year, the forum analysed and translated a series of key documents with the aim of subsequently making them available to all European Chamber members. These included the full text of the government work report of the 2019 Two Sessions, the State Council’s Legislative Work Plan of 2018 and the National People’s Congress’ 2018 Legislation Plan.

In 2018, the forum invited Gao Mingze, deputy director general of the Standing Committee of the National Grassroots Party Building Research Centre and editor-in-chief of the New Era Party Building Network, to present the roles the Chinese Communist Party plays in state-owned enterprises and other enterprises. Professor Cui Fan, University of International Business and Economics, Beijing, who is also the deputy general secretary and Standing Council member of the China Society for WTO Studies, Ministry of Commerce (MOFCOM), shared his insights on the influence the new international trade climate is having on foreign-invested enterprises in China.
Marketing and Communications Forum

Members of the Marketing and Communications Forum are marketing and communications professionals from a wide range of industries. It is comprised of more than 400 member companies from the European Chamber’s Beijing, Shanghai and South China chapters. Through regular meetings and events, this forum provides a platform to exchange information, experiences and best practices among member companies on the use of marketing and communications to achieve business objectives in China.

One of the more significant changes that took place in recent years that affects marketing and communications professionals was the introduction by the European Union (EU) of the General Data Protection Regulation (GDPR) in April 2016. The regulation looks to harmonise data privacy laws across Europe for the better protection of EU citizens’ privacy, by placing stricter requirements on companies’ collection of data on EU citizens. Companies were asked to ensure compliance with the GDPR’s new requirements before the regulation took effect on 25th May 2018. Meanwhile, in China, the Personal Information Protection Specification took effect on 1st May 2018. This provides the first concrete guidelines on the data protection provisions outlined under China’s ambitious 2017 Cybersecurity Law.

With many multinational companies in China having European customers, it is important they ensure their marketing departments are compliant with regulations both in China and the EU, especially with respect to dealing with customer data, email marketing, direct marketing and updating privacy policies. In response to these developments, the Marketing and Communications Forum hosted the event GDPR and China’s Personal Information Protection Specification: What Do These Mean for Marketers? to further analyse the potential consequences for European marketers in China.

Throughout 2018, the forum held a number of other events to help members understand the latest marketing technologies. These included: Marketing Analytics and Insights to Drive Growth held in Beijing; WeChat Mini Programmes and Solutions for B2B and How Data Changes Everything for Marketers from Creative to Media held in Shanghai; and Using MarTech to Increase ROI and Achieve Business Development in South China.

In addition, the South China Chapter’s forum also organised a training series on digital marketing, which covered topics including: Outstanding Copywriting for Official WeChat Accounts; Developing Excellent Cooperation with Media; Create a Powerful Visual Strategy for Your Company and Brand; Practical Strategies on Corporate PR Crisis: from Diagnosis Scorecard to Practice Guidelines, and; Getting the Right Customers Through Offline Events.

In the year ahead, the forum will continue to monitor industry trends and organise events to provide cutting-edge insights for members.
Manufacturing Forum

Since its establishment in November 2012, the Manufacturing Forum has kept pace with ever-changing challenges faced by European manufacturing companies in China.

The forum functions as a platform to share practical information between its 118 members and to support their businesses in China. Its membership includes companies from a wide range of industries such as automotive, healthcare, pharmaceuticals, medical devices, home appliances, consumer goods, chemicals, electronics, energy, and consultancies who support manufacturers with a focus on environmental, lean management and quality services.

In 2018, the forum organised 34 activities including networking dinners, factory tours, seminars and training courses. Speakers at these events addressed topics such as: manufacturing line leaders’ management; supplier quality management; project management; business continuity; Made in China 2025; and lean tools implementation. The forum also held several general managers’ meetings to help companies benchmark, share best practices and gain competitive advantages.

The forum has also continued utilising and improving the Manufacturing Forum WeChat group, which is only accessible to general managers of member organisations.

Issues that emerged for discussion in the WeChat group include:
• Regulatory implementation;
• Reliable suppliers’ contact information;
• Requests for help to solve delicate situations, like industrial action;
• Legal discussions on human resources;
• Sharing regulation updates;
• Licence applications and environmental certification; and
• Information-sharing regarding new infrastructure

The Manufacturing Forum is also looking to develop a Medical Device Manufacturing sub-group. This sub-group aims to support members in this category by organising meetings with experts and holding seminars specific to the medical device industry.

In 2019/2020, the Manufacturing Forum will continue to develop the above-mentioned activities and enlighten members on topics such as manufacturing innovation and quality, supplier information, cost deduction, safety and environmental regulations, and tax incentives for hiring employees with disabilities. Innovation and environmental regulation compliance will be areas of particular focus for the forum over the coming year.
Small and Medium-sized Enterprise Forum

The Small and Medium-sized Enterprise (SME) Forum was established in 2005 to provide a platform for European SMEs to share their experiences and gain practical information on how to successfully operate their business in China. This forum is comprised of more than 300 SMEs that span a wide range of industries. Relevant stakeholders also include European and Chinese government officials and SME support service organisations, such as the European Union (EU) SME Centre and China Intellectual Property Rights (IPR) SME Helpdesk.

In China’s increasingly competitive market SMEs face numerous challenges. To overcome these challenges, the forum provides a strong network for companies to share resources and information on the regulatory environment. This forum cooperates with relevant European Chamber working groups to ensure that specific requirements and concerns of SMEs are voiced in the European Chamber’s advocacy activities. Additionally, the forum organises regular workshops on SME-specific issues such as financing, brand-building, talent attraction and retention, and IPR.

In 2018, the Small and Medium-sized Enterprise Forum held 43 activities in the European Chamber’s Beijing, Shanghai and South China Chapters. The themes of these activities included e-Commerce Law, technology transfer, business opportunities in regional cities, digital marketing, pressure and emotion management, mind mapping techniques, Excel training and negotiation skills. Experts also provided clarity on topics like the EU General Data Protection Regulation (GDPR) and industrial standards in medical equipment.

In 2019/2020, the forum will continue to provide regular advice on how new visa regulations will affect EU SMEs in China and organise seminars and training sessions on labour employment management, best practice sharing as well as new regulations and guidelines that impact SME operations. The forum will continue to provide a strong network for SMEs to share solutions to commonly faced problems in their respective industries.
Section Seven
Appendix
## Abbreviations

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<th>Abbreviation</th>
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<tr>
<td>13FYP</td>
<td>13th Five-year Plan</td>
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<tr>
<td>3Rs</td>
<td>Reduce, Reuse, Recycle</td>
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<td>5G</td>
<td>Fifth Generation</td>
</tr>
<tr>
<td>ABS</td>
<td>Asset-Backed Security</td>
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<tr>
<td>ACFIC</td>
<td>All-China Federation of Industry and Commerce</td>
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<tr>
<td>ACS</td>
<td>Auto Component Supplier</td>
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<tr>
<td>ADA</td>
<td>Anti-dumping Agreement</td>
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<td>ADR</td>
<td>Adverse Drug Reaction</td>
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<tr>
<td>AEO</td>
<td>Authorised Economic Operator</td>
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<tr>
<td>AFB</td>
<td>Agriculture, Food and Beverage</td>
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<tr>
<td>AFC</td>
<td>Auto Finance Company</td>
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<tr>
<td>AI</td>
<td>Artificial Intelligence</td>
</tr>
<tr>
<td>AIC</td>
<td>Administration of Industry and Commerce</td>
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<tr>
<td>AICM</td>
<td>Association of International Chemical Manufacturers</td>
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<td>AMAC</td>
<td>Asset Management Association of China</td>
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<td>AMC</td>
<td>Asset Management Company</td>
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<td>AML</td>
<td>Anti-monopoly Law</td>
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<td>AMS</td>
<td>Advanced Manifest System</td>
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<td>API</td>
<td>Active Pharmaceutical Ingredient</td>
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<td>APP</td>
<td>Aviation Partnership Project</td>
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<tr>
<td>AQI</td>
<td>Air Quality Index</td>
</tr>
<tr>
<td>AQSIQ</td>
<td>Administration of Quality Supervision, Inspection and Quarantine</td>
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<tr>
<td>ASCM</td>
<td>Agreement on Subsidies and Countervailing Measures</td>
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<tr>
<td>ATC</td>
<td>Air Traffic Control</td>
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<tr>
<td>ATFM</td>
<td>Air Traffic Flow Management</td>
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<td>ATM</td>
<td>Air Traffic Management</td>
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<td>AUCL</td>
<td>Anti-unfair Competition Law</td>
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<td>B2C</td>
<td>Business to Consumer</td>
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<tr>
<td>BASA</td>
<td>Bilateral Civil Aviation Safety Agreement</td>
</tr>
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<td>BCM</td>
<td>Billion Cubic Metres</td>
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<td>BCS</td>
<td>Business Confidence Survey</td>
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<td>BEV</td>
<td>Battery Electric Vehicle</td>
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<tr>
<td>BIM</td>
<td>Building Information Module</td>
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<td>BIS</td>
<td>Bank for International Settlements</td>
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<tr>
<td>BMI</td>
<td>Basic Medical Insurance</td>
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<tr>
<td>BO</td>
<td>Beneficial Ownership</td>
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<tr>
<td>BRF</td>
<td>Belt and Road Forum for International Cooperation</td>
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<td>BRI</td>
<td>Belt and Road Initiative</td>
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<td>BWTS</td>
<td>Ballast Water Treatment System</td>
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<tr>
<td>CAAC</td>
<td>Civil Aviation Administration of China</td>
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<tr>
<td>CAAM</td>
<td>China Association of Automobile Manufacturers</td>
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<tr>
<td>CAC</td>
<td>Cyberspace Administration of China</td>
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<tr>
<td>CAE</td>
<td>Chinese Academy of Engineering</td>
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<td>CAFC</td>
<td>Corporate Average Fuel Consumption</td>
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<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>CAI</td>
<td>Comprehensive Agreement on Investment</td>
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<td>CAICT</td>
<td>China Academy of Information and Communication Technology</td>
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<td>CAR</td>
<td>Capital Adequacy Ratio</td>
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<tr>
<td>CBIRC</td>
<td>China Banking and Insurance Regulatory Commission</td>
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<tr>
<td>CBRC</td>
<td>China Banking Regulatory Commission</td>
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<td>CCAM</td>
<td>China Customs Advanced Manifest</td>
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<tr>
<td>CCC</td>
<td>China Compulsory Certification</td>
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<tr>
<td>CCDTIA</td>
<td>China Cross-border Data Telecommunications Industry Alliance</td>
</tr>
<tr>
<td>CCP</td>
<td>Central Counterparty</td>
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<tr>
<td>CCPS</td>
<td>Classified Cybersecurity Protection Scheme</td>
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<td>CCS</td>
<td>Carbon Capture Storage</td>
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<tr>
<td>CCS</td>
<td>China Classification Society</td>
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<tr>
<td>CDMD</td>
<td>Consumable and Disposable Medical Devices</td>
</tr>
<tr>
<td>CECS</td>
<td>China Association for Engineering Construction Standardisation</td>
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<tr>
<td>CFC</td>
<td>Consumer Finance Company</td>
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<tr>
<td>CFDA</td>
<td>China Food and Drug Administration</td>
</tr>
<tr>
<td>CFETS</td>
<td>China Foreign Exchange Trade System</td>
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<tr>
<td>CFSA</td>
<td>Centre for Food Safety Risk Assessment</td>
</tr>
<tr>
<td>CGAC</td>
<td>China Quality Supervising and Test Centre for Gas Appliances</td>
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<tr>
<td>CGB</td>
<td>Chinese Government Bonds</td>
</tr>
<tr>
<td>CGHC</td>
<td>China Gas Heating Speciality Committee</td>
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<tr>
<td>CGT</td>
<td>Compensated Gross Tonnes</td>
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<tr>
<td>ChP</td>
<td>Chinese Pharmacopeia</td>
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<td>CIBM</td>
<td>China Interbank Bond Market</td>
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<td>CII</td>
<td>Critical Information Infrastructure</td>
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<td>CIP</td>
<td>Clinical Investigation Protocol</td>
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<td>CIRC</td>
<td>China Insurance Regulatory Commission</td>
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<tr>
<td>CIT</td>
<td>Corporate Income Tax</td>
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<td>CM2025</td>
<td>China Manufacturing 2025</td>
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<td>CMDE</td>
<td>Centre for Medical Device Evaluation</td>
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<td>CNAS</td>
<td>China National Accreditation Service for Conformity Assessment</td>
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<td>CNCA</td>
<td>Certification and Accreditation Administration of China</td>
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<td>CND</td>
<td>China National Drug Administration</td>
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<td>CNIPA</td>
<td>China National Intellectual Property Administration</td>
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<td>CNIS</td>
<td>China National Institute of Standardisation</td>
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<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
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<tr>
<td>CO₂</td>
<td>Carbon Dioxide</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>CoO</td>
<td>Country of Origin</td>
</tr>
<tr>
<td>COP</td>
<td>Conference of the Parties</td>
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<td>CPC</td>
<td>Communist Party of China</td>
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<td>CPCIF</td>
<td>China Petrochemical and Chemical Industry Federation</td>
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<td>CPI</td>
<td>Creditor Protection Insurance</td>
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<td>CPIC</td>
<td>China Pacific Insurance Company</td>
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<td>C-ROSS</td>
<td>China Risk Orientated Solvency System</td>
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<td>CSAR</td>
<td>Cosmetics Supervision and Administration Regulations</td>
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<td>CSEI</td>
<td>China Special Equipment Inspection and Research Institute</td>
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<td>CSIC</td>
<td>China Shipbuilding Industry Corporation</td>
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<td>Abbreviation</td>
<td>Description</td>
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<td>CSP</td>
<td>Construction Service Provider</td>
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<td>CSPFTZ</td>
<td>China Shanghai Pilot Free Trade Zone</td>
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<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
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<td>CSSA</td>
<td>Customs Special Supervision Areas</td>
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<td>CSSC</td>
<td>China State Shipbuilding Corporation</td>
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<tr>
<td>DAL</td>
<td>Delta Air Lines</td>
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<td>DHA</td>
<td>Docosahexaenoic Acid</td>
</tr>
<tr>
<td>DPD</td>
<td>Days Past Due</td>
</tr>
<tr>
<td>DRG</td>
<td>Diagnostic Related Groups</td>
</tr>
<tr>
<td>DRI</td>
<td>Dietary Reference Intake</td>
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<tr>
<td>DVFA</td>
<td>Danish Veterinary and Food Administration</td>
</tr>
<tr>
<td>DWT</td>
<td>Deadweight Tonnage</td>
</tr>
<tr>
<td>EASA</td>
<td>European Aviation Safety Agency</td>
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<tr>
<td>EC</td>
<td>European Commission</td>
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<tr>
<td>ECHA</td>
<td>European Chemicals Agency</td>
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<tr>
<td>ECHI</td>
<td>Europe China Heating Initiative (the Heating Sub-Working Group)</td>
</tr>
<tr>
<td>ECIPPE</td>
<td>European Centre for International Political Economy</td>
</tr>
<tr>
<td>EMIR</td>
<td>European Market Infrastructure Regulation</td>
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<tr>
<td>EPR</td>
<td>Extended Producer Responsibility</td>
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<td>EQS</td>
<td>Environmental Quality Standards</td>
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<td>ERP</td>
<td>Enterprise Resource Planning</td>
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<td>ESMA</td>
<td>European Securities and Markets Authority</td>
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<td>ETS</td>
<td>Emissions Trading System</td>
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<td>EU</td>
<td>European Union</td>
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<td>EUR</td>
<td>Euro</td>
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<tr>
<td>EV</td>
<td>Electric Vehicle</td>
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<tr>
<td>FCEV</td>
<td>Fuel Cell Electric Vehicle</td>
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<td>FCM</td>
<td>Food Contact Material and Article</td>
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<td>FCPA</td>
<td>Foreign Corrupt Practices Act</td>
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<td>FCV</td>
<td>Fuel Cell Vehicle</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>FICLS</td>
<td>Foreign-invested Company Limited by Shares</td>
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<td>FIE</td>
<td>Foreign-invested Enterprise</td>
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<td>FIL</td>
<td>Foreign Investment Law</td>
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<td>Feed-in Tariff</td>
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<td>FSDC</td>
<td>Financial Stability Development Committee</td>
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<td>GI</td>
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<td>GLP</td>
<td>Good Laboratory Practice</td>
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<td>GMM</td>
<td>Genetically Modified Microorganisms</td>
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<td>GPSD</td>
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<td>Infrastructure as a Service</td>
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<td>Independent Automotive Aftermarket</td>
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<td>International Air Transport Association</td>
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<td>Internet of Things</td>
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<td>Internet of Vehicles</td>
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Abbreviations

JAL  Japan Airlines
JV  Joint Venture
km  Kilometre
KR  Key Recommendation
KYC  Know Your Customer
L  Litres
LDCD  Large-denominated Certificate of Deposit
LNG  Liquefied Natural Gas
LPWAN  Lower-power Wide-area Network
LTE  Long Term Evolution
M&A  Mergers and Acquisitions
m/m  mass-by-mass
m³  cubic meters
MAD  Mutual Acceptance of Data
MAH  Marketing Authorisation Holder
MARA  Ministry of Agriculture and Rural Affairs
MED  Marine Equipment Directive
MEE  Ministry of Ecology and Environment
MEM  Ministry of Emergency Management
MEP  Ministry of Environmental Protection
MFA  Ministry of Foreign Affairs
mg  milligrams
MHz  Megahertz
MIIT  Ministry of Industry and Information Technology
MNC  Multinational Corporation
MNCs  Multinational Corporations
MOA  Ministry of Agriculture
MOC  Ministry of Construction
MOF  Ministry of Finance
MOFCOM  Ministry of Commerce
MOH  Ministry of Health
MOHRSS  Ministry of Human Resources and Social Security
MOHURD  Ministry of Housing and Urban-Rural Development
MOJ  Ministry of Justice
MOST  Ministry of Science and Technology
MOT  Ministry of Transport
MOU  Memorandum of Understanding
MPA  Medical Products Agency
MPS  Ministry of Public Security
MRO  Maintenance, Repair and Operation
MRV  Monitoring, Reporting and Verification
MSE  Micro and Small Enterprises
MSS  Ministry of State Security
mtoe  million tonnes of oil equivalent
MVBER  Motor Vehicle Block Exemption Regulation
MW  Megawatt
NAFMII  National Association of Financial Markets Institutional Investors
NB  Narrowband
NBFI  Non-banking Financial Institution
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<tr>
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<th>Full Form</th>
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<td>NDC</td>
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<td>National Development and Reform Commission</td>
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<td>National Energy Administration</td>
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<td>New Energy Vehicle</td>
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<td>Natural Gas</td>
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<td>Non-governmental Organisation</td>
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<td>NO&lt;sub&gt;x&lt;/sub&gt;</td>
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<td>Off-cycle Technology</td>
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<td>OE</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>Original Equipment Manufacturer</td>
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<td>SDO</td>
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<td>SDoC</td>
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<td>UAS Traffic Management</td>
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<td>Vehicle to Everything</td>
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<td>Value-added Tax</td>
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