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2021/2022



The *European Business in China Position Paper 2021/2022* represents the views of the European Union Chamber of Commerce in China. Our working groups, fora and more than 1,700 member companies have together compiled the latest assessments, concerns and recommendations of European businesses operating in China.

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

European Union Chamber of Commerce in China

www.europeanchamber.com.cn

The information contained herein is based on input and analysis from January 2021 to August 2021.

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Message from the President

At first glance, all seems well in the Middle Kingdom, with a significant number of European Chamber members posting record figures for revenue and profit in 2020. After China's impressive recovery amid the unprecedented challenges thrown up by the COVID-19 pandemic, many European firms' China operations found themselves in a position to help stabilise their headquarters and make up for losses incurred in other markets. The Chinese economy looks set to remain strong for decades to come, and the near-term outlook for European companies operating in China is positive overall.

Yet there are troubling signs that China is increasingly turning inwards, as can be seen in its 14th Five-year Plan (14FYP), and this tendency is casting considerable doubts over the country's future growth trajectory.

China's current level of per capita GDP is comparable to that of the economies of Japan, Korea and Taiwan 40 years after they embarked upon their respective market opening and reform programmes. However, data show that, over the last five years, China's growth has already fallen slightly behind where it should be, a trend that could continue if Beijing chooses to dispense with bold market reforms in favour of a more insular approach. China's ambition to cement itself as a global economic superpower is by no means certain.¹

Of greater concern to European Chamber members is the extent to which they will be able to contribute to China's future economic growth.

The programme of bold reforms launched in the late 1970s propelled China forward at breath-taking speed, with the country achieving rapid economic growth through market opening and increased competition. Over the intervening four decades, reforms have vacillated as Beijing sought to balance growth with its conflicting need to maintain economic control. The solution that appears to have been settled upon in order to address these seemingly irreconcilable propositions is 'dual circulation' theory—the core of the 14FYP—adherence to which will require China to deviate from the spirit of the 1970s reforms as it increasingly relies on its own companies to service its vast domestic market.

Worryingly, although China's state-owned enterprises (SOEs) lag the private sector in terms of efficiency and productivity, it appears that they will continue to play a favoured role in the economy because they provide the kind of growth that China's leadership finds safe, predictable and, above all, controllable. In the meantime, it seems China will employ methods to increase control over its vibrant private sector in order to achieve its policy goals,² while finding ways to exclude foreign companies from the market, and particularly from strategic sectors. As one commentator recently noted, "China seems to be more preoccupied with control and power than with allowing free enterprise to help China catch or surpass US technological success."³ Although the costs of such an approach may not be felt for several years, they are considerable and should not be overlooked.

Building more resilient supply chains makes sense in order to counter the kind of challenges that saw production disrupted across multiple industries during the COVID-19 pandemic, but less diversification will ultimately result

1 In a 2020 letter to JPMorgan Chase shareholders, Chief Executive Jamie Dimon made the point that China's path to becoming a dominant economic power is far from clear. "To put this in perspective, America's GDP per person in 2019 was \$65,000 and China's was \$10,000. Even if we do a rather poor job at managing our economy (growing at 2%), our GDP per person in 20 years would be \$85,000. And if the Chinese do a good job managing their economy, their GDP per person in 2040 would still be under \$35,000. While China is well on its way to becoming a fully developed nation, it may face more uncertainty and moments of slower growth in the future (like the rest of us) than in the past." Full text of Jamie Dimon's 'Chairman and CEO Letter to Shareholders', *JP Morgan Chase & Co Annual Report 2020*, JP Morgan Chase, 7th April 2021, viewed 13th August 2021, <<https://reports.jpmorganchase.com/investor-relations/2020/>>

2 This may be achieved by increasing the influence of Party cells in the governance of Chinese private companies, or through direct market interventions, as witnessed in the recent cases involving some of China's high-profile technology giants.

3 Redwood, John, *Investors need to evaluate the impact of growing nationalism*, Financial Times, 12th August 2021, viewed 16th August 2021, <<https://www.ft.com/content/313d8ea9-7732-4b7d-b726-78e4066b15d0>>

in more expensive, yet suboptimal, solutions. Reducing international engagement will necessitate a steady flow of domestic subsidies and the maintenance of tariffs. The corresponding decrease in market competition will also dent China's ambition to become a leader in high-technology sectors and compromise its 2060 carbon neutrality goals, while resulting in a less dynamic and innovative market overall.

In December 2021, China will celebrate the 20th anniversary of its World Trade Organization (WTO) accession, from which it derived, and continues to derive, enormous economic benefits. The European Chamber was founded in 2000 to facilitate the translation of European businesses' expertise into policy recommendations to help China develop its economy, as well as to monitor China's adherence to its WTO commitments. Two decades on, China finds itself at another significant turning-point, and its current level of integration into the world economy means that whichever path it now chooses will have significant global ramifications.

The European Chamber believes that only by continuing along its original path of reform and opening up will China be able to cement its position as a major economic power and become an innovation leader. To that end, we share here the expertise of our member companies in the form of 930 constructive recommendations, made by our 35 working groups and sub-working groups, and stand ready to engage in discussions with the Chinese authorities at all levels to help turn China's ambitions into reality.



Jörg Wuttke
President
European Union Chamber of Commerce in China

ABOUT THE EUROPEAN UNION CHAMBER OF COMMERCE IN CHINA

FOUNDED IN

2000

BY 51 MEMBER
COMPANIES

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 34 working groups and fora representing European business in China.

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WORKING
GROUPS AND
FORA

The European Chamber has more than 1,700 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.

MORE THAN

1,700

MEMBER
COMPANIES

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 (EBOs), which connects European business associations and chambers of commerce from 42 non-EU countries and regions around the world.

Mission Statement

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

- 1 Ensure greater market access and a level playing field for European companies operating in China;
- 2 Improve market conditions for all businesses in China;
- 3 Facilitate networking and communication among members and stakeholders;
- 4 Provide specific, relevant information to its members on how to do business in China; and
- 5 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, which operate 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.



Executive Summary

China's 14th Five-year Plan (14FYP)¹ sets a clear course for the country to reduce its reliance on the rest of the world, before ultimately achieving a high degree of self-sufficiency. The first part of this plan—avoiding over-reliance on any one country—will require China to both diversify and strengthen its existing supply chains. This is a course that several other countries have opted to pursue, largely in response to the coronavirus pandemic having highlighted the fragility of many global supply chains, particularly for crucial goods like medical devices and pharmaceuticals.

However, the pursuit of self-sufficiency is a calculated risk that is being taken on the back of China's belief that, within the next decade or so, it can successfully attain a higher level of innovation and manufacturing capability that will allow it to lead in the technologies likely to define the global economy of the future.² At the same time, China looks set to further reduce the role that foreign companies currently play in its economy—particularly in high-technology sectors—while simultaneously attempting to increase global dependency on its own economy.

The size of its economy and strong gross domestic product (GDP) growth relative to most of the rest of the world seems to have given China the confidence that it can afford to largely go it alone. However, the European Chamber believes that while the potential costs—both to China and foreign companies—will not be felt immediately, they will be extensive and have a long-term, negative impact. They include the following:

- A decrease in foreign direct investment (FDI) as international companies are forced out of, or deterred from, expanding in or even entering the Chinese market.
- A deceleration of innovation capacity due to the continuing, rapid decrease of international talent from developed economies.
- An increase in challenges for Chinese companies attempting to expand globally, as the European banks that provide the cross-border services they rely on to facilitate their expansion into foreign markets face further constraints to do so.
- A significant misallocation of resources, as state support will be increasingly diverted to multiple industries in an attempt to replicate the manufacturing of goods that are already globally available.
- A reduction in access to the core technologies China requires to upgrade its value chains, as developed economies employ tools—such as export controls—in an attempt to force reciprocity.
- An increase in challenges for China to meet its ambitious 2060 carbon-neutral target due to a lack of access to innovative green technologies and solutions that European companies can provide.
- Growing international push-back against perceived mercantilist trade policies, leading to a deterioration of trade and political relations with other countries.

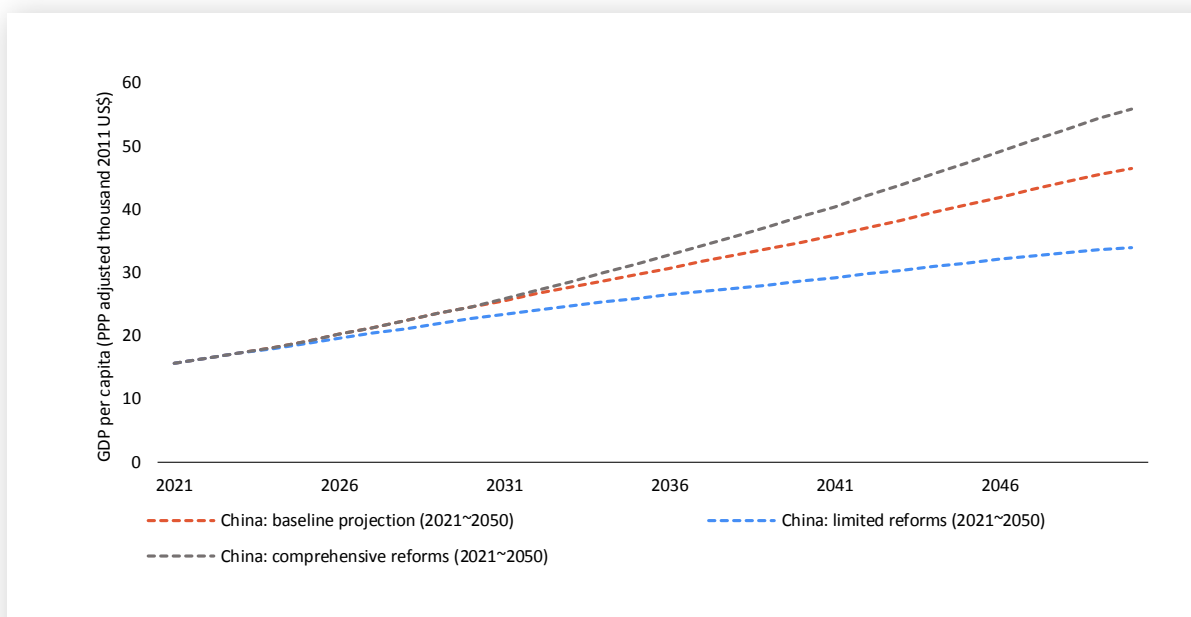
Simply put, the pursuit of self-sufficiency runs contrary to the spirit of comprehensive reform and opening up that China began in 1978, and persisting with this goal will have a direct impact on per capita GDP growth.

¹ Outline of the People's Republic of China 14th Five-Year Plan for National Economic and Social Development and Long-Range Objectives for 2035, Center for Security and Emerging Technology, 12th May 2021, viewed 28th July 2021, <https://cset.georgetown.edu/wp-content/uploads/t0284_14th_Five_Year_Plan_EN.pdf>

² These include semiconductors, fifth-generation mobile technology (5G), artificial intelligence (AI), automation, green technologies, biopharmaceuticals, advanced medical devices, big data, cloud computing, and aerospace and aviation equipment, among others.

This can be seen by viewing the trajectory Mainland China's growth could take from 2021 until 2050, based on three different growth scenarios – a baseline projection, one based on comprehensive reforms and one based on limited reforms. If China were to implement comprehensive reforms to boost productivity growth, after three decades it would attain per capita GDP of approximately United States dollars (USD) 55,876, which is 65 per cent higher than if it were to follow a path of limited reforms.

Output-side real GDP per capita (purchasing power parity- (PPP-) based) with three projections: limited reforms, baseline and comprehensive reforms



Source: World Bank

For these reasons, the European Chamber presents this paper with the recommendations that China instead continues with the spirit of the reform and opening plan it first started in 1978, (re)builds international bridges and recommits to increasing integration into the global economy.

1

Section One

Executive Position Paper

Executive Position Paper

In the mid-1960s, China embarked upon an economic development plan that was dominated not by industrial interests, but by national security concerns. Rather than developing industrial clusters to build economies of scale, robust efficiencies and a concentration of talent and innovation, the plan was to disperse industrial and human capital. The idea of redirecting industrialisation from the coast and river delta areas into China's interior core and hinterlands was to build up a highly self-sufficient industrial base that could serve as a strategic reserve in the event that foreign powers invaded. This was known as the 'Third Front', a movement that served as the core pillar of China's Third Five-year Plan (1966–1970).¹

When China embarked upon economic reform and opening up in 1978, Deng Xiaoping abandoned the 'Third Front' strategy.² The new generation of leaders established Special Economic Zones along the coast, and focussed capital and talent into these areas, which benefitted from close proximity to foreign money and know-how. The seeds for China's economic success were planted in Shenzhen, a small city composed of Chinese people from all over the country, situated just across the border from the international financial centre Hong Kong and containing very few state-owned enterprises (SOEs). Diversity and competition drive innovation, and the blend of people from different backgrounds coming together, with foreign companies acting as catalysts, saw entrepreneurship flourish in South China. Following in the footsteps of the four Asian Tigers,³ this illustrated, once again, how economies bloom when modernisation is prioritised and development is predicated on market opening and competition, drawing on a diverse working population.

This is why it is of growing concern to the European Chamber that, according to the 2021 census, out of Mainland China's total population of over 1.4 billion, only 845,697 are foreign nationals, which represents approximately 0.06 per cent of the total.⁴ Furthermore, the already very low number of foreign workers from developed economies that work in international companies—who tend to make significant contributions to innovation, efficiency and productivity in important areas of the economy—is falling in some key cities.⁵

For example, the foreign populations of Shanghai and Beijing—locations that have historically had a higher density of foreign nationals from developed economies relative to the rest of China—dropped from 208,602 to 163,954 (0.59 per cent of the total) and from 107,445 to 62,812 (0.3 per cent of the the total) respectively from 2010 to 2021.⁶ By contrast, in 2020, Luxembourg had nearly 300,000 foreigners, or

1 Naughton, Barry, *The Third Front: Defence Industrialization in the Chinese Interior*, The China Quarterly, 115, pp 351–386, viewed 28th July 2021, Cambridge University Press, <doi: 10.1017/S030574100002748X>

2 Preen, Mark, *Economic Reform in China: Current progress and Future Prospects*, China Briefing, 3rd April 2019, viewed 28th July 2021, <<https://www.china-briefing.com/news/economic-reform-china-opening-up-future-prospects/>>

3 The four 'Asian Tigers' are the economies of Hong Kong, Singapore, Taiwan and South Korea.

4 By contrast, foreign residents in Japan in 2019 made up about 2.3 per cent of the total population: *Number of foreign residents living in Japan from 2010 to 2019*, Statista, 8th February 2021, viewed 29th July 2021, <<https://www.statista.com/statistics/687809/japan-foreign-residents-total-number/>>; and as of March 2021, foreign residents in South Korea made up around 3.8 per cent of the total population: Yonhap, *Foreign population in S. Korea falls below 2m for 1st time in over 5 years*, The Korea Herald, 27th April 2021, viewed 29th July 2021, <www.koreaherald.com/view.php?ud=20210427000344>

5 While official Chinese statistics, released on 11th May 2021, indicate a total foreign population of 845,667 in Mainland China (or 1,430,695 including residents from Hong Kong, Macau and Taiwan), an increase of 251,865 over the 593,832 recorded in 2010, it is important to put these numbers—and in particular the geographical distribution of international talent—into context. The total number of foreigners living in Beijing and Shanghai, cities that are home to many large multinationals and that have historically had a relatively higher density of talent from developed economies, dropped by just over 28 per cent in the last decade, or 89,281: *How many Foreigners live in China – the seventh national census in 2021*, Registration China, 15th May 2021, viewed 28th July 2021, <<https://www.registrationchina.com/articles/how-many-foreigners-live-in-china/>>

6 The populations provided for Shanghai and Beijing include residents of Hong Kong, Macau and Taiwan.



nearly 49 per cent of the total population.⁷ Given China's increased focus on innovation under the 14FYP, the significance of a decreasingly diverse working population—particularly in cities that are expected to be important drivers of future growth—cannot be overstated.

In addition to a reduction in innovation capacity, a continuing decrease of talent that can add real value to China's economy will also lead to less foreign direct investment, a curtailment of people-to-people exchanges and a decreased understanding of China among headquarters (HQs) located in developed economies.

Unsurprisingly, the largest foreign population recorded in China's 2021 census is in Guangdong Province in South China, at 418,509.^{8,9} Zhang Weiying, professor of economics at Peking University's National School of Development, has written on how cities with larger migrant populations enjoy a higher level of creativity. He references the ratio of long-term residents to the registered population, which is 4.27 times higher than the national average in Dongguan and 3.31 times higher than the national average in Shenzhen, both located in Guangdong Province. "Shenzhen is a typical migrant city," Professor Zhang notes, "Only 35% of its long-term residents are from Guangdong, where Shenzhen is located; the remaining 65% are from other regions of China. This is likely an important driver of Shenzhen's strength in innovation."¹⁰

That much of the rest of China still lags far behind the vibrant south is not only an indication of the importance of having a diverse working population, it also suggests the extent to which China is punching below its economic potential. However, an even more pronounced gap can be seen when comparing China's most innovative private firms with those under state control.¹¹ Given the influence that SOEs have throughout the economy, this has clear implications on China's ability to increase productivity overall, a situation that is set to get worse due to demographic challenges. According to International Monetary Fund (IMF) analysis, "China's economy is only 30 per cent as productive as the world's best-performing economies, such as the US, Japan, or Germany...And as China's ageing population demands more resources for social services, this will place stress on the government's ability to continue propping up growth with government expenditures and state-sector investments."¹²

Until China fully realises comprehensive economic reforms, including pushing SOEs to operate more in line with market forces, and, perhaps most importantly, builds sound institutions, it risks being unable to meaningfully increase its productivity and could find itself stuck in the middle-income trap.¹³

7 Number of foreigners in Luxembourg in 2020, by nationality, Statista, 19th May 2020, viewed 4th August 2021, <<https://www.statista.com/statistics/584918/foreigners-in-luxembourg-by-nationality/>>

8 Note that this number includes residents of Hong Kong, of which there is a very high concentration in the province.

9 Second on the list in 2021 is Yunnan, with a population of 379,281 foreign nationals, however the province is not known for a high density of foreign nationals from developed economies.

10 Professor Zhang also notes that, "Of course, when compared to more internationalized metropolises, Shenzhen's demographic structure is not as diverse. In 2016, New York had a population of nearly 8.36 million, 37.5% of which had originated from outside of the US. In London, 60% of residents were born outside of the city and 34% outside of the UK. Of those born in London, 54.7% had a mother who was born outside of the UK."; Zhang, Weiying, *What China Needs to Do to Become a Real Manufacturing Power*, Caixin, 8th March 2021, viewed 21st July 2021, <<https://www.caixinglobal.com/2021-03-08/zhang-weiying-what-china-needs-to-do-to-become-a-real-manufacturing-giant-101672485.html>>

11 Chan, Bernard, *China's much-maligned SOEs should be seen more as social enterprises*, South China Morning Post, 30th July 2021, viewed 30th July 2021, <<https://www.scmp.com/comment/opinion/article/3143004/chinas-much-maligned-soes-should-be-seen-more-social-enterprises>>

12 Hass, Ryan, *How China is Responding to Escalating Strategic Competition with the U.S.*, China Leadership Monitor, 1st March 2021, viewed 30th July 2021, <<https://www.prcleader.org/hass>>

13 The term 'middle-income trap' "usually refers to countries that have experienced rapid growth and thus reached middle-income status, but then failed to overcome that income range to further catch up to the developed countries."; Glawe, Linda & Wagner, Helmut, *The middle-income trap – definitions, theories and countries concerned: a literature survey*, ResearchGate, May 2016, viewed 23rd July 2021, <https://www.researchgate.net/publication/303229870_The_middle-income_trap_-_definitions_theories_and_countries_concerned_a_literature_survey/link/573c4a2a08aea45ee8416e70/download>; for a more nuanced understanding, please also see: Im, Fernando Gabriel & Rosenblatt, David, *Middle-Income Traps: A Conceptual and Empirical Study*, World Bank, September 2013, viewed 23rd July 2021, <<https://documents1.worldbank.org/curated/en/9699914683339571076/pdf/WPS6594.pdf>>

While a full 'Third Front' is unthinkable in 2021, the European business community in China has observed an unsettling trend of economic policy-making once again being increasingly influenced by national-security concerns. The emergence of a 'technology third front' was precipitated by reactions to the shift in US policy towards China under the Trump Administration.

This deterioration in US-China relations ultimately prompted China's state planners to reinvigorate the push to increase self-sufficiency, due to fears of eventually being cut off from key technologies and supply chains originating from liberal democracies that have been characterised by one prominent Chinese official as being "determined to halt China's rise."¹⁴ To neutralise this perceived threat, policy-makers are trying to quickly attract foreign technology providers deemed essential for China's industrial upgrading process, such as in chemicals and industrial machinery, to onshore and secure access to these critical inputs, while at the same time preserving market share for hand-picked local technology champions that are expected to create an ecosystem that will allow China to largely 'go it alone'. This can be seen, for example, in the shielding of domestic digital service providers from foreign competition, the copious amounts of state aid flowing to China's semiconductor industry and China's increased divergence from international standards.

State planners' localisation demands and the push for dominance of indigenous technology is also impacting public, and even private, procurement of network equipment and telecommunications services. One of the most blatant examples is the '3-5-2' policy from 2019, a directive released by the Chinese Communist Party's Central Office in retaliation against the US placing limitations on Huawei and ZTE in its market.¹⁵ Under the '3-5-2' policy, the use of foreign hardware and software is to be reduced in Chinese government offices by 30 per cent in two years, 50 per cent in four, and the remaining 20 per cent in six.¹⁶

The *Regulation on Security Protection for Critical Information Infrastructure (CII Regulation)*,¹⁷ released by the State Council, is also having a considerable, negative impact on European companies.¹⁸ Requirements under this vaguely-worded regulation are not a problem exclusive to CII operators either. Companies that supply to CII operators are also going to be, or already are being, badly affected.

There are also sectoral initiatives that are pushing foreign companies to localise operations. European banks, for example, anticipate that not only will the material costs of localising their equipment be extensive, they will also be forced to partly disconnect from their global systems. This means that they will be increasingly constrained in their ability to provide cross-border services—one of the few areas in which they can currently add value in the Chinese market—which will have negative consequences for both their foreign clients in China and their Chinese clients looking to expand overseas. The result is that some European banks are now having to consider increased onshoring of their business.

Of course, this is not an option for those banks in China that only provide cross-border services – unfortunately, some have already recently taken the decision to exit the market, and more may soon have to follow suit. For others, they will need to contemplate the costs of localisation and whether it still makes sense to compete with Chinese banks in the few niche areas in which they will still be able to operate. For

14 Martin, Peter, *China's Wolf Warriors are Turning the World Against Beijing*, Bloomberg, 8th June 2021, viewed 15th July 2021, <<https://www.bloomberg.com/news/articles/2021-06-08/china-s-wolf-warriors-are-turning-the-world-against-beijing>>

15 Miller, Maggie, *Lawmakers dismiss Chinese retaliatory threat to US tech*, The Hill, 11th December 2019, viewed 9th August 2021, <<https://thehill.com/policy/cybersecurity/473986-lawmakers-dismiss-chinese-retaliatory-threat-to-us-tech>>

16 Liu, Nian & Yang, Yuan, *Beijing orders state offices to replace foreign PCs and hardware*, Financial Times, 9th December 2019, viewed 29th July 2021, <<https://www.ft.com/content/b55fc6ee-1787-11ea-8d73-6303645ac406>>

17 *Regulation on the Security Protection for Critical Information Infrastructure*, State Council, 30th July 2021, viewed 17th September 2021, <http://www.gov.cn/zhengce/content/2021-08/17/content_5631671.htm>

18 *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, viewed 29th July 2021, <https://www.eurochamber.com.cn/en/publications-archive/917/Business_Confidence_Survey_2021>



larger banks, it could still be worth staying, but for smaller and medium-sized banks the additional costs may not be justifiable and market exit may be their only choice.

The intersection of increasing securitisation and self-sufficiency is also observable in China's 'autonomous and controllable' (A&C) technology guidelines. These guidelines encourage Chinese companies to avoid the use of foreign technologies that the Chinese Government fears could be cut off by other countries, in favour of domestic technologies. A&C nomenclature has been increasingly referenced in business discussions between European and Chinese companies, and is expected to have a negative impact on business by 34 per cent of respondents to the European Chamber's *Business Confidence Survey 2021* (BCS 2021).¹⁹ European Chamber members, particularly those in industries prioritised by Chinese state planners to become more self-sufficient under the 14FYP, note that more and more customers are warning them that although they are still eager to source from foreign suppliers, it may soon be unfeasible for them to do so. While currently quite limited in impact, European Chamber members anticipate that A&C requirements will grow, and fear that if China's economic policy continues to be increasingly influenced by national security concerns, they may eventually be seen as 'unreliable'.

Despite this list of growing concerns, some European companies in China will benefit from remaining and even expanding in the market. Notwithstanding the enduring regulatory obstacles, the uneven playing field and the increasingly politicised business environment, China will contribute more than a fifth of global GDP growth over the next five years, up until 2026, based on IMF forecasts.²⁰ For many companies, the Chinese market is simply too important to neglect. However, the size of China's market alone does not guarantee success. By combing through the details of the 14FYP it is possible to identify the areas of China's economy where it makes sense to increase investment, as well as those that will hold far fewer, if any, opportunities over the coming decades.

Many have noted the 14FYP's lack of binding growth targets and its vagueness on a number of key structural reform issues, but its increased focus on quality growth may well provide an advantage to European companies that are positioned to bring high-quality technologies to the Chinese market. If China were to follow a principle of setting more general targets and allowing the market to find solutions, this would be more in line with the European Union's (EU's) approach. As noted in the European Chamber's 2017 study *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*, "European Member States focus primarily on facilitating the process of innovation and technological development." However, as the study goes on to note, for this to be a workable approach it also requires "the establishment of strong institutions; protection of intellectual property (IP); support for R&D in universities and public research centres (without assigning technological pathways through which innovation is meant to take place); ensuring small and medium-sized enterprises (SMEs) have an opportunity to contribute; and by being a highly demanding customer in public procurement."²¹

With the 14FYP continuing down the path of self-sufficiency, European enterprises will need to adjust their current strategies accordingly. All companies will need to take seriously the push for technology localisation, which may necessitate integration into systems that are incompatible with their global operations. For some companies, the costs may be worth it in order to remain compliant and maintain their licence to operate. For other, mostly smaller, companies, the expense will prove excessive and precipitate market exit, which will further diminish China's innovation ecosystem and disincentivise many

¹⁹ Ibid.

²⁰ Tanzi, Alexandre, *China's Growth Set to Drive World Economy in Post-Pandemic Years*, Bloomberg, 6th April 2021, viewed 15th July 2021, <<https://www.bloomberg.com/news/articles/2021-04-06/china-s-growth-set-to-drive-world-economy-in-post-pandemic-years>>

²¹ *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*, European Union Chamber of Commerce in China, 7th March 2017, viewed 29th July 2021, <<https://www.europeanchamber.com.cn/en/china-manufacturing-2025>>

start-ups from investing in the Chinese market.

However, as already alluded to, a company's success will depend largely on the industry they are operating in and their ability to facilitate China's policy goals:

- The red carpet is being rolled out for those who have technology that China needs for its overall industrial upgrade and to meet its decarbonisation targets – machinery, chemicals and semiconductors are welcome, as are green energy and environmental services.
- Those in consumer goods, like automotive; many services, such as consulting and healthcare; or in financial services, like insurance and banking, are seen as valuable to have onshored for the sake of growth and competition.
- Network equipment, telecommunications services and most things digital are increasingly unwelcome, officially on the grounds of national and economic security, although also for the purpose of preserving market share for indigenous providers.

It is now essential for HQs to strengthen their connections with their China operations and work together to formulate strategies that can help them to thrive in this new reality, and to ensure that there is alignment between local and global teams.

The EU and its member states must also face these new challenges. Sound, well-informed policy and strategies for economic competition with China and its protected national champions in third markets, as well as areas for cooperation, can only be formulated with a comprehensive understanding of what is happening on the ground.

The European Chamber believes that China is better off being integrated into the global economy—as are European companies—and stands ready to share its insights with all stakeholders on how best to engage with the challenges and opportunities on the horizon. To that end, the *European Business in China Position Paper 2021/2022* offers 930 constructive recommendations, formulated by the European Chamber's 35 working groups and sub-working groups, on how China can unlock its full potential and how European Chamber member companies can play a significant role in helping to achieve that goal.

National Security and Self-sufficiency

- As China's definition of 'national security' expands, European companies experience an exponential increase in challenges and a loss of business opportunities.
- Extensive requirements under China's Cybersecurity Law will likely see some European players being forced out of the market.
- For the time being, Beijing seems willing to accept the immediate costs of maintaining tight control over its economy.
- While China's economy will still contribute significantly to global growth in the coming years, it will perform well below its potential.
- The true impact of sacrificing economic vibrancy on the altar of political stability will not be felt for many years.
- China's plan to increase self-sufficiency will continue to create frictions with other major economies.
- By reducing the role that European companies play in its economy, China's innovation drive will decelerate.



European companies report a significant rise in challenges related to China's expanding definition of 'national security' and its goal of achieving a greater degree of self-sufficiency. While there are a wide variety of ways in which European companies are impacted by these two trends, they are most negatively affected by increasing technological divergence, as China moves towards a less globally-integrated information and communications technology ecosystem. In response, European companies are either embracing technology localisation to remain in the China market, or are looking for ways to maximise profits before being pushed out.

This comes at a considerable cost to China, with higher-quality, more-sustainable growth being surrendered in order to meet its self-sufficiency goals. This can be seen, for example, with SOEs being favoured to lead in strategic areas of the economy, such as carbon neutrality efforts, despite substantially lagging the private sector in terms of productivity,²² as well as innovation capacity.

Meanwhile, privately-owned enterprises are increasingly being pushed to align with China's political objectives, which further constrains innovation and growth. For example, political influence over China's private sector has been accelerated dramatically since 2012, following an increase of Chinese Communist Party units, known as party cells, in companies, with the mission of strengthening their role in human resources and management functions. The penetration of smaller companies is just under 50 per cent, largely due to the fact that "they do not employ three party members, the minimum [required] to form a cell." However, "[p]enetration of large private companies is, by contrast, almost total, with over 92% of China's top 500 private enterprises hosting party cells."²³

An additional cost of pursuing self-sufficiency is that it will exacerbate existing geopolitical tensions and increase the already widening gulf between China and its partners in the West. However, while China's economy continues to grow, the perception among its leaders seems to be that the strategy is working and is therefore worth sticking with, despite the risks.

The ever-expanding national security umbrella

Legitimate national security concerns will always impact what foreign companies are permitted to do in any given market, and this is factored into decision-making processes. However, the use of vague and broad language for what is designated a national security concern in China makes it extremely challenging for companies to make well-informed decisions and adjust investment strategies accordingly. This is resulting in foreign companies missing out on business opportunities, or even being pushed out of markets they had previously been allowed to operate in. While this issue manifests in many different ways, one of the more common is with regard to critical information infrastructure (CII).²⁴

Critical information infrastructure

Outlined under the Cybersecurity Law (CSL), CII operator requirements are potentially extensive, and may be applied according to an exceedingly broad definition.²⁵ The term captures any information infrastructure which, if destroyed, disabled or leaked from, would result in a threat to national security,

²² *People's Republic of China: Staff Report for the 2020 Article IV Consultation*, International Monetary Fund, 2nd December 2020, viewed 9th August 2021, <<https://www.imf.org/en/Publications/CR/Issues/2021/01/06/Peoples-Republic-of-China-2020-Article-IV-Consultation-Press-Release-Staff-Report-and-49992>>

²³ *Influence Without Ownership: The Chinese Communist Party Targets the Private Sector*, Institut Montaigne, 26th January 2021, viewed 4th August 2021, <<https://www.institutmontaigne.org/en/blog/influence-without-ownership-chinese-communist-party-targets-private-sector>>

²⁴ *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, viewed 29th July 2021, <https://www.europeanchamber.com.cn/en/publications-archive/917/Business_Confidence_Survey_2021>

²⁵ Ramsey, Carly & Wooltiff, Ben, *China's cyber security law: the impossibility of compliance?*, Control Risks, 20th May 2017, viewed 29th July 2021, <<https://www.controlrisks.com/our-thinking/insights/chinas-cyber-security-law>>

national welfare or the public interest. Some Chinese officials have suggested that supply chain security could also be a qualifying factor, meaning that disrupted, or the removal of, access to certain components or software required for a piece of network equipment could also constitute a threat.

Requirements under the regulations demand that network equipment and service providers of what constitutes CII undergo a national security review, a process that involves up to 13 of the different ministries/departments that oversee the rules. The broadness of the definitions contained within the regulations is resulting in CII operators taking a highly conservative approach to avoid non-compliance. This is having a vertical impact on the supply side of network equipment and services (those that provide them, the category that most European companies are likely to fall into), and a horizontal impact on the demand side (those that procure them), which comes not only at a direct cost to China's economy, but also to competition, as a more risk-averse business environment is not conducive to innovation.

CII requirements impact network equipment and service providers the most

European companies that provide customers with network equipment and services are experiencing the worst impacts of the CII requirements. Essentially, this includes European telecommunications equipment makers and service providers, including those that produce or service hardware and/or software in the affected areas, such as smart city applications, data storage and processing, and certain kinds of industrial software.

Many of the impacted European suppliers of these goods and services are attempting to adjust their strategies to stay afloat in the China market, which generally means more intensive localisation of supply chains, and research and development (R&D), to boost their perceived reliability. Some of the most negatively-impacted suppliers have already acknowledged in discussions with the European Chamber that their days are numbered, and that market exit is inevitable.

CII requirements trigger decoupling from HQs

While it may be a relatively easy decision for some Chinese customers to cease procuring European equipment or services, European and other foreign customers are finding themselves in an awkward position as they too have to decide how to deal with the new requirements.

The first challenge is how to manage their China operations on the technical side. Any European companies that supply to CII operators might need to undergo a national security review before they can supply new network equipment or services in China. Some CII operators that have used foreign suppliers for decades must now consider whether or not to maintain those European suppliers, as their 'foreignness' may well influence the review process and outcome. This may also impact the sub-suppliers of those European suppliers.

Second is how to manage interoperability and connections with global operations. Those that have switched to local Chinese ICT service suppliers, may find themselves cut off from their global networks. One of the most competitive things about multinational companies is their ability to leverage global systems when they enter a market. However, too much localisation can lead to interoperability issues with global systems. There is also the potential for clashes with China's rigid data governance model, which may make it difficult or even impossible to transfer certain data across the border. As such, many European Chamber members have reported that they are looking into 'island solutions', whereby they effectively decouple their China systems from their global ones to comply with local rules and maintain



effective operations to the greatest extent possible.

Security review or behaviour regulation?

Under rules issued by the Cyberspace Administration of China (CAC), within the framework of the vaguely-worded Data Security Law,²⁶ Chinese companies that store data on more than one million users must undergo a cybersecurity review before they can list overseas.²⁷ It is this rule that served as a pretext for putting DiDi Chuxing's initial public offering (IPO) on ice, after it had raised USD 4.4 billion from global investors. DiDi's app was removed from local app stores for the duration of the investigation.²⁸ This move spread alarm among global investors, particularly as it came in the wake of Ant Group's IPO suspension,²⁹ and many are now wondering if the potential rewards of buying into China's technology giants outweigh the risks. The increasingly visible hand of Beijing in China's financial sector must now be taken into consideration.

Although concern over data security was the official reason for launching the review of DiDi, some analysts have speculated that there is an important subtext to this story: that China wants to discourage its technology giants from listing in the US, and steer them towards listing in Hong Kong instead.³⁰ That would certainly give Beijing a greater sense of control over its companies, as it seeks to mitigate any potential fallout from spiralling tensions with the US, which to a large extent are derived from both the struggle to control certain technologies and the threats to delist Chinese companies from US stock exchanges.

The US' promulgation of the Holding Foreign Companies Accountable Act,³¹ which requires all public companies listed in the US to comply with American accounting standards and disclose if they are controlled by a government, has raised the risk that some companies may be forcibly delisted from US bourses by the end of 2024.³² While not specifically targeting Chinese companies, the law is seen as a *de facto* ban on their listing on US exchanges, with Chinese companies stating that China's National Security Law prohibits them from handing over accounting information to the US Public Companies Accounting Oversight Board.³³

Beijing's recent interventions in DiDi's IPO do not appear to have been solely geared towards trying to enforce discipline among its technology giants—many of whom have benefitted from a historical lack of market regulation in their respective segments—as has been argued by some. The fact that China's leadership is struggling to find the balance between developing a dynamic economy while maintaining control is also a factor. As argued by Rhodium Group, “China's leaders must confront this trade-off”, before concluding that “sustainable economic efficiency and political omnipotence do not go hand in

26 China's new cyber-security law is worryingly vague, The Economist, 3rd June 2017, viewed 29th July 2021, <<https://www.economist.com/business/2017/06/01/chinas-new-cyber-security-law-is-worryingly-vague>>

27 Measures for Cybersecurity Review (Revised Draft for Comments), CAC, 10th July 2021, viewed 21st July 2021, <http://www.cac.gov.cn/2021-07/10/c_1627503724456684.htm>

28 Pacheco, Filipe & Turner, Matt, DiDi Plunges Below IPO Price as China Expands Crackdown, Bloomberg, 6th July 2021, viewed 21st July 2021, <<https://www.bloomberg.com/news/articles/2021-07-06/didi-slumps-after-china-regulators-order-stores-to-remove-app>>

29 Kharpal, Arjun, Alibaba shares dive 7% as Ant Group's record \$34.5 billion IPO is suspended, CNBC, 3rd November 2020, viewed 9th August 2021, <<https://www.cnbc.com/2020/11/03/ant-group-ipo-in-shanghai-suspended.html>>

30 Lee, Georgina & Yiu, Enoch, Hong Kong to benefit from Beijing's DiDi crackdown, IPO rules overhaul, analysts say, South China Morning Post, 13th July 2021, viewed 21st July 2021, <<https://www.scmp.com/business/companies/article/3140825/hong-kong-benefit-beijings-didi-crackdown-ipo-rules-overhaul>>

31 Bill forcing Chinese firms to meet US accounting standards passes Congress, CNBC, 2nd December 2020, viewed 30th July 2021, <<https://www.cnbc.com/2020/12/02/bill-forcing-chinese-firms-to-meet-us-accounting-standards-passes-congress-.html>>

32 Bray, Chad, US ratchets up pressure on Chinese firms to share audits as failure to comply could lead to delisting from American bourses, South China Morning Post, 14th May 2021, viewed 21st July 2021, <<https://www.scmp.com/business/banking-finance/article/3133487/us-ratchets-pressure-chinese-firms-share-audits-failure>>

33 Bain, Ben, Chowdhury, Naoreen & Smallberg, Michael, Why the U.S. is Threatening to Delist China Stars Like Alibaba, The Washington Post, 1st April 2021, viewed 21st July 2021, <https://www.washingtonpost.com/business/why-the-us-is-threatening-to-delist-china-stars-like-alibaba/2021/03/30/a65f7d32-9117-11eb-aad6-af78701a30ca_story.html>

hand.”³⁴

The DiDi case highlighted the fact that China’s approach of allowing companies to grow rapidly in a relatively unregulated market, only to tighten the net once it senses a lack of control, creates a demonstrably unpredictable investment environment, which has global implications. This underscores the importance of taking a more holistic approach to market governance, by ensuring that sound institutions, underpinned by strong rule of law, are put in place.

Dual circulation

China’s drive for self-sufficiency is exemplified by its ‘dual circulation’ theory, a central pillar of the 14FYP.^{35&36} According to the Center for Strategic and International Studies (CSIS), the justification for dual circulation is rooted in Beijing’s conviction that China now finds itself being subjected to increasing hostility from external actors in a more volatile global environment, “with new opportunities afforded by a floundering and listless United States, which China has long viewed as its most important geopolitical rival.”³⁷

Dual circulation elaborates China’s plan of tapping into the unexploited potential of its huge domestic market in order to become a global leader in intelligent manufacturing and the technologies that will define the future, such as semiconductors, fifth generation mobile technology (5G), artificial intelligence (AI), automation, biopharmaceuticals, advanced medical devices, big data and cloud computing, among others. Key to this will be finding the right balance that will enable China to still engage with foreign capital markets and technologies when advantages can be gained, while reducing its dependence on the global economy.

China has previously attempted to achieve a higher level of technological ability and self-sufficiency through the use of industrial policy that supports hand-picked national champions to become leaders in strategic industries. A prime example of this is its *Medium- to Long-Term Programme for the Development of Science and Technology*,³⁸ the guiding principles of which were reiterated in the Strategic Emerging Industries initiative in 2010,³⁹ and then again in the China Manufacturing 2025 (CM2025) initiative, released in 2015.⁴⁰ It has also used its market access regime as an additional lever to spur developments in this regard. In some industries, foreign investors’ market access is restricted in order to preserve market share for local players; in others, market access is granted either to create competition that can condition indigenous companies, or to encourage the onshoring of the production of goods that Chinese consumers would buy in any case.

However, new tools are now being brought to bear with the aim of China achieving greater self-sufficiency. For instance, European companies in China report that they face growing pressure as a result of A&C

34 Kempe, Frederick, *Op-Ed: The crackdown on DiDi and companies like it could cost China as much as \$45 trillion in new capital flows by 2030*, CNBC, 10th July 2021, viewed 21st July 2021, <https://www.cnbc.com/2021/07/10/op-ed-crackdown-on-didi-and-companies-like-it-could-cost-china-as-much-as-45-trillion-by-2030.html?__source=sharebar>

35 Wong, Dorcus, *What to Expect in China’s 14th Five Year Plan? Decoding the Fifth Plenum Communique*, China Briefing, 12th November 2020, viewed 29th July 2021, <<https://www.china-briefing.com/news/what-to-expect-in-chinas-14th-five-year-plan-decoding-the-fifth-plenum-communique/>>

36 Cheng, Evelyn, *China’s Ministry of Commerce plans to scrutinize foreign investment more closely*, CNBC, 9th July 2021, viewed 29th July 2021, <<https://www.cnbc.com/2021/07/09/chinas-ministry-of-commerce-to-scrutinize-foreign-investment-more-closely.html>>

37 Blanchette, Jude & Polk, Andrew, *Dual Circulation and China’s New Hedged Integration Strategy*, CSIS, 24th August 2020, viewed 15th July 2021, <<https://www.csis.org/analysis/dual-circulation-and-chinas-new-hedged-integration-strategy>>

38 *The Medium- and Long-Term Programme for Science and Technology Development (2006–2020), An Outline*, State Council, December 2005, viewed 21st July 2021, <https://www.itu.int/en/ITU-D/Cybersecurity/Documents/National_Strategies_Repository/China_2006.pdf>

39 *China’s Strategic Emerging Industries: Policy, Implementation, Challenges, and Recommendations*, The US-China Business Council, March 2013, viewed 2nd August 2021, <<https://www.uschina.org/sites/default/files/sei-report.pdf>>

40 *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*, European Union Chamber of Commerce in China, 7th March 2017, viewed 2nd August 2021, <https://www.eurochamber.com.cn/en/publications-archive/473/China_Manufacturing_2025_Putting_Industrial_Policy_Ahead_of_Market_Force>



requirements. This term basically encourages the adoption of technologies that cannot be disrupted by external factors. In plainer terms, China's state-planners want its companies to use technology that cannot be restricted or cut off by foreign states, the US in particular. Intended or otherwise, A&C guidelines are being interpreted by Chinese businesses in a broad manner, and European companies report that they feel pressure over the origin of the components and equipment they use, especially with regard to software and digital solutions.

Case study: how self-sufficiency in the aluminium industry could impact China's 2060 ambitions

China's drive to increase self-sufficiency is not restricted to high-technology sectors. Aluminium smelting encapsulates the costs that can result from divergence between China's 2060 carbon neutrality goals and its self-sufficiency ambitions.

For the past two decades, China has been the world's largest producer and consumer of aluminium, satisfying almost all of its demand with its own production. But its industry is still largely inefficient and undisciplined.⁴¹

Measures to curb structural overcapacity in the industry—characterised by multi-year surpluses, high inventories and a seemingly infinite smelter capacity—have not yet been extended to address the fact that subsidies provided in order to achieve a greater degree of self-sufficiency and empower SOEs are the enablers of cheap production, which in turn is the root cause of overcapacity.

Smelting aluminium requires vast quantities of electricity, and the bulk of China's aluminium production is coal-dependent, with an estimated half being derived from subcritical coal burners, the least efficient and most polluting kind. According to 2020 data, China's aluminium sector had 74.6 gigawatts (GW) of coal-dependent captive power plants, of which 40 GW was provided by subcritical burners.⁴²

With decarbonisation now a priority issue—and China pushing for a 2030 carbon peak and 2060 carbon neutrality—policy-makers must find a way to bring the country's aluminium industry in line with these goals.

China has so far focussed on moving millions of tonnes of smelting capacity from the coal-rich northeast to the hydro-powered south (mainly Yunnan Province), but this entails significant costs. The power shortages experienced in Guangdong Province in 2021 have also highlighted the importance of ensuring that old industries' access to green energy is not prioritised at the expense of new industries.

Importing aluminium would be a far more affordable, and greener, option. For example, Russia—with its plentiful resources of hydro-power—presents a viable partner, as it produces some of the lowest-carbon aluminium on the market and has an increasingly strong relationship with China.

So, while dual circulation will result in the opening up of some doors to foreign investment and some foreign companies in certain sectors receiving better treatment, it will also inevitably result in some doors

⁴¹ Home, Andy, *Column: Is China nearing peak aluminium after record 2020 output?*, Reuters, 22nd January 2022, viewed 21st July 2021, <<https://www.reuters.com/article/us-metals-aluminium-ahome-idUSKBN29R1TG>>

⁴² Yang, Muiyi & Wu, Yixiu, *Aluminium: A barometer for China's green recovery*, China Dialogue, 15th April 2021, viewed 21st July 2021, <<https://chinadialogue.net/en/business/aluminium-a-barometer-for-chinas-green-recovery/>>

being, or remaining, firmly shut. As described in the report *Decoupling: Severed Ties and Patchwork Globalisation*, enterprises will find themselves either in 'business class', 'economy class' or the 'cargo hold', depending on which sector they are operating in and the extent to which they can help China to achieve its policy goals.⁴³

Business class

In industries where China needs foreign technology or expertise to upgrade its value chains, European companies are being handed business class tickets. This is particularly so in areas upstream where disruption would limit the ability of domestic companies further downstream to improve the quality of their production. Chemicals and financial services are recent examples where thresholds for investment have been lowered and onshoring encouraged.

Economy class

Most business-to-consumer industries fall into economy class. China's increasingly prosperous and discerning middle class have greatly benefitted from the economy's opening up to European consumer goods. Restricting their ability to consume the same goods and services that are available elsewhere in the world would likely not go down well, although access to consumer goods could be disrupted in a more targeted way, such as through boycotts, making it less harmful than interference with business-to-business goods, which would ripple across multiple sectors. Therefore, at least for the time being, most producers of European consumer goods are welcomed for the jobs and tax revenue that they generate, as well as for meeting the needs of China's demanding middle class.

The cargo hold

Companies in industries in which China aims to become self-sufficient, or intends for its national champions to dominate globally, will find themselves stuck in the cargo hold, if they were allowed to board at all. China's push for self-sufficiency in this regard is largely to hedge against the possibility of certain key technologies being cut off by foreign governments, which would impede progress with its industrial upgrading.

Technology localisation and onshoring

With the definition of national security being expanded to cover more areas of China's economy, and the push for self-sufficiency strengthening, more and more European companies are being driven further towards two choices: technology localisation and onshored supply chains, or market exit.

Why stay at all with so many hurdles?

European companies capable of making the necessary investments are eager to remain in the China market. This is imperative for many, not only because of the growth potential that China continues to represent, but also because of the increasing need to be in the market for competitive reasons. European companies want to immerse themselves in an environment that is highly complementary to European strengths – China's innovation is chiefly at the consumer end of value chains, while European companies excel in industrial innovation.

⁴³ *Decoupling: Severed Ties and Patchwork Globalisation*, European Union Chamber of Commerce in China & MERICS, 14th January 2021, viewed 29th July 2021, <https://www.europeanchamber.com.cn/en/publications-archive/869/Decoupling_Severed_Ties_and_Patchwork_Globalisation>



It is also increasingly important to compete with Chinese companies on their home turf to benefit from operating in a business environment in which the sheer pace and scale of developments are so vastly different from most other markets. It helps European companies to gain a clearer understanding of how their competitors innovate in China before scaling up and taking their goods and services abroad.

Localisation and onshoring, or how to decouple China operations from global ones

For many companies, remaining compliant in China will increasingly require a thorough evaluation of cross-border connections that might cause problems due to CII and A&C requirements. This is most likely to have an impact where technology that is being employed is either of foreign origin or uses components and/or equipment sourced from abroad, especially from countries that China identifies as hostile. As such, European companies are exploring which of these ties can, or must, be severed.

One way to achieve this is through onshoring of supply chains to create a value chain that is as localised as possible. Some are bringing as much of their own production into China as they can, and/or enticing existing suppliers to enter the China market. Others are looking at replacing their overseas suppliers with local ones that are more likely to be in line with relevant regulations and guidelines. Overall, 26 per cent of respondents to the BCS 2021 said they were onshoring some or all of their supply chains, five times as many as reported they are considering offshoring.⁴⁴ However, fully onshoring may not always be possible, as any company that uses cutting-edge semiconductors is well aware.

Another step deemed necessary by some is localisation of R&D. IP export restrictions in the US and elsewhere pose a risk of disruption in the eyes of China's regulators. As such, IP that is generated and maintained locally is considered to be more reliable, as it is not subject to external restrictions – the very definition of A&C. One member in the rail industry reported that they were aiming for full localisation of their China operations, particularly in R&D, so that they can make “China-made solutions for China-based customers”. It should be noted, though, that even for European companies that take this approach risks still remain. Should current geopolitical tensions take a turn for the worse, Chinese buyers may feel pressure to cease using European suppliers altogether, even those whose supply chains and production have been completely onshored and whose products are bound only for the Chinese market.

Companies will also need to localise their network equipment and services as much as possible to stay within the new boundaries defined by China's state-planners. European Chamber members in the chemicals industry, for example, report that they are exploring how to shift from their standard global providers to either Chinese solutions, or ones that are based or even developed in China by foreign brands. Meanwhile, automotive companies are being pushed to localise their digital solutions in a variety of traditional areas, such as global positioning satellite (GPS) systems or data gathering and storage, as well as in cutting-edge areas like the RADAR/LIDAR ranging and positioning systems that will play a fundamental role in autonomous driving systems. By the end of 2019, there were already more than 6.5 million cars with navigation systems enabled by BeiDou, China's satellite navigation system. BeiDou applications can be found across multiple industries, and its use will proliferate further as China builds out its 5G infrastructure and integrates it with blockchain, AI, big data, cloud computing and other breakthrough technologies.⁴⁵

⁴⁴ *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, viewed 29th July 2021, <https://www.europeanchamber.com.cn/en/publications-archive/917/Business_Confidence_Survey_2021>

⁴⁵ Zhu, Peng, *The Ripple Effect of the Beidou Satellite System on the Market*, Equal Ocean, 4th September 2020, viewed 15th July 2021, <<https://equalocean.com/analysis/2020090414711>>

In general, European companies are leaning towards one of two strategies to address the technology localisation challenge, as identified in the report *Decoupling: Severed Ties and Patchwork Globalisation*.⁴⁶

The first solution is a ‘dual system’ approach, whereby companies maintain normal global operations while creating a completely separate supply chain and technology stack for China in the areas that are affected by localisation requirements. While the initial investment would be extremely expensive, once done it should prove relatively resilient.

The second solution is a ‘flexible architecture’ approach, whereby companies maintain global supply chains and technology stacks to the greatest extent possible, and localise into China only what is strictly necessary. While this would be much cheaper, it would also be more unpredictable, as every time the national security umbrella expanded they would potentially be left exposed.

Localise or leave

Along with the companies already in the ‘cargo hold’ waiting to be jettisoned out of the market are firms that China is keen to keep, but that may have to leave in any case. Some European banks fall into this category.

For Mainland China to fulfil its ambitions of creating a truly international financial centre, and to ensure that its companies can expand successfully into global markets, the presence of foreign banks is required. China’s financial regulators are also keen for foreign banks to operate in the market in order to condition some local players. However, when the market was finally opened up in 2018/2019, foreign banks found themselves constrained to operating only in niches where they identified they could add value.

As such, when looking at the costs of localisation, small and medium-sized banks are understandably balking. Switching over to local providers to suit different localisation requirements would demand a complete gutting of current operations followed by a comprehensive rebuild with local alternatives.

European banks that decide to stay and localise will therefore need to sever certain ties with their global operations. Much of this is due to the fact that the complete replacement of network equipment and service providers will cause interoperability issues with their global systems. In addition, China’s data governance model severely limits the types of data that can flow across its border,⁴⁷ and this creates an enormous disadvantage for foreign banks, in particular for those that currently add value to Chinese companies through the provision of cross-border services. If a European bank wants to finance a Chinese company to expand overseas, it needs to send information about that company—such as its shareholding structure or board of directors—to its European branch. Similarly, if it finances a European company in China, the bank needs to be able to send information on that company back to its head office. If forced to cut ties and comply with restrictions imposed on data flows, these banks will no longer be able to provide this service to the same level, which will negatively impact European companies in China while also making it increasingly challenging for Chinese companies that want to expand overseas.

The only banks even considering localisation are therefore the largest ones that stand a chance of competing with Chinese banks in certain niches that remain available to them, so an exodus of smaller and medium-sized European banks from China should be anticipated in the not-too-distant future. This

⁴⁶ *Decoupling: Severed Ties and Patchwork Globalisation*, European Union Chamber of Commerce in China & MERICS, 14th January 2021, viewed 28th July 2021, <https://www.europeanchamber.com.cn/en/publications-archive/869/Decoupling_Severed_Ties_and_Patchwork_Globalisation>

⁴⁷ Borak, Masha & Shen, Xinmei, *China has the most restrictions on cross-border data flows, says Washington think tank*, South China Morning Post, 19th July 2021, viewed 9th August 2021, <<https://www.scmp.com/tech/tech-war/article/3141679/china-has-most-restrictions-cross-border-data-flows-says-washington>>



neutering of European banks, as their ability to provide value is gradually eroded, should serve as a wake-up call to the EU that similar actions could follow in other industries. European policy-makers may need to consider developing measures and initiatives that ensure that European businesses forced out of the China market have viable opportunities for growth in other third-country markets.

It also needs to be understood in the EU that, as more European banks are forced to leave, European corporates in China that currently rely on them for financing will increasingly have to turn to Chinese state-owned banks instead, and deal with all the implications arising from that situation.

Finally, it is a serious consideration for China that without the expertise of internationalised European banks providing cross-border services to Chinese companies looking to expand overseas, their global ambitions will be hindered.

The 14th Five-year Plan (14FYP)

- The 14FYP doubles down on previous commitments to transition China's economic model away from one that is driven by low-end manufacturing and exports towards one driven by more consumption and technological dominance.
- Continuing the long-standing policy of prioritising SOEs in its economy could have a serious impact on China's long-term economic growth.
- Over-reliance on SOEs could wipe out China's ambitions to become a leader in innovation and make it much more challenging to achieve carbon neutrality by 2060.
- China's ongoing attempts to catch up in semiconductor technology represent a gross misallocation of resources – despite the perceived security concerns, Beijing would be better advised to identify where in the semiconductor value chain it can add most value.
- The aerospace industry encapsulates the costs that China is willing to bear in an attempt to present a highly visible display of technological prowess.
- In order to increase the number of new-energy vehicles (NEVs) on the road to levels that will contribute meaningfully to its environmental targets, China will need to ensure an open, transparent and predictable market that provides European automotive manufacturers with equal access.
- China needs European expertise and technology to help it make a smooth transition from fossil fuels to renewable energy sources.
- Local governments must be incentivised to increase renewables in the energy mix now, to allow businesses to meet their global carbon neutrality obligations (some of the deadlines for which come well before China's 2030 peak emissions target) – failure to do so will force market exit for many.
- China's self-sufficiency drive, and the constraints it imposes on private enterprises, clash with its ambition to become an innovation leader – innovation only thrives in an open and competitive market in which private enterprises are given the flexibility to develop and the population can move freely.
- China has identified standardisation as one of the key 'battlegrounds' in the fight for supremacy in emerging technologies.

On 11th March 2021, the National People's Congress (NPC) passed the 14FYP. Five-year plans (FYPs) are strategic documents intended to guide China's economic and social progress, including foreign policy objectives. Long-term strategies, such as CM2025 and the Vision 2035, are parts of FYPs which, by contrast, outline more concrete pathways for achieving policy goals.

Doubling down on the 13FYP

The general policy direction laid down in the 14FYP is by no means new. As previously mentioned, dual circulation merely formalises and elaborates upon the long-standing commitment to reinventing China's economic model as it gradually loses competitive advantage in the industries that have traditionally been at the centre of its export-orientated model. The 14FYP differs only in that it is even more explicit than previous plans about reducing reliance on the global economy and increasing self-sufficiency.

China's intention to shift towards becoming a middle-income economy—by de-emphasising foreign investment and the development of urban coastal areas, and focussing more on domestic consumption and rural, inland development—was apparent in its 12FYP (2011–2015).^{48&49} Under the 13FYP (2016–2020), there was an increase of state aid and protectionism geared towards increasing innovation-driven development and manufacturing capabilities to promote self-sufficiency.⁵⁰

This laid the foundation for China's plan to transition from a low-cost, export-driven manufacturing hub to a centre for high-tech innovation, which culminated in the formulation of the CM2025 industrial policy, released in May 2015. In its report *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*, the European Chamber identified that CM2025 at its core is “a large-scale import substitution plan aimed at nationalising key industries, or at least curtailing the position of foreign business in them, both as suppliers of key components and finished products.”⁵¹

Mapping policy priorities under the 14FYP

The role that Chinese policy-makers expect specific industries to play over the next five years can be understood by observing changes from the 13FYP to the 14FYP, such as the amount of industrial policy resources being devoted to specific areas, or which aspects of market governance are being prioritised. What follows is a look at some of the more significant aspects of the 14FYP and the potential implications for both China and European business.

SOE dominance

Although China has spent decades pumping funds into SOEs, its private companies have outperformed in terms of efficiency, return on investment and innovation, as well as in crucial areas such as decarbonisation. According to a World Economic Forum working paper, China's private sector contributes 60 per cent of GDP, is responsible for 70 per cent of innovation, accounts for 80 per cent of urban employment and creates 90 per cent of new jobs in the Chinese economy.⁵²

Despite this, the central and protected role that SOEs occupy in China's economy looks set to increase. This is because, “while state-owned firms are a drag on China's economic growth, they are essential to maintaining the position and control of the Chinese Communist Party and achieving the party's strategic

48 China has since achieved upper-middle-income country status according to the World Bank's definition.

49 Ash, Robert, Porter, Robin & Summers, Tim, *China, the EU and China's Twelfth Five-Year Programme*, Europe China Research and Advice Network, 2012, viewed 30th July 2021, <https://www.chathamhouse.org/sites/default/files/public/Research/Asia/0312ecran_ashportersummers.pdf>

50 Koleski, Katherine, *The 13th Five-Year Plan*, US-China Economic and Security Review Commission, 14th February 2017, viewed 30th July 2021, <[https://www.uscc.gov/sites/default/files/Research/The%2013th%20Five-Year%20Plan_Final_2.14.17_Updated%20\(002\).pdf](https://www.uscc.gov/sites/default/files/Research/The%2013th%20Five-Year%20Plan_Final_2.14.17_Updated%20(002).pdf)>

51 *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*, European Union Chamber of Commerce in China, 7th March 2017, viewed 29th July 2021, <<https://www.europeanchamber.com.cn/en/china-manufacturing-2025>>

52 Guluzade, Amir, *The role of China's state-owned companies explained*, World Economic Forum, 7th May 2019, viewed 7th August 2021, <<https://www.weforum.org/agenda/2019/05/why-chinas-state-owned-companies-still-have-a-key-role-to-play/>>



objectives.”⁵³

The current situation stands in contrast to that in the 1990s and early 2000s, when Chinese policy-makers rolled out a campaign aimed at bringing SOEs more in line with market forces through the adoption of modern governance structures to improve efficiency and profitability. Unfortunately, as reform efforts stalled, the convergence in productivity between SOEs and private companies slowed. In 2008, reforms took a back seat and the central role that SOEs play in China’s economy was brought back to the fore, with many of them providing stability during the global economic crisis.

Under the current leadership, SOEs are being encouraged to become “stronger, better and bigger”.⁵⁴ They are expected to continue providing public services, while staunchly supporting industrial and government policy, and stabilising the economy during periods of volatility, as witnessed in 2020 during the coronavirus pandemic. It therefore should be anticipated that instead of allowing unproductive SOEs to be shut down or displaced by private sector competition, the recent practice of allowing megamergers to take place, to increase scale and eliminate competition,⁵⁵ will continue.

Yet the costs of continuing to favour SOEs over the more productive private sector are clear. According to Nicholas Lardy, “[d]espite producing only one-fifth of the output, among industrial firms, SOEs account[ed] for nearly three-fifths of total losses in 2016.”⁵⁶

The fact that China continues to pour support into its SOEs highlights just how much potential quality growth Beijing is prepared to surrender in order to maintain political control over the economy.

Semiconductors: the posterchild of China’s self-sufficiency campaign

In its report *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*, the European Chamber detailed China’s attempt to climb the semiconductor value chain. This included the construction of large semiconductor manufacturing plants (also known as fabs), the creation of huge investment funds, an overseas shopping spree to buy up semiconductor equipment manufacturers and a general consolidation of its domestic industry around a few central actors. Despite this significant investment, China continues to lag in semiconductor chip design and foundry technology, and yet the objective remains the same – to replace China’s imported chips with domestic ones.⁵⁷

China is not alone in supporting its domestic semiconductor industry, which it sees as intrinsically linked to its national security, a conviction that sharpened after recent US export controls targeted its supply-chain vulnerabilities. Reinvestment incentives such as tax breaks, grants and funds are deployed by many governments because the structure of the semiconductor industry is such that young companies or companies with cutting-edge trials may not be willing to reinvest profits into R&D without them.⁵⁸ However,

53 Lardy, Nicholas, *The State Strikes Back: The End of Economic Reform in China?*, Peterson Institute for International Economics, 2019, viewed 7th August 2021, <<https://www.piie.com/bookstore/state-strikes-back-end-economic-reform-china>>

54 *Xi calls for further SOE reform*, China Daily, 18th October 2017, viewed 30th July 2021, <https://www.chinadaily.com.cn/china/2017-10/18/content_33403609.htm>

55 Widlau, Gabriel, *China prepares fresh round of state-orchestrated megamergers*, Financial Times, 10th July 2017, viewed 3rd August 2021, <<https://www.ft.com/content/e3972f54-62e2-11e7-91a7-502f7ee26895>>

56 *China: Mao Strikes Back*, Money and Banking, 28th January 2019, viewed 9th August 2021, <<https://www.moneyandbanking.com/commentary/2019/1/26/china-mao-strikes-back>>

57 For more information on how cross-border acquisitions gathered pace following the creation in 2014 of China’s state-backed national semiconductor fund and related sister funds at local levels, see *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*, European Union Chamber of Commerce in China, 7th March 2017, viewed 23rd July 2021, <<https://www.europeanchamber.com.cn/en/china-manufacturing-2025>>; the reason for the slowdown of Chinese cross-border semiconductor acquisitions since then is twofold. First is the tightening of China’s restrictions on capital outflows, in response to downward pressures on the *renminbi* (RMB) and declining foreign-currency reserves. Second is the general trend towards more stringent foreign-investment screening mechanisms, as an increasing number of countries have adopted a more cautious stance on foreign investment in strategic or sensitive industries.

58 According to the OECD, Ireland, Israel, Italy, Korea, Malaysia, the Philippines, Singapore, Taiwan, and the United States, to name a few.

most Chinese government-invested semiconductor companies cannot be considered young. The majority are way past their growth phase, with their assets and revenues being consolidated as conglomerates.

The CM2025 initiative set the extremely ambitious goal of achieving 40 per cent self-sufficiency in chips by 2020, and 70 per cent by 2025. However, according to a recent IC Insights report, while USD 143.4 billion-worth of semiconductors were sold in China in 2020, only USD 22.7 billion-worth of them were produced in the country. Of that amount, domestic companies produced USD 8.3 billion-worth, accounting for only 5.9 per cent of the country's total semiconductor market in 2020.⁵⁹

Even though China is a prodigious importer of semiconductors, having spent USD 350 billion in 2020,⁶⁰ many of these chips do not stay in China. Organization for Economic Co-operation and Development (OECD) countries mainly occupy upstream segments of the value chain—exporting silicon wafers (Japan), specialty gases and chemicals, and lithography equipment (the EU, the US and Japan)—while China imports vast amounts of semiconductors that it then uses in assembling electronics for re-export. South Korea and Taiwan usually stand in the middle of that value chain, importing silicon wafers and equipment for producing the chips for export to China to be assembled into electronics.

As highlighted in *China Manufacturing 2025: Putting Industrial Forces Ahead of Market Forces*, import-substitution industrial policy is typically poor because it shelters domestic firms from international competition, which slows innovation and dynamism while making it harder to obtain crucial inputs from abroad.⁶¹ This is especially applicable in the semiconductor industry, in which companies are interconnected through complex production networks. The impact of any one measure may trickle down the value chain, or instead affect companies upstream that provide crucial parts and components.

In the report *Decoupling: Severed Ties and Patchwork Globalisation*, the European Chamber warned of what form such a disruption to critical inputs could take.⁶² This became a reality, with supply-chain disruptions at the end of 2020 subsequently resulting in a global chip shortage for the automotive industry in early 2021,⁶³ a situation that is still ongoing at the time of writing.⁶⁴

A significant number of European manufacturers surveyed in the BCS 2021 state that they are exposed to critical input disruptions, including semiconductors, with 34 per cent of those noting that there simply are no viable alternatives. Only 21 per cent of manufacturers report that they have no such components or equipment.⁶⁵ The remainder of the respondents reported that they can find some sort of alternative, but that it would come at a higher cost, lower quality and/or with compatibility issues.

Although this is one of the key factors driving many European companies to onshore in China, the semiconductor industry is by nature extremely difficult to localise. Maximising productivity in this industry relies on the cross-border movement of parts, machinery, talent and technology. As the OECD highlighted

59 Research Bulletin: Sales of Logic ICs Account for Largest Share of China's IC Market in 2020, IC Insights, 18th February 2021, viewed 21st July 2021, <<https://www.icinsights.com/data/articles/documents/1347.pdf>>

60 Semiconductors and the U.S.-China Innovation Race, FP Insider, 16th February 2021, viewed 9th August 2021, <<https://foreignpolicy.com/2021/02/16/semiconductors-us-china-taiwan-technology-innovation-competition/>>

61 China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces, European Union Chamber of Commerce in China, 7th March 2017, <<https://www.europeanchamber.com.cn/en/china-manufacturing-2025>>

62 Decoupling: Severed Ties and Patchwork Globalisation, European Union Chamber of Commerce in China, 14th January 2021, <<https://www.europeanchamber.com.cn/en/publications-decoupling>>

63 Shear, Sam, The global chip shortage is starting to have major real-world consequences, CNBC, 7th May 2021 (updated 17th May 2021), viewed 29th July 2021, <<https://www.cnbc.com/2021/05/07/chip-shortage-is-starting-to-have-major-real-world-consequences.html>>

64 Kostov, Nick, Auto Makers Warn Chip Shortage Will Continue to Impact Vehicle Production, The Wall Street Journal, updated 3rd August 2021, viewed 5th August 2021, <<https://www.wsj.com/articles/jeep-dodge-maker-posts-strong-results-amid-higher-demand-and-prices-11627983391>>

65 European Business in China Business Confidence Survey 2021, European Union Chamber of Commerce in China, 8th June 2021, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>



in its policy paper *Measuring distortions in international markets: The semiconductor value chain*, attempts by countries to establish domestic semiconductor champions by way of subsidies and other trade-restricting policies may therefore fail to meet their objective, while still distorting international markets.⁶⁶

In order to avoid the consequences of continuing to grossly misallocate resources, China would be better off adopting policy measures in an attempt to foster its integration into the existing global semiconductor value chain. In that regard, the rollout of new technologies, such as 5G or machine learning, could offer opportunities for China as a new market entrant at the chip-design stage, where entry barriers are lower but product sophistication and skill intensity remain high. Government support could be part of such a policy package, but it would be most effective if designed in a way that maximises innovation and access to capital markets, while minimising distortions to trade and competition.

Ultimately, however, China's closer integration into global supply chains may not be feasible. Many Chinese technology companies that were previously reluctant to use Chinese-made components, in order to remain competitive in global markets, may no longer have the option of using US suppliers as a result of Washington-imposed sanctions. In effect, the US has unwittingly engendered greater acceptance of China's industrial policy among Chinese companies. According to one analyst, "US sanctions may have caused pain, but they have also aligned the interests of Chinese tech firms with the government's goal of self-reliance. The entire Chinese tech industry now has a strong incentive to cooperate with the self-reliance drive."⁶⁷

Aerospace

China's commercial aircraft sector serves as an additional illustration of misallocated resources, as well as the pronounced gap in productivity between the state and private sectors. Over the years, the Commercial Aircraft Corporation of China (COMAC) has received billions of USD in state support. Much of this support has gone into the development of the C919, an aircraft China hopes will eventually rival Airbus's A320. While chief designer of the C919 Wu Guanghui has stated his expectation that the aircraft will be certified by the end of 2021, in time for the delivery of the first model to China Eastern Airlines,⁶⁸ at the time of writing only Chinese buyers are either placing orders or indicating interest to buy. The C919 cannot be flown in international airspace until it has been certified either by regulators from the countries' airspace it intends to enter, or regulators from jurisdictions those countries trust if they lack their own, and this does not seem likely any time soon.⁶⁹

According to estimates, Chinese state support provided to COMAC since its foundation in 2008 up until 2020 was somewhere in the region of USD 49 billion to USD 72 billion.⁷⁰ This does not take into account additional, unreported support such as subsidised R&D activities, free or discounted land, and tax benefits. By comparison, according to the World Trade Organization (WTO), Airbus received USD 22 billion since 2006 from the EU, Germany, France, the United Kingdom and Spain.^{71&72}

⁶⁶ *Measuring distortions in international markets: The semiconductor value chain*, OECD, 12th December 2019, viewed 21st July 2021, <https://www.oecd-ilibrary.org/trade/measuring-distortions-in-international-markets_8fe4491d-en>

⁶⁷ Pan, Che, *US-China tech war: semiconductor supply chain risks a worry for both sides*, South China Morning Post, 21st April 2021, viewed 27th August 2021, <<https://www.scmp.com/tech/trends/article/3130437/us-china-tech-war-semiconductor-supply-chain-risks-worry-both>>

⁶⁸ Ahlgren, Linnea, *China's New Narrowbody COMAC C919 On Track for 2021 Certification*, Simple Flying, 5th March 2021, viewed 28th July, <<https://simpleflying.com/comac-c919-2021-certification/>>

⁶⁹ Kennedy, Scott, *China's COMAC: An Aerospace Minor Leaguer*, CSIS, 7th December 2020, viewed 21st July 2021, <<https://www.csis.org/blogs/trustee-china-hand/chinas-comac-aerospace-minor-leaguer>>

⁷⁰ Ibid.

⁷¹ Ibid.

⁷² *United States Prevails As WTO Panel Finds EU Subsidies to Airbus Break WTO Rules*, Office of the United States Trade Representative, September 2016, viewed 9th August 2021, <<https://ustr.gov/about-us/policy-offices/press-office/press-releases/2016/september/united-states-prevails-wto-panel>>

The level of state support provided to China's aerospace industry becomes even more difficult to comprehend given that the C919 can barely be considered a Chinese aircraft. American and European companies comprise the vast majority of the aircraft's component suppliers. In addition to selling components to COMAC, foreign suppliers also provide critical guidance on the process of integrating various components, something that has been absolutely critical to the development of the C919.⁷³

The most likely explanation behind China's perseverance with an industry that is still far from producing any return on investment therefore seems to be that, unlike semiconductors—which while crucial, remain hidden within components and completed equipment—aircraft are highly visible demonstrations of technological prowess.

New-energy vehicles (NEVs)

The creation and subsequent growth of China's NEV industry has only been possible through the provision of prodigious state support. According to estimates, by the end of 2017, central and local authorities had pumped Chinese yuan (CNY) 393 billion (USD 58.7 billion) into the sector. While the majority went to consumer subsidies and rebates, and an exemption from sales tax, NEV manufacturers also benefitted from support in R&D, charging infrastructure and government procurement.⁷⁴ Estimates for total government funding for the NEV sector in 2018 was CNY 148.2 billion (USD 22.9 billion) and CNY 134.9 billion (USD 20.1 billion) in 2019, bringing total support over the past decade to around CNY 676 billion (more than USD 100 billion). These figures only include direct support and do not take into account other benefits such as corporate income tax reductions and cheap land awarded for the establishment of factories.⁷⁵

Support for the NEV industry shows no signs of abating, with the State Council in 2021 releasing policies to incentivise NEV consumption, including the extension of NEV purchasing subsidies and the exemption of purchase tax on NEVs. Although such policies are aimed at giving manufacturers time to recover losses and market share post-COVID-19, the State Council also released new targets for NEV sales to account for "20 per cent of sales by 2025 and account for the majority of sales by 2035",⁷⁶ the achievement of which will require continued significant investments in charging infrastructure, R&D and government procurement.⁷⁷

To promote sales of NEVs, many local governments are lifting restrictions on NEV licence plate quotas. However, there are exceptions. For example, in Beijing, there is still an annual quota in place, which substantially restricts purchases.

It is of significance to European manufacturers that NEV subsidy policies for units manufactured in China and those that are imported are different: central and local subsidies are currently only provided for NEVs made in China. This unequal treatment makes it extremely difficult for foreign manufacturers to reach their NEV targets and requirements. The imbalance is even more unfair given that, in the EU, subsidies are available for both imported and locally manufactured NEVs. With much riding on China being able to reach its environmental goals, the European Chamber's Automotive Working Group is advocating for the

73 Kennedy, Scott, *China's COMAC: An Aerospace Minor Leaguer*, CSIS, 7th December 2020, viewed 21st July 2021, <<https://www.csis.org/blogs/trustee-china-hand/chinascomac-aerospace-minor-leaguer>>

74 Kennedy, Scott, *The Coming NEV War? Implications of China's Advances in Electric Vehicles*, CSIS, 18th November 2020, viewed 15th July 2021, <<https://www.csis.org/analysis/coming-nev-war-implications-chinas-advances-electric-vehicles>>

75 Ibid.

76 Randall, Chris, *China to push forward with electrification targets*, electrive.com, 3rd November 2020, viewed 15th July 2021, <<https://www.electrive.com/2020/11/03/china-pushes-forward-with-their-electrification-targets-for-2025/>>

77 Kennedy, Scott, *The Coming NEV War? Implications of China's Advances in Electric Vehicles*, CSIS, 18th November 2020, viewed 15th July 2021, <<https://www.csis.org/analysis/coming-nev-war-implications-chinas-advances-electric-vehicles>>



creation of a predictable, non-discriminatory and balanced legislative environment, to ensure sustainable development of the NEV market.

Renewable energy

China's renewable energy market is split into two layers – one for SOEs and the other for private enterprises, both Chinese and foreign. The second layer sees less market access and more constraints to develop, own or operate renewable assets. Maintaining this dynamic could severely dent China's carbon neutrality ambitions, as private companies are far more likely to bring the kind of breakthrough technologies and solutions that China needs to meet its global commitments.

In addition to high investment costs and a frequently-changing regulatory environment, foreign companies (particularly SMEs) investing in China's renewable sector face a range of other challenges. For example, European investors' minimum profitability threshold is significantly higher than that of SOEs,⁷⁸ a situation that is exacerbated when feed-in tariff (FIT) payments are delayed.⁷⁹ This was best illustrated by certain solar power projects in northwest China that faced bankruptcy when subsidy payments were delayed.⁸⁰

Another example of foreign companies being prevented from competing fairly with SOEs is in tendering processes for renewable projects. Most Chinese provinces have implemented competitive tendering processes to determine which projects sponsored by different developers should be included in their annual construction plans, a pre-condition for a project to be approved. Many such tendering rules have a score-based system to measure a developer's 'track record' in the renewable energy industry. However, similar to procurement in construction and other industries, only track records within China can be assessed, with international records currently not being taken into consideration.

By maintaining these constraints, China's renewable energy market is missing out on foreign investment (direct and indirect) and the deployment of innovative solutions developed by competitive, private enterprises, as well as new types of financing models. Without taking a more inclusive approach, achieving China's 2060 goal will become increasingly challenging.

According to the International Energy Agency, approximately 28 per cent of China's electricity supply is composed of renewable sources, mostly hydropower, as of the first quarter of 2020.⁸¹ In early 2021, China's National Energy Agency proposed that 40 per cent of its electricity should be sourced from renewables and nuclear by 2030. This ambitious goal will entail the installation of 300 GW more wind and solar capacity than under current targets.⁸²

China's 14FYP sets a carbon intensity reduction target of 18 per cent, and an energy intensity reduction target of 14 per cent. The plan still contains multiple references to coal and other fossil fuel development, albeit under "clean and efficient utilisation" conditions.⁸³ The Energy Working Group is therefore expecting the transition from coal to gas and other renewables to accelerate, and a carbon cap to be set at sectoral

⁷⁸ The break-even point at which a business becomes profitable.

⁷⁹ A feed-in tariff (FIT) is a policy designed to support the development of renewable energy sources by offering long-term contracts and guaranteed prices to renewable energy producers.

⁸⁰ *Chinese subsidy backlog 'leaves solar projects facing bankruptcy'*, South China Morning Post, 12th October 2018, viewed 26th May 2021, <<https://www.scmp.com/news/china/politics/article/2168270/chinese-subsidy-backlog-leaves-solar-projects-facing-bankruptcy>>

⁸¹ *Electricity mix in China, Q1 2020*, International Energy Agency, 13th May 2020, viewed 16th July 2021, <<https://www.iea.org/data-and-statistics/charts/electricity-mix-in-china-q1-2020>>

⁸² Lo, Joe, *China's energy agency floats increase in 2030 renewables target*, Climate Home News, 11th February 2021, viewed 16th July 2021, <<https://www.climatechangenews.com/2021/02/11/chinas-energy-agency-floats-increase-2030-renewables-target/>>

⁸³ Shi, Yi, *The 14th Five Year Plan sends mixed message about China's near-term climate trajectory*, China Dialogue, 8th March 2021, viewed 23rd May 2021, <<https://chinadialogue.net/en/energy/the-14th-five-year-plan-sends-mixed-message-about-chinas-near-term-climate-trajectory/>>

and provincial levels in China's *Special 14FYP for Energy Development*.

The development of China's renewable market has historically benefitted greatly from state support. However, as a result of the expansion of renewables capacity outstripping electricity demand, a government fund established to subsidise renewable projects was estimated to be in deficit at the end of 2020 to the tune of approximately CNY 328 billion (USD 50 billion). This has prompted a change in policy, with an expectation that renewable projects can start to become competitive with fossil fuels.⁸⁴

The nature of the challenge facing China in transitioning from coal-fired to clean energy is encapsulated by its need to maintain economic growth while expanding its renewable energy capacity. Local governments are simply not incentivised to invest more in renewable solutions, as existing fossil fuel solutions provide a quicker, and more convenient, path towards economic growth. There is not enough reason for them to move away from highly-polluting energy and integrate more renewables into the grid until 2030, the year that China aims to peak its carbon emissions.

Not only does this leave a 10-year window during which the damage caused by carbon emissions could spiral out of control, it could put some European companies' China operations in an untenable position. Many European Chamber member companies have global green energy targets that they have to meet before 2030. Achieving these targets will require them to have access to green sources of energy. If it is not possible for them to achieve carbon neutrality in China, their company will not be able to meet its binding global compliance obligations, and may be forced to cease investment in China altogether.

Intellectual property rights (IPR)

European companies have noted a steady improvement in China's IPR enforcement over the last decade. Among other reasons, this has been achieved through the introduction of specialist IP courts in Beijing, Shanghai and Guangzhou, and the subsequent narrowing of the gap between administrative authorities and the judicial system, a result of increases in manpower and training of non-specialist enforcement authorities.

One of the most significant factors driving the development of China's IPR framework is the increasing competitiveness of domestic Chinese companies. Their growing innovation capacity can be roughly gauged by the 1.3 million domestic invention patent applications that were filed in 2020.⁸⁵ While the absolute number of patent applications is not the most accurate indicator of advanced technological capability, the increased sophistication of Chinese enterprises is further attested to by the 72 per cent of respondents to the BCS 2021 that see Chinese firms as equally or more innovative than European ones.⁸⁶ China therefore needs to further strengthen its IPR protection mechanism to facilitate the continued expansion of these innovative Chinese firms into prominent global markets.

While general improvements are of course positive, 50 per cent of respondents to the BCS 2021 still see the enforcement of IPR laws and regulations in China as inadequate, which is poor by any objective assessment. There is therefore a need to rapidly build the kind of institutions that can provide fair and equal IPR enforcement throughout China. Failure to do so comes at the cost of an unpredictable business

⁸⁴ Wong, Jacky, *China's Green-Power Funding is Blowing in the Wind*, The Wall Street Journal, 21st April 2021, viewed 16th July 2021, <<https://www.wsj.com/articles/chinas-green-power-funding-is-blowing-in-the-wind-11619003815>>

⁸⁵ *China Utility Patent Application Filings Up 29% in 2020, Foreign-Originated Chinese Invention Patent Application Filings Down 3%*, The National Law Review, 8th May 2021, viewed 21st July 2021, <<https://www.natlawreview.com/article/china-utility-model-patent-application-filings-29-2020-foreign-originated-chinese>>

⁸⁶ *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, viewed 29th July 2021, <https://www.europeanchamber.com.cn/en/publications-archive/917/Business_Confidence_Survey_2021>



environment, a decrease in business sentiment and foreign companies remaining reluctant to bring their best technology to the market.

R&D and innovation

A key element of China's 14FYP is the goal to increase R&D spending and focus more on innovation, in an attempt to gain dominance and achieve self-sufficiency in core technologies. This is merely a repackaging of a previous, long-standing policy goal, the roots of which can be traced back to 2006, with the release of the *Medium- to Long-Term Programme for the Development of Science and Technology*.⁸⁷ As mentioned previously, the guiding principles of this strategy were reiterated in later initiatives, such as the 2010 Strategic Emerging Industries initiative, and followed through to CM2025, which was released in 2015. The notions that China should in particular engage more in basic research in science and technology in order to find "new opportunities for catching up and leapfrogging" in emerging technology; and that developing a nation focussed on innovation is "a major strategic choice for China's future development",⁸⁸ are common throughout all of these plans.

The challenge that China faces here is the inherent contradiction between its goal of achieving technological superiority and its desire to go it alone.

According to Zhang Weiying, professor of economics at Peking University's National School of Development, while China can be considered a major global manufacturer it has not yet achieved the status of a 'manufacturing powerhouse'. In order to reach that point, he says, China needs to be making significant contributions to core manufacturing technologies and innovation. Currently, Zhang points out, while developed countries are all capable of producing the goods that China does (but are now simply unwilling to do so), the reverse does not hold true. "China's manufacturing capabilities remain limited to products of the Second Industrial Revolution, while it merely does assembly work for most products of the Third Industrial Revolution," he says, continuing, "Today, over 40% of China's exports are made by foreign-funded enterprises." Professor Zhang also highlights the key role of immigration in fostering innovation, and points to the correlation between the sizeable immigrant communities in countries like the US and Switzerland and their position as global innovation leaders.⁸⁹

To make significant advances in R&D and innovation, companies rely on collaboration between multiple stakeholders drawn from a diverse workforce that is able to travel freely, as well as strong and fair competition from other companies engaged in similar activities. This is no less true for China than it is for other countries. However, as the European Chamber's Research and Development Working Group points out, its members are struggling to recruit international talent, particularly young researchers, a situation that has been exacerbated by the coronavirus pandemic. These difficulties also impact Chinese companies, resulting in a less competitive environment overall and thereby slowing the pace of innovation in China.

While the main drivers of innovation are entrepreneurship, technological know-how and a diverse workforce, a truly attractive innovation ecosystem also requires a sound institutional and policy environment in which all stakeholders can operate freely and safely. Because R&D requires significant investment and operates on long cycles, companies need the reassurance that can only be provided by strong rule of law, to ensure that they will not face discrimination in terms of access to resources

⁸⁷ *The Medium- and Long-Term Programme for Science and Technology Development (2006–2020), An Outline*, State Council, December 2005, viewed 21st July 2021, <https://www.itu.int/en/ITU-D/Cybersecurity/Documents/National_Strategies_Repository/China_2006.pdf>

⁸⁸ Ibid.

⁸⁹ Zhang, Weiying, *What China Needs to Do to Become a Real Manufacturing Power*, Caixin, 8th March 2021, viewed 21st July 2021, <<https://www.caixinglobal.com/2021-03-08/zhang-weiying-what-china-needs-to-do-to-become-a-real-manufacturing-giant-101672485.html>>

or barriers to the free flow of legitimate sources of information, and that they will have sufficient IPR protection. Members of the Research and Development Working Group are grappling with challenges in all of these areas, which makes it increasingly difficult for them to develop R&D strategies that balance China's attractiveness as an innovation destination with the inherent risks involved, in order to justify setting up shop here. How they resolve these issues can potentially have negative consequences for all players involved. Companies' costs will be significantly inflated and their economies of scale vastly reduced if they choose to separate their China R&D from global operations (as many are already opting to do); and China will lose out as companies choose to not develop their most cutting-edge technologies in the country.

Standards

While European companies are eager to play a role in shaping the standards they will operate under in China, members of the European Chamber's Standards and Conformity Assessment Working Group report direct and indirect barriers to their participation in standardisation activities, especially in 'contentious areas' such as the digital realm. They also suffer from other inefficiencies in the Chinese standardisation system that prevent them from effectively contributing with their expertise and know-how. These issues are compounded by the fact that standards-setting has become one of the key 'battlegrounds' in the fight for supremacy in emerging technologies, and, as such, will have an increasing impact on geopolitical developments.

Although still not publicly released at the time of writing, the China Standards 2035 plan is expected to set objectives for China to become a leader in global standards-setting in areas such as 5G, AI, smart manufacturing and green technologies. China will continue to push for its homegrown standards in strategic sectors to be adopted internationally, while applying, at least partially, existing international standards in more traditional industries.

These issues are outlined in the *Standards and Conformity Assessment Working Group Position Paper 2021/2022* on page 129, and will be explored in more depth in a comprehensive report on standardisation that the European Chamber is jointly publishing with the Swedish Institute of International Affairs in late 2021.

Market governance

A significant 90 per cent of respondents to the European Chamber's BCS 2021 reported that the ease of doing business in China either did not improve or became more difficult in 2020. Furthermore, 45 per cent reported having missed business opportunities due to market access restrictions or regulatory barriers, and 75 per cent expect that the number of regulatory obstacles that they currently face will either remain the same or increase over the next five years.⁹⁰

Yet China is gradually scaling back on traditional market access constraints, such as joint venture requirements and negative lists for foreign investment, in favour of its Corporate Social Credit System (CSCS). It can be anticipated that this trend will accelerate, as the Chinese Government becomes more confident that the CSCS can be used to steer market behaviour across an increasing number of industries.

⁹⁰ *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, viewed 29th July 2021, <https://www.europeanchamber.com.cn/en/publications-archive/917/Business_Confidence_Survey_2021>

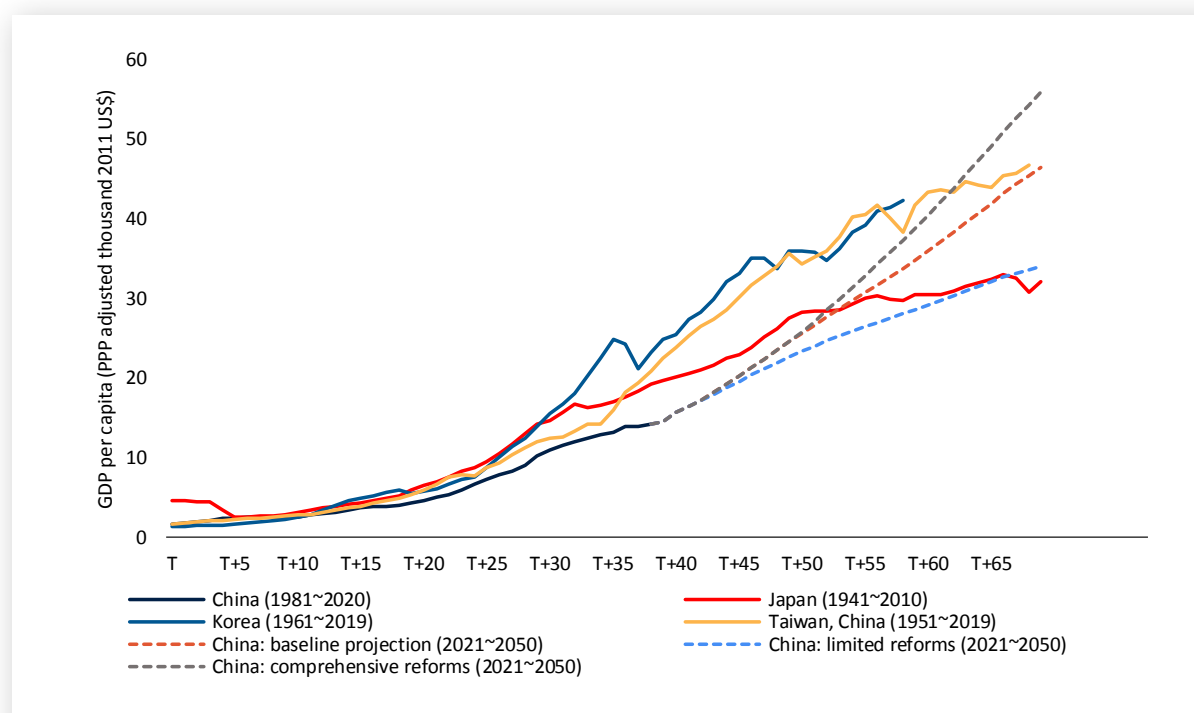


China's Growth Trajectory

- Mainland China's economic growth since it first embarked on reform and opening up is comparable to that of the economies of Japan, South Korea and Taiwan over a similar time period.
- A reinvigoration of China's reform and opening plan is required to ensure that per capita GDP does not stagnate over the next 30 years.
- If China fails to build a sound institutional framework, it risks getting stuck in the middle-income trap.
- Key to pushing beyond the middle-income trap will be increasing productivity, which will require more efficient allocation of resources, reforming SOEs to become market-driven and scaling back industrial support.
- Meeting China's targets for technology and innovation relies upon further market opening to foreign companies, while strengthening IPR protection and improving the quality of patents.

As the European Chamber described in its *Executive Position Paper 2020/2021*,⁹¹ China's economic rise over the past forty-odd years is not a unique story. To illustrate this point, the following World Bank chart shows GDP per capita in PPP terms since the introduction of market reforms in Mainland China, with three different scenarios for the next 30 years – a baseline projection, one based on comprehensive reforms and one based on limited reforms. It also includes growth trajectories for two of the 'Asian Tigers'—South Korea and Taiwan—and Japan, over a comparable timeline since the introduction of their respective market reforms.

Output-side real GDP per capita (PPP-based) realities and projections: distance from start of market reforms measured against economies of Japan, South Korea and Taiwan



Source: The World Bank

⁹¹ *Executive Position Paper 2020/2021*, European Union Chamber of Commerce in China, 10th September 2020, viewed 9th August 2021, <https://www.europeanchamber.com.cn/en/publications-archive/865/Executive_Position_Paper_2020_2021>

As can be seen, since the introduction of market reforms, Mainland China's economy has followed a similar growth trajectory to those of Taiwan, South Korea and Japan. If China were to push ahead with comprehensive reforms, its per capita GDP would surpass that of all three economies by around 2043.

However, if China adheres to its plan to increase its level of self-sufficiency, it will be forced to deviate further from the reform path that it first embarked upon more than 40 years ago, which will come at a considerable cost to growth. As the World Bank chart illustrates, if Mainland China were to follow a path of limited reforms, it would only just manage to surpass the economy of Japan around 2048, while remaining behind both those of Taiwan and South Korea. Continuing to punch well below its growth potential raises the risk that China will get stuck in the middle-income trap, a scenario that becomes increasingly likely in the absence of strong institutions.

Institution building

The need to develop sound institutions is already recognised by many in China. For example, it was a central recommendation in *China 2030: Building a Modern, Harmonious, and Creative Society*, a report jointly published by the World Bank and the Development Research Centre (DRC) of the State Council in 2013.⁹² The link between a country's ability to increase its per capita GDP to high levels and its institutional quality has also been outlined by numerous academics and organisations.^{93&94}

For example, when INSEAD examined the quality of institutions of 166 economies, based on six World Bank governance indicators,⁹⁵ relative to 2013 per capita GDP (PPP terms at 2011 prices), a clear pattern emerged.⁹⁶

In the first stage of development, an economy can achieve high growth regardless of the quality of its institutions. China experienced success early on in its reform and opening up period by designing central policies that provided broad guidance. This allowed local governments to interpret policies before implementation, which incubated a more innovative approach and facilitated a steep growth trajectory.

However, it is during the second stage of development, which should take economies beyond middle-income trap levels, that the correlation between sound institutions and income per capita becomes apparent. "To produce value above this threshold, economies need complex organization of production, which is possible only with good institutions."⁹⁷

Essentially, as economies become larger and more complex, the limitations of experimental policy-making are exposed. Instead, consistent and strong policies are needed to ensure that regulations are not enforced by different jurisdictions in a discretionary manner, and that local protectionism does not take hold. This must be underpinned by the rule of law. Without this kind of framework in place, the business environment is too unpredictable and investor sentiment can rapidly deteriorate.

92 *China 2030: Building a Modern, Harmonious, and Creative Society*, The World Bank & the Development Research Centre of the State Council, 2013, viewed 20th July 2021, <<https://documents1.worldbank.org/curated/en/781101468239669951/pdf/China-2030-building-a-modern-harmonious-and-creative-society.pdf>>

93 Samarasinghe, Tharanga, *The relationship between institutions and economic development*, Munich Personal RePEc Archive, 2019, viewed 30th July 2021, <<https://mpra.ub.uni-muenchen.de/97755/>>

94 Fatás, Antonio & Mihov, Ilian, *Another Challenge to China's Growth*, Harvard Business Review, March 2009, 20th July 2021, <<https://hbr.org/2009/03/another-challenge-to-chinas-growth>>

95 These governance indicators are: 1) voice and accountability (democracy); 2) political stability; 3) quality of regulation; 4) control of corruption; 5) government effectiveness; and 6) rule of law.

96 Witt, Michael, A., *How China Can Avoid the Middle Income Trap*, INSEAD, 12th April 2016, viewed 20th July 2021, <<https://knowledge.insead.edu/blog/insead-blog/how-china-can-avoid-the-middle-income-trap-4629>>

97 Fatás, Antonio & Mihov, Ilian, *Another Challenge to China's Growth*, Harvard Business Review, March 2009, 20th July 2021, <<https://hbr.org/2009/03/another-challenge-to-chinas-growth>>



This links back to one of the main arguments of the joint World Bank / DRC report, which is that the key to China's future growth is tied to its ability to increase productivity, which has largely been stagnant since the global economic crisis in 2008. The report makes recommendations as to how this can be achieved, which align with the arguments made by the European Chamber in this position paper. These include allocating resources more efficiently by following through on SOE reform to make these firms more competitive, and the government taking a more disciplined approach to industrial support; accelerating the adoption of advanced technologies and innovation, which will require further market opening to foreign companies that can bring investment and competition; as well as strengthening IPR protection and improving the quality of patents.

When European businesses are looking to make long-term investments, they require the high degree of certainty that solid institutions provide. China's current approach to managing foreign investment does not provide sufficient transparency or legal certainty, and therefore makes China less attractive, particularly in the current climate in which companies are becoming more and more risk adverse. Increasing predictability—by creating a reliable mechanism for granting licences and approvals based on transparent and measurable factors, and scaling back on the drive to achieve self-sufficiency—would boost business confidence and result in an increase of foreign investment.

China's Declining Soft Power

- Outspoken Chinese diplomats, dubbed 'wolf warriors' by some, have undermined China's diplomatic efforts, and caused years of soft-power influence to unravel.
- Democratically-elected European leaders have less and less room to engage with Beijing, which risks further isolating China from the rest of the world.
- European companies have no interest in politics, yet are increasingly having to respond to issues that result directly from the business environment becoming more politicised.
- There is a lack of understanding on the Chinese side that European companies must adhere to European, and other globally-applicable, regulations in order to remain compliant and maintain their licence to operate.
- Although escalatory sanctions imposed by China derailed the EU-China Comprehensive Agreement on Investment (CAI), both sides would be well advised to find a way to fulfil obligations under the agreement in the absence of ratification, while continuing to cooperate in other areas of mutual interest.

China's soft power has been on the wane for several years now, due to several factors and, according to the Pew Research Center, overseas public opinion on China is reaching an all-time low.⁹⁸

A significant part of this deterioration is a result of the rhetoric used by hard-line Chinese officials, who believe that China is engaged in a public opinion war launched by a West seeking to constrain the country's economic development while also preventing Beijing from "fighting back" and safeguarding its sovereignty and national interests.⁹⁹

At the same time, the EU has become increasingly vocal about human rights, while bolstering its toolbox to impose sanctions to deal with alleged human rights concerns it believes have not been satisfactorily resolved by China.

98 Silver, Laura, Devlin, Kat & Huang, Christine, *Large Majorities Say China Does Not Respect the Personal Freedoms of Its People*, Pew Research Center, 20th June 2021, viewed 15th July 2021, <<https://www.pewresearch.org/global/2021/06/30/large-majorities-say-china-does-not-respect-the-personal-freedoms-of-its-people/>>

99 Martin, Peter, *China's Wolf Warriors Are Turning the World Against Beijing*, Bloomberg, 8th June 2021, viewed 15th July 2021, <<https://www.bloomberg.com/news/articles/2021-06-08/china-s-wolf-warriors-are-turning-the-world-against-beijing>>

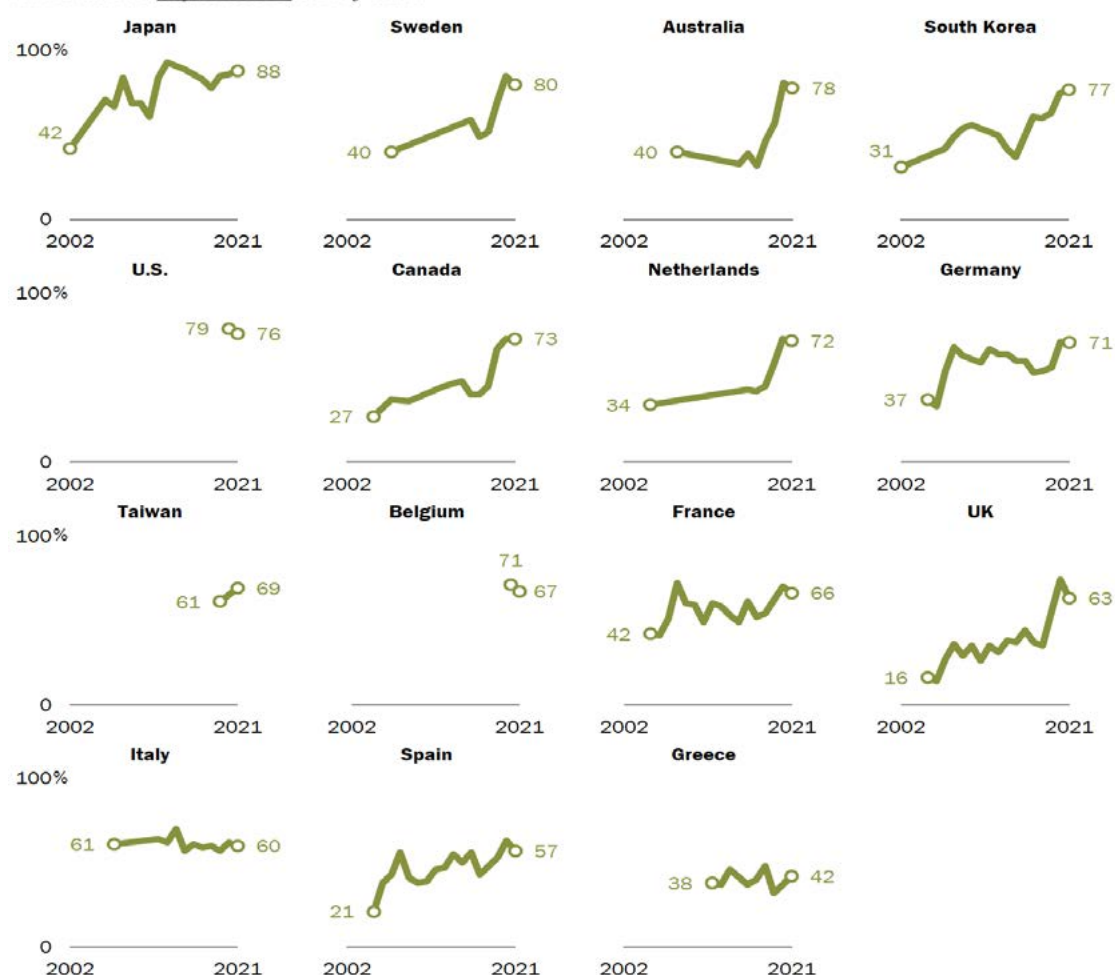
Wolf warriors

The space for political leaders in the EU and China to engage has further diminished due to so-called ‘wolf warrior’ diplomacy. This approach, in which Chinese diplomats embrace a ‘fighting spirit’ in their interactions with other countries, is causing public opinion of China to sour in Western civil societies.

According to the Pew Research Center, in 2021, negative views of China are already “at or near historic highs. Large majorities in most of the advanced economies surveyed have broadly negative views of China, including around three-quarters or more who say this in Japan, Sweden, Australia, South Korea and the U.S.”¹⁰⁰

Unfavorable views of China remain at or near historic highs in many places

% who have an unfavorable view of China



Note: Prior to 2020, U.S. surveys were conducted by phone. See topline for results.
Source: Spring 2021 Global Attitudes survey, Q4b.
“Large Majorities Say China Does Not Respect the Personal Freedoms of Its People”

PEW RESEARCH CENTER

100 Martin, Peter, *China's Wolf Warriors Are Turning the World Against Beijing*, Bloomberg, 8th June 2021, viewed 15th July 2021, <<https://www.bloomberg.com/news/articles/2021-06-08/china-s-wolf-warriors-are-turning-the-world-against-beijing>>



Growing diplomatic tensions between China and the rest of the world have already had a negative impact on its companies going overseas. For example, although Alibaba and Tencent had until recently been among the most influential foreign investors in India's fast-growing start-up scene, they are now coming up against restrictions.¹⁰¹

China appears to be concerned that it may lose credibility if its current rhetoric is de-escalated. Yet the opposite holds true: by making room for constructive discussions, China's diplomats would be able to take a firmer stance on issues of genuine national concern. As it stands, democratically-elected leaders in the EU are finding themselves with less and less room to engage with Beijing.

Escalatory sanctions further derail progress

On 22nd March, the EU imposed sanctions on four officials and one entity in China over alleged human rights abuses in the Xinjiang Uyghur Autonomous Region (XUAR), with China subsequently counter-sanctioning ten individuals and four entities in the EU.^{102&103}

Prior to these escalatory sanctions, very positive developments had taken place in 2020, with the signing of the long-awaited EU-China bilateral Agreement on the Cooperation on, and Protection of, Geographical Indications (GI Agreement).¹⁰⁴ The GI Agreement is the first EU-China bilateral trade agreement, and the European business community in China was hoping that it would pave the way for a robust and ambitious CAI.

The European Chamber supported the CAI negotiations and was pleased to see the EU and China come to a political agreement in December 2020. Although ultimately not as ambitious as anticipated, the European business community felt the CAI was a step in the right direction. It is therefore regrettable that the subsequent diplomatic frictions between the EU and China resulted in an indefinite freezing of the ratification process, a real setback to a trade relationship that was worth more than USD 650 billion in bilateral trade in 2019.¹⁰⁵

The likelihood of the CAI now being ratified is unfortunately very low, with prominent parties in the European Parliament having stated that this is conditional upon China withdrawing the sanctions.¹⁰⁶ In the interests of regaining momentum in the EU-China relationship, the European Chamber recommends that both sides now consider how they might proceed with their respective end of the deal in the absence of a ratified agreement, while also continuing to cooperate in areas of mutual interest, such as decarbonisation and climate change, international standards-setting, sustainable development, WTO reform and the fight against COVID-19.

¹⁰¹ In the second quarter of 2021, out of the 336 funding rounds conducted by Indian start-ups, which raised a record USD 7.2 billion, Chinese investors only participated in 10 of those rounds worth USD 745 million. American investors, meanwhile, participated in 100 of those rounds, worth USD 5.7 billion: Parkin, Benjamin & Ruehl, Mercedes, *Chinese investors miss out on record year of Indian tech fundraising*, Financial Times, 12th July 2021, viewed 22nd July 2021, <<https://www.ft.com/content/94ad2e3e-e2f0-4333-b105-c980cddb212b>>

¹⁰² *EU imposes further sanctions over serious violations of human rights around the world*, Council of the European Union, 22nd March 2021, viewed 23rd July 2021, <<https://www.consilium.europa.eu/en/press/press-releases/2021/03/22/eu-imposes-further-sanctions-over-serious-violations-of-human-rights-around-the-world/>>

¹⁰³ *Foreign Ministry Spokesperson Announces Sanctions on Relevant EU Entities and Personnel*, Ministry of Foreign Affairs of China, 22nd March 2021, viewed 23rd July 2021, <https://www.fmprc.gov.cn/mfa_eng/xwfw_665399/s2510_665401/t1863106.shtml>

¹⁰⁴ *EU-China agreement protecting geographical indications enters into force*, European Commission, 1st March 2021, viewed 29th July 2021, <https://ec.europa.eu/info/news/eu-china-agreement-protecting-geographical-indications-enters-force-2021-mar-01_en>

¹⁰⁵ Harper, Joe, *EU-China investment deal done and dusted*, DW, 29th December 2020, viewed 9th August 2021, <<https://www.dw.com/en/eu-china-investment-deal-done-and-dusted/a-56087516>>

¹⁰⁶ *MEPs refuse any agreement with China whilst sanctions are in place*, European Parliament, 20th May 2021, viewed 29th July 2021, <<https://www.europarl.europa.eu/news/en/press-room/20210517IPR04123/meps-refuse-any-agreement-with-china-whilst-sanctions-are-in-place>>

Boycotts and anti-foreign sentiment

Increasing concerns in developed economies over the human rights situation in regions like the XUAR, as well as the general deterioration of bilateral relations between the EU and China, have resulted in European companies being increasingly vulnerable to boycotts. A case in point is the backlash against the Better Cotton Initiative (BCI) and the subsequent boycotts by some Chinese consumers of foreign retailers over supply-chain-related decisions.

In March 2020, the BCI—a group that monitors labour conditions for cotton production around the world—announced it would cease assurance of cotton products produced in the XUAR in 2021.¹⁰⁷ Soon after that, at least one European retailer announced it would no longer source products from the XUAR.

On 24th March 2021, a whole year later, and just after the exchange of sanctions between the EU and China, an attack on that company was launched on the Chinese microblogging platform Weibo, which prompted a coordinated response by Chinese netizens to investigate which other foreign retailers are associated with the BCI. Calls for boycotts of this company, and other international brands, rapidly grew online, albeit toned down within a relative short period. However, the consequences were real, with the European retailer being prevented from selling its products on Chinese online shopping platforms, and its stores' addresses being blocked on China's most popular ride-hailing app.¹⁰⁸

For European companies, it is simply good practice to assess suppliers to ensure that the rights of workers along their supply chains are guaranteed. These are standard procedures conducted in all markets in which they operate. If such audits cannot be conducted in China, many companies may be left with no choice but to eliminate certain suppliers. China's market may be unmatched in size, but the need to remain compliant in the rest of the world exerts the stronger force in corporate decision-making processes.

There is a high likelihood that further measures will be rolled out in Europe that will compel European companies to guarantee that their supply chains are compliant. Germany recently joined France in formulating a national Supply Chain Act, binding its companies to conduct supply chain due diligence against breaches of human rights and environmental standards.^{109,110} This mechanism is expected to be gradually rolled out and will apply to companies with over 3,000 employees from 2023, and to those with over 1,000 employees from 2024.

Similar EU-level legislation is already under consideration. The European Commission has released a guidance on due diligence for EU companies to address the risk of forced labour in their supply chains, and a proposal on a regulation that would include clauses on mandatory due diligence across supply chains is currently being developed.^{111,112} European companies operating in China are advised to closely track these developments and participate in relevant discussions whenever possible.

107 China: Better Cotton Initiative suspends activities in Xinjiang due to concerns over labour abuses, Business & Human Rights Resource Centre, 7th April 2020, viewed 29th July 2021, <<https://www.business-humanrights.org/en/latest-news/china-better-cotton-initiative-suspends-activities-in-xinjiang-due-to-concerns-over-labour-abuses/>>

108 Brant, Robin, *Xinjiang cotton: Western clothes brands vanish as backlash grows*, BBC, 26th March 2021, viewed 29th July 2021, <<https://www.bbc.com/news/world-asia-china-56533560>>

109 Supply Chain Act (Lieferkettengesetz): Greater protection for people and the environment in the global economy, Bundesregierung, 3rd March 2021, viewed 21st July 2021, <<https://www.bundesregierung.de/breg-en/news/supply-chain-act-1872076#:~:text=The%20new%20Supply%20Chain%20Act%20%28Lieferkettengesetz%29%20aims%20to,labour%2C%20exploitation%2C%20discrimination%20and%20inadequate%20labour%20law%20protection>>

110 Lopez, Edwin & McKevitt Jennifer, *France passes law requiring supply chain due diligence*, Supply Chain Drive, 2nd March 2017, viewed 21st July 2021, <<https://www.supplychaindrive.com/news/France-supply-chain-human-rights-reporting-audits/437191/>>

111 New EU guidance helps companies to combat forced labour in supply chains, European Commission, 13th July 2021, viewed 16th July 2021, <<http://trade.ec.europa.eu/doclib/press/index.cfm?id=2287&title=New-EU-guidance-helps-companies-to-combat-forced-labour-in-supply-chains>>

112 Sustainable Corporate Governance (public consultation page), European Commission, viewed 16th July 2021, <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance_en>



While the EU is working on initiatives to guarantee responsible business conduct, it is at the same time in the process of developing autonomous measures to counter coercive actions by non-EU countries. According to the European Commission, “[t]his instrument would empower the Commission to apply trade, investment or other restrictions towards any non-EU country unduly interfering in the policy choices of the EU or its Member States.”¹¹³

Extraterritorial push back

China is stepping up attempts to address the exposure of its companies to sanctions and export-controls imposed mainly by the US and other developed economies. On 10th June 2021, the NPC fast-tracked the Anti Foreign Sanctions Law (AFSL),¹¹⁴ which alarmed European companies due to the speed and lack of transparency of the process. For instance, the first reading was never announced, and the law was passed following the second reading (the NPC normally holds three readings).

The AFSL is the latest tool in Beijing’s emerging formal legal framework for countering foreign long-arm jurisdiction policies, following on from the Ministry of Commerce’s *Provisions on the Unreliable Entity List*,¹¹⁵ and its *Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures*.¹¹⁶

Although Beijing has yet to make use of these tools, their formal introduction suggests that they will most certainly be employed should cause be given, if only selectively. This puts foreign companies between a rock and a hard place – if they comply with home government measures (such as export-controls) or engage in activities perceived to be ‘anti-China’, they run the risk of being subjected to Chinese extraterritorial measures. This is not conducive to attracting foreign investment on either side, or reassuring companies that increasingly feel that they will be used as sacrificial pawns in a game of political chess.

Recommendations

Recommendations for China

- Increase integration into the global economy and steer away from ‘self-sufficiency’.
- Develop nuanced strategies for strengthening supply chains that do not err towards trade protectionism.
- Avoid duplication in the manufacturing of both goods that would result in misallocated resources and those that are already globally available and produced sustainably.
- Take a more proportionate approach to ‘national security’ and ‘critical information infrastructure’, with definitions that are as narrow as possible, and clearly differentiate these concepts from ‘commercial security’.
- Review existing and planned security-related laws and regulations, and release unambiguous implementation guidelines to ensure consistent requirements and enforcement.
- Clarify the roles and responsibilities of government authorities involved in cybersecurity rule-making and enforcement.

¹¹³ *Strengthening the EU’s autonomy – Commission seeks input on a new anti-coercion instrument*, European Commission, 23rd March 2021, viewed 27th July 2021, <https://ec.europa.eu/commission/presscorner/detail/en/IP_21_1325>

¹¹⁴ Tang, Sophia, *China Enacts the Anti-Foreign Sanctions Law*, Conflict of Laws, 21st June 2021, viewed 21st July 2021, <<https://conflictoflaws.net/2021/china-enacts-the-anti-foreign-sanctions-law/>>

¹¹⁵ *MOFCOM Order No. 4 of 2020 on Provisions on the Unreliable Entity List*, Ministry of Commerce, 19th September 2020, viewed 21st July 2021, <<http://english.mofcom.gov.cn/article/policyrelease/questions/202009/20200903002580.shtml>>

¹¹⁶ *MOFCOM Order No. 1 of 2021 on Rules on Counteracting Unjustified Extra-territorial Application of Foreign Legislation and Other Measures*, Ministry of Commerce, 9th January 2021, viewed 21st July 2021, <<http://english.mofcom.gov.cn/article/policyrelease/announcement/202101/20210103029708.shtml>>

- Ensure cybersecurity regulations are appropriate to and commensurate with risks.
- Recognise the key role that European companies play in increasing competition and innovation capacity in China, and ensure that they can contribute fully to the Chinese economy, through further market opening and the provision of a level playing field.
- Continue with reforms that bring SOEs more in line with market forces through the adoption of modern governance structures to make them more efficient, and eventually implement competitive neutrality.
- Maximise the role that European expertise and technology can play in ensuring China's smooth transition from fossil fuels to renewable energy sources.
- Incentivise local governments to increase renewables in the energy mix, to allow European businesses to meet their global carbon-neutrality obligations before China's 2030 peak emissions target.
- Develop an open and competitive market in which private enterprises are given the flexibility to develop and the population is able to move freely.
- Strengthen further IPR enforcement and continue to build a sound, transparent and inclusive standardisation system, in the interests of meeting China's technology and innovation goals.
- Reconsider whether China's zero-tolerance approach to COVID-19 is manageable with regard to meeting policy goals.
- Build a sound institutional framework, underpinned by rule of law, to ensure continued high-quality economic growth and to reduce the risk of China getting stuck in the middle-income trap.
- Increase overall productivity through more efficient allocation of resources, SOE reform and a scaling back of industrial support, while giving greater play to the role of the private sector.
- Recognise that European companies must adhere to European, and other globally-applicable, regulations in order to remain compliant and maintain their licence to operate, and avoid politicising business in such instances.
- De-escalate sanctions imposed against EU individuals and entities, in order to work towards ratification of the CAI.
- Work with EU counterparts in the meantime to find alternative ways to implement the commitments enshrined in the CAI.
- Continue cooperation with the EU in areas of mutual interest, such as decarbonisation and climate change, international standards-setting, sustainable development, WTO reform and the fight against COVID-19.
- Take a more conciliatory approach to diplomacy in order to help rebuild bridges with international partners.
- Avoid unnecessary duplication of existing mechanisms that facilitate EU-China business-to-government and business-to-business dialogues, such as chambers of commerce.
- Read the 930 constructive recommendations provided in the European Chamber's *Position Paper 2021/2022* to understand how European companies can make even greater contributions to increasing the quality and sustainability of China's economic growth.

Recommendations for the EU

- Enhance the overall coordination between member states and EU institutional stakeholders in order to foster a united European approach towards China.
- Re-calibrate the EU's overall engagement strategy with China so that it reflects both new and emerging priorities and challenges, ensures that cooperation in areas of common interest continues, and strikes the right balance between cooperation and competition.
- Engage with chambers of commerce, industry organisations and standards-setting bodies when formulating China policy, to ensure that it reflects on-the-ground realities.
- Strengthen the competitive capabilities of European players by developing bottom-up industrial



policy that promotes market competition and innovation in strategic industries, without prescribing technological pathways.

- Continue to develop and implement transparent and proportionate autonomous measures that shield European stakeholders from unfair practices and guarantee a level-playing field within the Single Market, including initiatives like the proposed instrument to tackle foreign subsidies, the anti-coercion mechanism and the network of investment screening tools.
- Develop instruments and initiatives that encourage reciprocity with third countries, such as the International Procurement Instrument.
- Streamline the complex network of EU-China dialogues to enhance their efficiency and ensure they deliver concrete outcomes.
- Continue cooperation with China in areas of mutual interest, such as decarbonisation and climate change, international standards-setting, sustainable development, WTO reform and the fight against COVID-19.
- Communicate to the Chinese Government the importance of lifting sanctions on European individuals and entities in the interests of getting the CAI ratified.
- Work with Chinese counterparts to find alternative ways to implement the commitments enshrined in the CAI in the meantime.
- Develop and implement a strategy on Global Connectivity that is based on concrete, transparent and sustainable projects, and that creates synergies with similar initiatives undertaken by like-minded partners and multilateral bodies.
- Continue to expand and upgrade the EU's free-trade agreement (FTA) network with third countries in order to establish frameworks based on transparency, sustainability and fair competition.
- Coordinate with like-minded partners on issues of common interest, both bilaterally and in fora like the WTO, the Group of 7 (G7) and the G20.

Recommendations for European companies

- Continue to integrate foreign staff into China operations—as well as Chinese staff into global operations—in order to maintain diverse teams and avoid talent silos.
- Strengthen links between global and China teams, in order to both increase understanding of China among headquarters and develop coherent China strategies.
- Establish 'decoupling teams' to evaluate the costs associated with both localisation in China and disconnection from certain global systems.
- Develop a cost/benefit analysis of adopting either a 'flexible architecture' model that can be localised for different markets or a 'dual system' model that completely separates China production from production for the rest of the world.
- Audit all supply chains to determine the current and future level of exposure to sanctions.
- Adopt a realistic strategy for remaining abreast of, and reacting positively to, changes in markets, public opinion and governments that could have an impact on China operations.
- Avoid entering certain segments, or consider winding down certain business lines, that are exposed to existing or potential sanctions, whenever the costs outweigh the benefits.
- Develop flexible global corporate decarbonisation strategies that can be adjusted in the event that China operations are unable to access green sources of energy.
- Invest and participate more in government advocacy efforts through chambers of commerce, industry associations and standards-setting bodies.

Section Two

Horizontal Issues

2

Horizontal Issues

The position papers in this section address the main horizontal issues that affect European businesses in China, covered by the following 10 working groups and one sub-working group:

- 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

While the Chinese economy recovered much faster than anticipated following the outbreak of the coronavirus disease 2019 (COVID-19), and European companies in most business areas saw their revenue less negatively affected than feared in the first months of 2020,¹ the effects of China's pandemic prevention measures are still being felt well into 2021. In particular, continued travel restrictions are having a negative impact on the operations of European companies in China and their interactions with their headquarters (HQ) in Europe. While local business is thriving, the gap between China operations and HQ is increasing as in-person communication remains almost impossible. Very few business visitors have been able to get business visas and, even if they do so, are deterred by lengthy and strict quarantine requirements of up to four weeks in certain regions. These hurdles delay planned projects and jeopardise new investments into China, as HQs are unsurprisingly reluctant to make final decisions on substantial investments without key personnel being able to visit the country. In addition, many expatriate employees, who normally serve as a bridge between a company's China operations and HQ, are deciding to leave China because of the impact of the travel restrictions on their family life, but also in anticipation of the new individual income tax (IIT) regime, introduced by *Caishui [2018] No. 164*² and to be implemented from 1st January 2022.

According to the new regulation, foreign employees will no longer receive tax exemption on allowances for housing rental, language training and children's education, but shall follow the "additional special deductions" that only allow a minimal fraction of the actual cost to be deducted. According to calculations by the Finance and Taxation Working Group, under the new regime, companies will be faced with cost increases of up to 76.9 per cent extra for an employee with two children in school.³ This will not only hamper the attraction and retention of foreign talent, but also in the long-term negatively impact foreign investment into China. The Finance and Taxation Working Group has engaged with the Chinese authorities on this issue at central and local levels, yet no clear indication regarding postponement of the

¹ *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, p. 11, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

² *Notice on the Convergence of Preferential Policies after the Revision of the Individual Income Tax Law (Caishui [2018] No. 164)*, State Taxation Administration (STA), 27th December 2018, viewed 8th July 2021, <<http://www.chinatax.gov.cn/n810341/n810755/c3978994/content.html>>

³ For more information, please see the *Finance and Taxation Working Group Position Paper 2021/2022*, p. 59.

implementation of *Caishui* [2018] No. 164 had been made as of the time of writing.

Small and medium-sized enterprises (SMEs) were hit hardest by the travel and supply chain disruptions caused by pandemic prevention measures. Despite the government introducing policies aimed at supporting this sector of the economy, many European SMEs still struggle with the effects of the disorder, in addition to long-standing issues like limited access to financing.⁴

Overall, European companies have to deal not only with COVID-19 restrictions fallout but also with pre-existing issues, since the Chinese Government understandably prioritised fighting the pandemic over pushing forward the reform agenda. Market access remains a central concern for legal services, as outlined in the *Legal and Competition Working Group Position Paper 2021/2022*.⁵ The impact can be seen in the *European Business in China Business Confidence Survey 2021 (BCS 2021)*, where 65 per cent of respondents in the legal services industry indicated having missed out on business opportunities as a result of market access restrictions or regulatory barriers.⁶

Market competitiveness and the lack of a level playing field with state-owned enterprises is a concern in most industries, as outlined in the *Investment Working Group Position Paper 2021/2022*.⁷ This is particularly evident in new industries, where restricting regulations such as data localisation requirements have a stronger impact on foreign players, who are barred from achieving synergies through integrating their China data in home data and analytics (D&A) processes. This widens the gap between foreign-invested companies and local players. While there is some progress, still almost half of BCS 2021 respondents indicate that they expect the state-owned sector to gain more opportunities in the next two years at the expense of the private sector.⁸

Environmental protection is currently at the centre of the Chinese Government's attention. In this regard, European Union Member States can lean on years of experience in legislation, technology and capitalisation relating to green development. Meanwhile, European companies are keen to use the opportunities that will arise from China's recent commitments to carbon neutrality⁹ to share their knowledge and support the government's agenda. They can leverage their advanced technologies and management systems to provide green solutions that can help China achieve its 2030 and 2060 carbon neutrality goals while ensuring energy security. The *Environment Working Group Position Paper 2021/2022* puts forward recommendations on how to improve environmental protection enforcement and promote green, low carbon and circular economy development, among others.¹⁰

4 For more information, please see the *Inter-chamber Small and Medium-sized Enterprises Working Group Position Paper 2021/2022*, p. 88.

5 For more information, please see the *Legal and Competition Working Group Position Paper 2021/2022*, p. 108.

6 *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, p. 11, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

7 For more information, please see the *Investment Working Group Position Paper 2021/2022*, p. 99.

8 *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, p. 38, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

9 *Annual Installed Capacity Significantly Increases*, Energy Storage World Forum, n.d., viewed 27th June 2021, <<https://energystorageforum.com/news/energy-storage/annual-installed-capacity-significantly-increases>>

10 For more information, please see the *Environment Working Group Position Paper 2021/2022*, p.48.

Compliance and Business Ethics Working Group

Key Recommendations

1. Consider the Adequacy and Effectiveness of a Corporate's Compliance Programme in the Principle of Enforcement

- Modify related legislation and implementation guidelines to allow recognition of the implementation of a robust compliance system as a valid defence in bribery cases.
- Issue guidance on the key elements of an adequate and effective compliance programme.
- Enhance experience exchanges between the government and business community on best practices in combatting corruption and bribery.

2. Encourage Systematic Compliance Talent Cultivation and Establish a Compliance Professional Qualification and Management System

- Cultivate compliance professionals by creating a standardised curriculum in universities and training programmes in law firms.
- Establish a compliance professional qualification certification at various levels and incentivise companies to build international compliance management systems.

3. Incentivise Business Entities to Allocate Sufficient Resources for Developing Compliance Expertise

- Draft and issue guidelines, local standards or industry standards to educate business entities and society on compliance matters.
- Learn best practices from other law jurisdictions such as the United States or European Union on government-enterprise cooperation on compliance topics.

Introduction to the Working Group

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, by promoting market integrity, will also help build trust among clients and business. Such practices 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

Over the past few years, compliance in China has evolved from the traditional areas of anti-corruption



and anti-bribery to new and broader areas—in line with the government's strengthening of a rule of law society—that include data and privacy protection, export control and competition law compliance, among others.¹ In President Xi Jinping's speech on 14th October 2020, he mentioned the rule of law seven times, and expressly stated that China needs to “make rule of law the consensus and basic norm of society, and develop a market-orientated, law-based and internationalised business environment”.² The promotion of internationalising legal standards for business environment development in China is welcomed by both domestic and international businesses, as it presents good opportunities and challenges for the compliance community and governmental enforcement agencies. The announcement on 9th March 2021 by the Ministry of Human Resources and Social Security (MOHRSS) that ‘corporate compliance officer’ is now officially recognised as a new profession in China is a good example of such internationalisation efforts.³

National and local governments have actively enacted laws, regulations, and guidelines in recent years to help build a rule of law society and compliance management systems in China. For instance, the Civil Code of China—consisting of seven sections with a total of 1,260 articles, it well deserves its nickname as an ‘Encyclopaedia of Social Life’—took effect from 1st January 2021, and provides basic guidance for civil activities, transaction activities and civil disputes.⁴ Although China already has numerous stand-alone civil laws and regulations in place, these were introduced at different times, sometimes overlap and occasionally even contradict each other. The unified civil code provides an overarching law that lawyers and judges can refer to when resolving civil cases in order to minimise contradicting verdicts.

The following are highlights of other recent compliance-related legislation developments:

- 1 *Outline for Implementing the Building of a Rule of Law Society*, State Council, 7th December 2020, viewed 23rd April 2021, <http://www.gov.cn/zhengce/2020-12/07/content_5567791.htm>
- 2 Xi Jinping: Speech at the 40th Anniversary Celebration of Shenzhen Special Economic Zone, Xinhua, 14th October 2020, viewed 23rd April 2021, <http://www.xinhuanet.com/politics/leaders/2020-10/14/c_1126611290.htm>
- 3 *The Ministry of Human Resources and Social Security, the State Administration for Market Supervision and Administration, and the National Bureau of Statistics jointly release 18 new occupations including integrated circuit engineering and technical personnel*, MOHRSS, 18th March 2021, viewed 23rd April 2021, <http://www.mohrss.gov.cn/SYrtzyhshbzb/dongtaixinwen/buneyiaowen/rsxw/202103/120210318_411376.html>
- 4 *Civil Code*, National People's Congress, 2nd June 2020, viewed 23rd April 2021, <<http://www.npc.gov.cn/npc/c30834/202006/75ba6483b8344591abd07917e1d25cc8.shtml>>

Anti-monopoly Law and Regulations

During the State Administration for Market Regulation's (SAMR's) public consultation on the Anti-monopoly Law (AML) in January 2020, the working group raised concerns about the law's lack of clear definitions on the implementation process, and the need for measures to prevent the abuse of power, as the proposed revisions will give enforcement agencies great discretion over the awarding of penalties.⁵

The Anti-monopoly Commission of the State Council issued the *Anti-monopoly Guidelines*, effective from 7th February 2021, which aim to prevent monopolistic activities in the field of online platform economies.^{6&7} The *Shanghai Anti-unfair Competition Regulations* promulgated by the Shanghai Municipal Government and effective since 1st January 2021 require all business operators in Shanghai to strengthen their internal control and compliance management.⁸ The working group welcomes these guidelines and believes that they will boost the development of corporate compliance programmes while increasing efficiency and consistency in compliance enforcement.

Social Credit System (SCS)

The Chinese Government is committed to establishing a national Corporate Social Credit System that will be an embedded mechanism, based on existing laws and regulations, to sanction or reward enterprises' bad and good behaviour. In 2014, the State Council published the *Plan for Establishing a Social Credit System (2014–2020)*, which was implemented by 2020, and a unified social credit code system at the state-level has been established.⁹ On 10th February 2021, the SAMR published draft amendments to the *Administrative Measures for the List of Enterprises with Seriously*

- 5 *Announcement of the State Administration for Market Regulation on the Public Consultation on the Anti-monopoly Law Amendment Draft (Draft for Public Consultation)*, SAMR, 2nd January 2020, viewed 20th May 2021, <http://www.samr.gov.cn/hd/zjdc/202001/t20200102_310120.html>
- 6 *The Anti-monopoly Guidelines of the Anti-monopoly Commission of the State Council on the Platform Economy*, SAMR, 7th February 2021, viewed 23rd April 2021, <http://gkml.samr.gov.cn/nsjg/fldj/202102/t20210207_325967.html>
- 7 The platform economy is economic and social activity facilitated by platforms. Such platforms are typically online sales or technology frameworks. By far the most common type are ‘transaction platforms’, also known as ‘digital matchmakers’. Examples of transaction platforms include Amazon, Airbnb, Uber, and Baidu.
- 8 *Regulations of Shanghai Municipality on Anti-unfair Competition*, Shanghai Municipal People's Congress, 28th October 2020, viewed 23rd April 2021, <<http://www.spcc.sh.cn/n8347/n8467/u1ai222523.html>>
- 9 *Plan for Establishing a Social Credit System (2014–2020)*, State Council, 27th June 2014, viewed 7th July 2020, <http://www.gov.cn/zhengce/content/2014-06/27/content_8913.htm>





Illegal and Dishonest Acts for public consultation.¹⁰ While improvements on previous measures have been introduced in these draft amendments, many clauses still need to be clarified. In addition, more directives or guidelines on credit repair are expected to be released in the near future.¹¹

These measures and their associated risks and rewards have motivated companies to look more closely at their own internal compliance procedures, and have facilitated the acceptance of compliance protocols by third parties. 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 and reform efforts. Regarding compliance regulations, such ambiguity increases the risk of unintentional infractions and can incentivise non-compliance in businesses.

Key Recommendations

1. Consider the Adequacy and Effectiveness of a Corporate's Compliance Programme in the Principle of Enforcement

Concern

The implementation of a robust compliance system by a company has not been taken into consideration for penalty reduction in prosecution and measurement of punishment in China.

Assessment

Currently, there are no implementation measures on lenient treatment for companies with a robust compliance system when a bribery or corruption issue arises. Although the Anti-unfair Competition Law (AUCL) was amended in 2017 and distinguished bribery behaviour committed by a single employee and that committed by the business operator, there are no official interpretations or real-life case studies of the types of evidence companies can

use to make such distinctions.¹² Equally, there are no official interpretations or real-life case studies of how a company with a robust compliance system may use, for example, its good compliance policy or history of good compliance as a point of plea for lenient treatment.

However, in other countries, such as Germany and Spain, adequate compliance measures and policies adopted by the prosecuted company are recognised as a valid defence. On 9th May 2017, the German Federal Court of Justice ruled that a compliance management system can lead to a reduction of a fine against the company.¹³ According to the ruling, two issues are to be taken in consideration during the determination of fines: first, whether an effective and risk-adequate compliance management system was in place before the misconduct took place; second, and most importantly, whether the management reacted promptly, identified the gaps in the system and bridged those gaps to prevent similar misconduct in the future.

This means that if companies can show they took meaningful actions to prevent bribery by employees, they may be 'rewarded' with a partial or full defence. Other factors are also taken into account, such as willingness to cooperate with the authorities. The applicability of the defence of adequate procedures depends 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.

Prerequisites for using a compliance system as a defence include the following principles:

- Proportionate processes which are clear, practical, accessible, effectively implemented and enforced to maintain an anti-bribery stance and to create a corporate culture that supports it;
- A strong tone from the top of the organisation to

¹⁰ *Administrative Measures for the List of Enterprises with Seriously Illegal and Dishonest Acts draft*, SAMR, 10th February 2021, viewed 14th April 2021, <<http://www.samr.gov.cn/hd/zjdc/202102/120210210210326053.html>>

¹¹ On May 12th 2021, the National Development and Reform Commission (NDRC) issued a review of the *Administrative Measures for Credit Repair (Trial) (Draft for Comment)*, which provides detailed regulations on credit repair. The public consultation ran from 12th May 2021 to 12th June 2021. However, it is hard to predict when this *Measures* will be finalised and take effect. *Administrative Measures for Credit Repair (Trial) (Draft for comment)*, NDRC, 12th May 2021, viewed 9th June 2021, <https://hd.ndrc.gov.cn/yjzx/yjzx_add.jsp?SiteId=359>

¹² Article 7 of the AUCL states that: "Bribery committed by a staff member of a business operator shall be deemed as bribery committed by the business operator, except where the business operator has evidence to prove that the conduct of the said staff member has nothing to do with seeking transaction opportunities or competitive advantage for the business operator." *Anti-unfair Competition Law of the People's Republic of China*, National People's Committee Standing Committee, 4th November 2017, viewed 8th June 2021, <http://www.gov.cn/xinwen/2017-11/05/content_5237325.htm>

¹³ *Judgment of the 1st Criminal Senate of 9th May 2017*, Bundesgerichtshof Im Namen des Volkes, 9th May 2019, viewed 20th May 2021, <<https://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&nr=78723&pos=0&anz=1>>





foster a culture of integrity, where management should be involved in key decisions regarding, as well as in the communication of, anti-bribery policies to ensure a meaningful impact;

- External communication to reassure third parties of the company's principles;
- Comprehensive training, well-rounded risk assessment, effective due diligence and monitoring of the effectiveness of their anti-bribery policies and procedures.

Allowing the compliance system defence will in addition promote greater transparency and compliance, as companies are encouraged to improve their internal compliance systems. This statutory defence may also allow other companies to assess what constitutes best practices and implement their own strong compliance systems. Consequently, it leads to continuous improvement by authorities, companies, their shareholders and society, contributing to a reduction in bribery risk.

Recommendations

- Modify related legislations and implementation guidelines to allow recognition of the implementation of a robust compliance system as a valid defence in bribery cases.
- Issue guidance on the key elements of an adequate and effective compliance programme.
- Enhance experience exchanges among the government and business community on best practices in combatting corruption and bribery.

2. Encourage Systematic Compliance Talent Cultivation and Establish a Compliance Professional Qualification and Management System

Concern

China lacks an overall framework for supporting the development of compliance officers/professionals qualified to respond to the ever-expanding scope of compliance challenges.

Assessment

In recent years, several central government departments, including the SAMR and the Ministry of Commerce, have issued regulations and guidelines on compliance management. As a result, Chinese enterprises and institutions are beginning to pay more attention

to compliance management systems. It is a very encouraging news that, in March 2021, the MOHRSS added 'corporate compliance officer' to the list of official professions, with the key responsibilities of setting up a company's compliance management strategy, identifying and assessing compliance risks, implementing compliance management systems and conducting compliance training and investigations.¹⁴

Although external monitoring pressure by both domestic and overseas regulatory bodies (such as the United States' (US) Department of Justice (DOJ)) and internal development needs continue to grow, the corresponding increase in demand for qualified compliance professionals in China is not being met. In addition, China currently has few systematic university-level curriculum for compliance; most compliance professionals come from legal, risk management or finance backgrounds. With the recent official recognition of corporate compliance officer as a profession, China should step up its efforts to develop compliance talent by improving compliance curriculum in universities and occupational schools, and establishing compliance professional qualification systems. Guidelines or policies should be developed at national or local government levels to promote a culture of compliance in society, as well as encouraging the establishment of a compliance organisation or a dedicated compliance team and management system in enterprises. These could then contribute to creating a robust and sustainable compliance culture and 'ecosystem' in China.

Recommendations

- Cultivate compliance professionals by creating a standardised curriculum in universities and training programmes in law firms.
- Establish a compliance professional qualification certification at various levels and incentivise companies to build internal compliance management systems.

¹⁴ The Ministry of Human Resources and Social Security, the State Administration for Market Supervision and Administration, and the National Bureau of Statistics jointly released 18 new occupations including integrated circuit engineering and technical personnel, MOHRSS, 18th March 2021, viewed 23rd April 2021, <http://www.mohrss.gov.cn/SYrlzyhshbzb/dongtaixinwen/buneyiaowen/rsxw/202103/t20210318_411376.html>





3. Incentivise Business Entities to Allocate Sufficient Resources for Developing Compliance Expertise

Concern

Compliance professionals lack sufficient investment and resources to develop new expertise, and therefore may not be able to cope with increased requirements arising from geopolitical tensions and various jurisdictions.

Assessment

Due to increasing geopolitical tensions and repeated outbreaks of COVID-19, jurisdictions are increasingly ring-fencing their regulatory framework to protect their national security interests and critical assets. As a result, legal professionals today not only need to manage traditional compliance challenges, such as anti-bribery and anti-corruption, but also need to tackle 'newly emerging' challenges, such as requirements for sanctions and export control, personal data protection, cybersecurity, safety, health and environment (SHE), customs and tax compliance. Some of those 'newly emerging' topics—for example, personal data protection or SHE—need special expertise, thus necessitating investment in training. Despite this, neither business entities nor the government are willing to allocate sufficient resources to developing compliance professionals. Given this conservative approach to investment in compliance amid the current volatility, uncertainty, confusion and ambiguity (VUCA)¹⁵ general conditions, working group members have reported high levels of burnout and overstretching among compliance professionals.

Compliance should not be left to business alone to manage and invest in; it also requires input from all stakeholders in society, including the government, industry associations, and corporate citizens. Only when all these stakeholders allocate sufficient resources to promoting a strong compliance culture, sharpening professional expertise and advocating compliance best practice, can a robust compliance scheme gain a solid foothold in society.

One way to mitigate burnout among compliance officers is to learn best practices from other jurisdictions. For

example, the US DOJ and Securities and Exchange Commission (SEC) have jointly issued a 100-page guide to the US Foreign Corrupt Practices Act (FCPA).¹⁶ The guide provides companies, practitioners, and the public with detailed information about the statutory requirements of the FCPA while also providing insight into DOJ and SEC enforcement practices through examples, summaries of applicable case law and DOJ opinion releases. It also summarises applicable new policies announced in recent years.

Similar practices are implemented by the European Commission with respect to anti-trust compliance. As an example, the European Commission and the national competition authorities in all European Union (EU) Member States cooperate with one other through the European Competition Network (ECN), in which ECN members engage in cooperation and exchange of best practices on merger control by setting up an EU Merger Working Group.¹⁷ The Compliance Working Group hopes that the Chinese Government, as a part of continuing efforts to provide increased transparency, could learn and adopt *mutatis mutandis* best practices from other jurisdictions to help businesses operating in China combat the everchanging compliance challenges.

Recommendations

- Draft and issue guidelines, local standards, or industry standards to educate business entities and society on compliance matters.
- Learn best practices from other law jurisdictions such as the US or the EU on government-enterprise cooperation on compliance topics.

¹⁵ *Mastering 2020: How to get prepared for the VUCA world with Light Footprint management*, Roland Berger, February 2014, viewed 25th May 2021, <http://contentworks.ro/wp-content/uploads/2019/05/Roland_Berger_TAB_Mastering_2020_20140228-2.pdf>

¹⁶ *A Resource Guide to the US Foreign Corrupt Practices Act*, DOJ, 25th November 2020, viewed 20th May 2021, <<https://www.justice.gov/criminal-fraud/fcpa-resource-guide>>

¹⁷ European Competition Network, 2021, European Commission, viewed 10th June 2021, <<https://ec.europa.eu/competition/ecn/mergers.html>>





Abbreviations

AML	Anti-monopoly Law
AUCL	Anti-unfair Competition Law
DOJ	Department of Justice
ECN	European Competition Network
EU	European Union
FCPA	Foreign Corrupt Practices Act
MOHRSS	Ministry of Human Resources and Social Security
NDRC	National Development and Reform Commission
SAMR	State Administration for Market Regulation
SCS	Social Credit System
SEC	Securities and Exchange Commission
SHE	Safety, Health and Environment
US	United States
VUCA	Volatility, Uncertainty, Confusion and Ambiguity



Environment Working Group

Key Recommendations

1. Increase the Transparency and Predictability of Corporate Social Credit Evaluation and Enforcement of Environmental Protection 3

- Enforce the Environmental Protection Law and related regulations in a transparent fashion.
- Communicate environmental enforcement plans well in advance of the 2021/2022 winter season, and discuss how best to mitigate any potential negative impact on relevant industries.
- Provide full online access to official environmental information, including policies and standards that are applied locally and nationally.
- Install direct communication channels for companies to notify central government authorities of any issues/irregularities related to 'one-size-fits-all' approaches or other unreasonable environmental enforcement.
- Improve the effectiveness of mediation as a dispute resolution tool by establishing an expert group of environmental mediators to conduct high-level mediation for major environmental disputes and facilitate the training of government officials, judges and private sector actors.

2. Engage with the European Union (EU) to Align on Policies that Support the Transition Towards a Circular Economy, Jointly Implement Projects on 'Zero-waste City' Pilots and Facilitate the Broader Application of Renewable Energy Technologies 3

- Enhance industrial players' involvement in, and promote frequent and in-depth exchange and dialogue on, the joint Memorandum of Understanding (MOU) on Circular Economy Cooperation.
- Improve high-level bilateral cooperation and engagement between China and the EU.
- Define an overall strategy for circular economy development, with a mid- and long-term legislative 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 of the highest possible quality and reduce secondary pollution in the current down-cycling process.
- 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 as cardboard and polyethylene terephthalate (PET), but also materials such as polypropylene, polyethylene, polystyrene, glass, non-ferrous metals and critical mineral resources.
- Involve more European companies in China's 'zero-waste city' initiative, to create not only





economic growth and innovation, but also better living conditions.

- Enhance China's hazardous waste traceability system to prevent illegal treatment, to allow the recycling industry to thrive while also generating products from hazardous waste.
- Decarbonise the power sector, interconnect energy systems and enhance the integration of renewable energy sources into the grid.
- Facilitate regional cooperation to broaden the use of renewable energy sources by utilising an appropriate carbon tax, carbon credit allocation and subsidisation policies.

3. Reinforce the Role that Environmental Facilities Play in China's National Emergency Response System

- Enhance construction of environmental facilities.
- Recognise the key role played by environmental facilities in ensuring the effectiveness of the Chinese public health emergency response system, and extend to them the support they need.

4. Contribute to Decarbonisation by Pushing Green, Low Carbon and Circular Economy Development

- Introduce environmental policies in addition to environmental compliance regulations, and encourage more financial incentives for material recycling and re-use in order to reduce carbon emissions.
- Link energy consumption to the environmental performance of industrial parks and plants so as to encourage them to adopt energy-saving solutions and consume less fossil fuels.

5. Improve the Regulatory Framework for the Remediation of Contaminated Land and Encourage Government at all Levels to Develop Efficient and Reliable Action Plans for Soil Pollution Remediation 🌱 3

- Adopt scientific, practical and nationally-aligned approaches for standards development in order to limit soil contaminants to those of genuine potential harm, and set up reasonable environmental quality criteria for water and soil.
- 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 so that they comply with the principles of the newly-revised Environmental Protection Law and the Law on Soil Pollution Prevention and Control.
- Provide financial support for provinces to put in place local soil remediation solutions, thereby providing a more accessible solution for manufacturers.

Introduction to the Working Group

There is only one earth. 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 reduction of carbon emissions and the prevention of pollution are 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 a commitment





that they are unwilling to compromise on. European companies in China are driven by a desire to contribute to 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 160 member companies involved in engineering, manufacturing, construction, consulting 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, 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),¹ the Ministry of Water Resources (MWR) and the Ministry of Natural Resources (MNR),² along with local bureaus. The working group also provides regular feedback to the Chinese authorities on environmental regulations, standards and technologies in China, and serves as a platform for companies to share best practices, experiences, solutions and recommendations on how to best protect the environment.

Recent Developments

On 22nd September 2020, President Xi Jinping stated in his speech at the 75th General Debate of the United Nations General Assembly that China will increase its nationally determined contributions, adopt more powerful policies and measures, “and strive to reach its peak carbon dioxide emissions by 2030, and strive to achieve carbon neutrality by 2060.”³ The Fifth Plenary Session of the 19th Central Committee of the Communist Party of China (CPC) adopted the *Proposals on Formulating the 14th Five-year Plan for National Economic and Social Development and Long-Term Goals for 2035* (14FYP), which highlighted the

major tasks that need to be undertaken for China’s green development, with the overarching goal of reaching carbon neutrality by 2060. Europe has a great deal of experience in green development with regard to legislation, technology and capitalisation. European companies in China now have an opportunity to leverage their advanced technologies and management systems to provide green solutions that can help China achieve its 2030 and 2060 goals while ensuring energy security.

High pollutant-emitting and energy-consuming enterprises, such as those in the energy, agriculture, transportation and construction sectors, will shoulder the major share of responsibility in emission reduction. Many of the European Chamber’s member companies are engaged in these industries, and can bring their rich experience and mature technologies to assist in fulfilling this challenging task.

For China to achieve its goals in climate mitigation and pollution control, the People’s Bank of China (PBOC) estimates that in the region of Chinese yuan (CNY) 2–4 trillion will be needed per year, illustrating the size of the challenge that lies ahead. However, not only does China’s transformation from the biggest carbon dioxide emitter to a carbon-neutral country require significant investment, it also needs to raise ‘healthy’ capital. To tackle this issue, China has been heavily promoting green financing, which the PBOC defines as “financial services provided for economic activities that are supportive of environmental improvement, climate change mitigation and more efficient resource utilisation.”⁴

The newly revised Prevention and Control of Environmental Pollution from Solid Waste Law (Solid Waste Law) took effect on 1st September 2020. The Solid Waste Law puts forward the principles of waste reduction, ‘resourcisation’⁵ and innocuous disposal⁶ in the prevention and control of solid waste pollution, and strengthens the binding provisions related to these principles. The joint and individual liability provisions for new industrial solid waste producers include incorporating industrial solid waste into the

1 Previously known as the Ministry of Environmental Protection (MEP). It became the MEE at the end of March 2018 following wider government restructuring.

2 Previously known as the Ministry of Land and Resources. It became the MNR at the end of March 2018 following wider government restructuring.

3 *Annual Installed Capacity Significantly Increases*, Energy Storage World Forum, n.d., viewed 27th June 2021, <<https://energystorageforum.com/news/energy-storage/annual-installed-capacity-significantly-increases>>

4 *Guide to Chinese Climate Policy: Green Finance*, Columbia University in the City of New York, viewed 21st May 2021, <<https://chineseclimatepolicy.energypolicy.columbia.edu/en/green-finance>>

5 The process of transforming waste into a useable resource.

6 Disposing of waste only once it has been rendered safe by removing pathogens and other contaminants.





sewage permit system management and improving the management of medical waste. It also places the responsibility for pollution on the polluter and the responsibility for properly treating waste on the original producer. The working group believes that the implementation of this new Solid Waste Law will improve and promote environmental protection technologies and management.

If China is to successfully realise the aforementioned principles, then the public, industry associations, domestic and foreign enterprises alike must all contribute accordingly. This can be done best by ensuring clear, transparent, consistent and predictable enforcement of these new policies.

Due to the strengthened environment protection efforts, domestic coal production, storage and imports of fossil fuels have been cut. As a result, certain areas, such as Guangdong Province, have experienced electricity blackouts, as the power supply cannot satisfy local consumer demand.⁷ The working group urges the government and authorities to handle carbon reduction reasonably and progressively, based on energy security and public access, in order to avoid such situations.

Key Recommendations

1. Increase the Transparency and Predictability of Corporate Social Credit Evaluation and Enforcement of Environmental Protection



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 and their Corporate Social Credit System (SCS) environmental protection scores.

Assessment

Local government agencies are being encouraged to implement rigorous environmental protection initiatives on top of existing strict rules, regulations and standards, in order to meet their targets. This has resulted in stricter environmental standards for wastewater discharge

and air emissions, among others. A one-size fits all approach has led to environmental enforcement sometimes unexpectedly impacting companies that comply with relevant regulations.

To reduce the frequent occurrences of severe air pollution in some parts of the country, the Chinese Government has taken special measures to control emissions. The State Council released the *Three-year Action Plan for Winning the Blue-Sky War* on 27th June 2018,⁸ setting air pollution prevention as a high priority. Since the release of this plan, many relevant initiatives have been implemented in different areas, often without sufficient planning and forethought.

One well-known example is the Beijing-Tianjin-Hebei area, where air pollution control measures were applied from 1st October 2019 until 31st March 2020.⁹ The final action plan, along with detailed measures, was only made available to affected industries and the public on 25th September 2019, leaving companies almost no time to prepare. This made it hard for many to take the necessary technical measures to reduce emissions; at the same time, production limits put these companies under enormous pressure, with some unable to complete client orders they had already committed to.

Another important factor related to environmental inspections is China's Corporate SCS.¹⁰ Since conception of the SCS in 2013, several official documents have been issued, including a trial version of the *Administrative Measures for Corporate Environment Credit Evaluation*,¹¹ the *Guideline on Improvement of Corporate Environment Credit System Development*,¹² and the *Joint Sanction Memorandum of Understanding (MoU) of Illegal and Untrusted Production Units in*

⁷ Iris Hong, *China's export hub Guangdong disrupted by power crunch, Covid*, Asia Financial, 2nd June 2021, viewed 28th June 2021, <<https://www.asiafinancial.com/chinas-export-hub-guangdong-disrupted-by-power-crunch-covid>>

⁸ *Notice on the State Council Three-year Action Plan for Winning the Blue Sky War*, State Council, 27th June 2018, viewed 23rd May 2021, <http://www.gov.cn/jzhengce/content/2018-07/03/content_5303158.htm>

⁹ *Notice on 2019-2020 Comprehensive Control and Management Plan on Beijing-Tianjin and Hebei and Surrounding Areas*, MEE, 11th October 2019, viewed 23rd May 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk03/201910/t20191016_737803.html?keywords=京津冀>

¹⁰ *Notice on the State Council Plan for Establishing a Social Credit System (2014–2020)*, State Council, 14th June 2014, viewed 23rd May 2021, <http://www.gov.cn/jzhengce/content/2014-06/27/content_8913.htm>

¹¹ *Notice on Administrative Measures for Corporate Environment Credit Evaluation*, State Council, 18th December 2013, viewed 23rd May 2021, <http://www.gov.cn/gongbao/content/2014/content_2667624.htm>

¹² *Guideline on Improvement of Corporate Environment Credit System Development*, State Council, 27th November 2015, viewed 23rd May 2021, <http://www.gov.cn/gongbao/content/2016/content_5059107.htm>





*the Environmental Protection Field.*¹³ Based on these documents, and in cooperation with the Fiscal, Finance Affairs and Credit Building Department of the NDRC, the MEE is taking a leading role in drafting a national comprehensive guideline for the implementation of a corporate environmental protection credit rating system.

While the system could be seen as a sign of mature development of environmental enforcement, it will also have a profound impact on companies in all sectors. For example, a poor credit rating or being blacklisted might lead to joint sanctions being enforced by other government agencies or the company's removal from procurement bidding lists.

Many European companies report that they encounter unexpected requirements to reduce their environmental impact, and to source energy from renewable energy, occasionally beyond what is realistically possible. Sometimes companies are forced by local authorities to cease production even if they are environmentally compliant. For companies that are already operating in authorised locations, such as designated industrial parks, and that adhere to the highest standards in order to comply with applicable regulations, these unexpected requirements bring exactly the kind of business uncertainty they try to avoid when choosing where to invest and manufacture.

The Environment Working Group realises that the Chinese Government faces the difficult task of balancing the needs of a healthy population and fair business environment with a sustainable economy, and wishes to contribute in any reasonable way possible. Balance could be achieved by, for example, involving affected industries in the development of industry-level action plans. The working group believes such cooperation would allow for constructive dialogue and agreement that will result in 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.

Another area where the working group would like to see improvements in the environmental protection sector is dispute settlement mechanisms. Increasing

sophistication in the monitoring, enforcement and court system within China's environmental sector should be matched by the enhancing alternative dispute resolution (ADR) processes, in particular mediation. Currently there are three ADR options available: people's mediation, administrative mediation and judicial mediation,^{14,15&16} together with the *xinfang* or 'letters and visits' system,¹⁷ which handle the vast majority of China's environmental disputes. While these processes channel and settle certain types of environmental complaints in an economical way, they are inadequate for handling the more complex, higher-stakes disputes that commonly arise.

To deal with such cases, the working group believes it would be far more efficient to establish a specialist and national environmental mediation body along the lines of the Environmental Dispute Adjustment Committee in South Korea and the Environmental Dispute Coordination Commission in Japan. These bodies consist of a panel of neutral mediation experts that have solid experience in environmental matters and the ability to quickly facilitate the resolution of environmental disputes. Such an expert body would also be expected to conduct training programmes for government officials, non-government organisations and the private sector, so that mediation can be more widely used in environmental dispute resolution throughout China.

Recommendations

- Enforce the Environmental Protection Law and related regulations in a transparent fashion.
- Communicate environmental enforcement plans well in advance of the 2021/2022 winter season, and discuss how best to mitigate any potential negative impact on relevant industries.
- Provide full online access to official environmental information, including policies and standards that are applied locally and nationally.
- Install direct communication channels for companies

¹⁴ People's mediation: a mechanism provided under the People's Mediation Law, which is conducted through people's mediation committees that are established by rural village committees, resident committees, enterprises, institutions or administrative organisations.

¹⁵ Administrative mediation: a mechanism where administrative organs mediate civil disputes that fall within their authority.

¹⁶ Judicial mediation: a mechanism integrated into litigation procedures that is conducted under the guidance of a People's Court with the mediation settlement agreement having the same legal effect as a judgment.

¹⁷ *Xinfang* or 'letters and visits' system: a mechanism where citizens, legal persons or other organisations lodge complaints with People's Governments at any level and through written correspondence, e-mail, fax, phone, visits, and so on, with such complaints being dealt with by relevant administrative departments.

¹³ Notice on Joint Sanction MoU of the Illegal and Untrusted Production Units in the Environment Protection Field, State Council, 20th July 2016, viewed 23rd May 2021, <http://www.gov.cn/xinwen/2016-08/19/content_5100687.htm>





to notify central government authorities of any issues/irregularities related to 'one-size-fits-all' approaches or other unreasonable environmental enforcement.

- Improve the effectiveness of mediation as a dispute resolution tool by establishing an expert group of environmental mediators to conduct high-level mediation for major environmental disputes and facilitate the training of government officials, judges and private sector actors.

2. Engage with the European Union (EU) to Align on Policies that Support the Transition Towards a Circular Economy, Jointly Implement Projects on 'Zero-waste City' Pilots and Facilitate the Broader Application of Clean Energy Technologies

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 and there is no holistic strategy or management system, which hinders implementation of waste classification policies in certain cities.

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.

In 2015, the European Commission adopted an ambitious circular economy package, creating a comprehensive framework that will truly enable the transition from linear economies.¹⁸ The EU has since delivered on all 54

actions outlined in the package, becoming a trailblazer for the rest of the world. In addition, the EU rolled out its Circular Economy Action Plan 2.0 on 11th March 2020,¹⁹ as one of the key priorities of the EU Green Deal. Under this plan, a comprehensive legislative initiative will ensure that only sustainable products with a strict eco-design framework and proven circularity in the production process can be sold in the EU market. Informative and trustworthy labelling and 'right to repair'²⁰ will be enforced. This legislation will obviously affect Chinese manufacturers and exporters to the EU.

On 17th July 2018, China and the EU signed a Memorandum of Understanding (MOU) on Circular Economy Cooperation,²¹ 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. Bilateral cooperation and engagement between China and the EU are expected by the Environment Working Group.

It is important to acknowledge that the EU's achievements relating to the circular economy would not have been possible without a comprehensive 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 legislative framework, including targets and roadmaps. This

¹⁸ *Closing the Loop: Commission Adopts Ambitious New Circular Economy Package to Boost Competitiveness, Create Jobs and Generate Sustainable Growth*, European Commission, 2nd December 2015, viewed 23rd May 2021, <http://europa.eu/rapid/press-release_IP-15-6203_en.htm>

¹⁹ *A new Circular Economy Action Plan for a Cleaner and More Competitive Europe*, European Commission, 11th March 2020, viewed 23rd May 2021, <<https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1583933814386&uri=COM:2020:98:FIN>>

²⁰ 'Right to repair' refers to the new horizontal material rights for consumers, for instance, regarding the availability of spare parts or access to repair and, in the case of information and communications technology and electronics, to upgrading services. See: *Opinion on Further Strengthening Plastic Waste Management*, NDRC, 16th January 2020, viewed 23rd May 2021, <https://www.ndrc.gov.cn/xxgk/zcfb/tz/202001/t20200119_1219275.html>

²¹ *EU-China Summit: deepening the strategic global partnership*, European Commission, 6th July 2018, viewed 23rd May 2021, <https://ec.europa.eu/commission/presscorner/detail/en/IP_18_4521>



will lay 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 public-private partnership model, particularly with the joint involvement of both Chinese and European companies, thereby creating a circular economy ecosystem.

Plastic waste is one of the key issues that 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.²² 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.

The NDRC and MEE jointly issued the *Opinions on Further Strengthening Plastic Waste Management (Opinions)* on 16th January 2020,²³ followed in April by the *Catalogue of Plastic Products Prohibited and Restricted from Production, Sale and Use* for public comment.²⁴ The *Catalogue* included a five-year action plan to reduce the use of some non-degradable, single-use plastics items, such as plastic bags, straws and other utensils. This overdue move was welcomed by many environmental activists. However, it also stirred widespread concern that this may simply lead to a switch from single-use plastics to other types of single-use materials, i.e., paper-plastic composite materials or the still-heavily-debated, so-called 'bio-degradable' materials.

China has a functioning plastic recycling industry, consisting of a long-standing informal scrap collecting and processing system. However, the industry is not well-regulated and, in many cases, secondary pollution and unavoidable down-cycling result. 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 also provides accurate data to all stakeholders along the value chain, thereby creating a stable demand-supply relationship, as well as transparency that can help the government improve policy. Moreover, the mechanism creates new job opportunities, meaning that unofficial or part-time collectors can be offered better working conditions.

The circular economy is not only about end-of-life recycling; its success also depends on the use of recycled raw materials. To eventually achieve a closed loop, it needs a proven business case for the trade of recycled content to production markets, which have high standards related to the quality of materials. This could mean that some types of plastic products will be banned, because if a replacement material is available, it would be difficult to justify an economic case for recycling. More importantly, the market for recycled plastics will need to be better regulated and enlarged, and more products will have to be made of recycled materials. China must form relevant policies and national or industrial standards in 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 for producers to make products that have longer durability and are more 3Rs-friendly should be set and enforced. Extended Producer Responsibility policies—already in place in the automobile industry—should be adopted in all sectors of the circular economy, in which producers pay different financial contributions to the scheme based on the end-of-life costs of their products.²⁵ This would help create economic incentives for designing products that can be more easily recycled or reused.

Currently, circular economy models are better established for certain 'high value' and 'easy-to-recycle' materials such as cardboard, metal and polyethylene terephthalate (PET) plastic, because the collection and recycling value chain is more mature. But there are many other waste materials—such as polyolefins, glass

²² *The Commission's plan for plastics*, European Commission, 8th January 2019, viewed 23rd May 2021, <<https://www.innovationnewsnetwork.com/plastics-in-a-circular-economy/540/>>

²³ *Opinions on Further Strengthening Plastic Waste Management*, NDRC, MEE, 16th January 2020, viewed 23rd May 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk10/202001/t20200120_760495.html>

²⁴ *Call for Comments on the Catalogue of Plastic Products Prohibited and Restricted from Production, Sale, and Use (Draft for Comments)*, NDRC, 10th April 2020, viewed 23rd May 2021, <https://hd.ndrc.gov.cn/yjzx/yjzx_add_wap.jsp?SiteId=332>

²⁵ *Extended Producer Responsibility*, Organisation for Economic Cooperation and Development, viewed 23rd May 2021, <<https://www.oecd.org/env/tools-evaluation/extendedproducerresponsibility.htm>>





and ceramics—that are not only high in volume, but also high in material value. Technological 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 'zero-waste cities' pilots.²⁶ This project aimed 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 a vast amount 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 zero-waste cities pilots, and that EU cities and enterprises be encouraged to jointly work with their Chinese counterparts on these projects.

The Chinese Government would also benefit greatly from enhancing its hazardous waste traceability system to prevent illegal treatment, which will in turn benefit the recycling industry while also generating products from hazardous waste. A specific permit system for industrial companies using recycled hazardous waste could be implemented, to ensure only a defined range of recycled waste is accepted, and that companies have adequate facilities to do so safely and with controlled environmental impact.

A key goal of the circular economy is to become climate neutral. Half of total greenhouse gas (GHG) emissions and more than 90 per cent of biodiversity loss and water stress come from resource extraction and processing. Scaling up the circular economy and involving mainstream economic players, instead of just those at the forefront, will make a decisive contribution to achieving climate neutrality by 2060 and decoupling economic growth from resource use.²⁷

China is making an effort to deploy more clean energy for power generation to reduce air pollution and GHG emissions. The government should therefore facilitate

broader application of renewable energy in power generation and industrial operations nationwide, to move towards a low-carbon energy system,²⁸ secure an affordable energy supply by prioritising energy efficiency and develop a power sector largely based on renewable sources.

Recommendations

- Enhance industrial players' involvement in, and promote frequent and in-depth exchange and dialogue on, the joint MOU on Circular Economy Cooperation.
- Improve high-level bilateral cooperation and engagement by China and the EU.
- Define an overall strategy for circular economy development, with a mid- and long-term legislative 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 of the highest possible quality and reduce secondary pollution in the current down-cycling process.
- 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 as cardboard and PET, but also other materials such as polypropylene, polyethylene, polystyrene, glass, non-ferrous metals and critical mineral resources.
- Involve more European companies in China's 'zero-waste city' initiative, to create not only economic growth and innovation, but also better living conditions.
- Enhance China's hazardous waste traceability system to prevent illegal treatment, to allow the recycling industry to thrive while also generating products from hazardous waste.

26 *Work Plan for 'Zero-waste Cities' Pilots*, State Council, 21st January 2019, viewed 23rd May 2021, <http://www.gov.cn/xinwen/2019-01/21/content_5359705.htm>

27 *A new Circular Economy Action Plan for a Cleaner and More Competitive Europe*, European Commission, 11th March 2020, viewed 23rd May 2021, <<https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1583933814386&uri=COM:2020:98:FIN>>

28 *Carbon Market Sub-working Group Position Paper 2020/2021*, p. 225, European Union Chamber of Commerce in China, 10th September 2020, <https://www.europeanchamber.com.cn/en/publications-archive/858/Carbon_Market_Sub-working_Group_Position_Paper_2020_2021>





- Decarbonise the power sector, interconnect energy systems and enhance the integration of renewable energy sources into the grid.
- Facilitate regional cooperation to broaden the use of renewable energy sources by utilising an appropriate carbon tax, carbon credit allocation and subsidisation policies.

3. Reinforce the Role Played by Environmental Facilities in China's National Emergency Response System

Concern

Although environmental facilities can play a key role in tackling public emergencies, such as national health crises, they have been largely neglected in China, which hinders the recovery process and even poses potential risks to public safety.

Assessment

Environmental facilities providing quality sanitation, wastewater treatment, municipal waste treatment and hazardous/medical waste treatment services are not only able to contribute to promoting environmental quality, but also play an important, frontline role in dealing with public emergencies, including but not limited to public health crises, chemical plant accidents and oil spills. However, their role is usually downplayed in China.

For example, during the initial COVID-19 outbreak in China, by investing more in disinfection processes, environmental facilities made a significant contribution to preventing the coronavirus from entering the environment again via sewage networks and waste.

However, this role played by environmental facilities was largely neglected. Amid the pandemic, while managing risks and the burdens of an increased workload, environmental companies were not officially regarded as essential to COVID-19 prevention measures. As a result, it was difficult for them to benefit from favourable policies or protective equipment support, as many other companies that worked to contain the virus did. Such lack of support may put staff safety, supply chains and the financial stability of environmental companies at severe risk, which would affect the quality of environmental services critical for dealing with this health crisis.

Similar issues have been observed in relation to other environmental emergencies that have raised public safety concerns. According to the Ministry of Emergency Management (MEM), from January to November 2020, there were 127 accidents in the chemical sector, resulting in 157 deaths.²⁹ Without an efficient emergency response system in place, such accidents might threaten public safety and health if resulting pollution and waste is not properly dealt with. This, again, is a key role those environmental facilities play.

In many Chinese cities, environmental facilities are excluded from emergency response systems, either because those cities are short of environmental facilities, or their role is simply unacknowledged by local governments. If this neglect continues, it may result in serious consequences that cities cannot mitigate. The working group therefore advocates that local governments acknowledge and improve this situation, to prevent potential risks.

Recommendations

- Enhance construction of environmental facilities.
- Recognise the key role played by environmental facilities in ensuring the effectiveness of the Chinese public health emergency response system, and extend to them the support they need.

4. Contribute to Decarbonisation by Pushing Green, Low Carbon and Circular Economy Development

Concern

There are currently limited incentives that encourage green, low carbon and circular economy development with the aim of achieving decarbonisation.

Assessment

To put China's plan to peak carbon emissions by 2030 and then achieve neutrality by 2060 into perspective, there are currently 54 developed countries that have set peak carbon targets, and it took from 50 to 70 years for them to reach that stage. China's carbon emissions are currently equivalent to the total amount of emissions from the United States, the EU, Japan and

²⁹ The first list of accidents of chemical and hazardous chemical production, MEM, 8th December 2020, viewed 23rd May 2021, <https://www.mem.gov.cn/xw/bndt/202012/t20201208_374872.shtml>





the Pacific Island countries combined.³⁰ The enormity of the challenge of balancing China's rapidly increasing energy demand as its economy continues to grow, while achieving significant reductions in carbon emissions, cannot be understated.

While the many issues in China's power market are being broadly addressed, it is also essential to come up with more specific environmental strategies that will guide green, low-carbon and circular economy development. This will also require incentives that will encourage such investments. For example, waste is still largely regarded as pollution, therefore environmental policies need to encourage material recycling and re-use rather than a one-size-fits-all treatment. In many cases, due to current requirements from environmental protection bureaus, chemical plants have to treat chemicals that could be recycled as waste. In addition, even though there is no technical hindrance, recycled plastics are still not allowed to be used as food contact materials in China. These examples show how under-developed policies can result in unnecessary additional carbon emissions and waste.

It is also important for China to optimise its energy mix by consuming fewer fossil fuels to facilitate improvements to the environmental performance among different industries. Hence, industrial parks or plants should be encouraged to adopt energy optimisation solutions. For instance, wastewater, biomass waste and even wasted heat can all be recovered as new energy sources. Environmental policies should be more incentivised to encourage industries to optimise their energy consumption so as to reduce carbon emissions. This is also increasingly significant in terms of attracting investment – access to clean sources of energy is an extremely important factor for European companies when making decisions on where to invest in China.

Recommendations

- Introduce environmental policies in addition to environmental compliance regulations, and encourage more financial incentives for material recycling and re-use in order to reduce carbon emissions.
- Link energy consumption to the environmental performance of industrial parks and plants so as to

encourage them to adopt energy-saving solutions and consume less fossil fuels.

5. Improve the Regulatory Framework for the Remediation of Contaminated Land and Encourage Government at all Levels to Develop Efficient and Reliable Action Plans for Soil Pollution Remediation 3

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 that prioritise the management of certain dangerous substances: *The List of Toxic and Harmful Water Contaminants (First Batch)*,³¹ which was released in July 2019; and the List of Toxic and Harmful Air Contaminants, released in January 2019.³² Both lists define a small group of substances that are recognised globally as toxic, including cadmium, lead, mercury, hexavalent chromium and arsenic. In addition, Article 20 of the Soil Pollution Prevention and Control Law,³³ which came into effect on 1st January 2019, mandates the development of a list of toxic and harmful soil contaminants for priority control. The working group recommends that this list be both concise and highly specific, adopting science-based approaches to better determine which substances actually belong on the list.

Since the enacting of soil and groundwater standards, different provinces and cities have started developing their own regional and local policies and standards. For example, Shandong Province implemented the *Shandong Province Soil Pollution Control Regulations*

³⁰ *China Needs to Establish and Improve its Carbon and Electricity Market with the Carbon Game Becoming a New Stage among Major Countries*, China Times, 28th March 2021, viewed 23rd May 2021, <<https://www.chinatimes.net.cn/article/105778.html>>

³¹ *List of Toxic and Harmful Water Contaminants (First Batch)*, MEE, 24th July 2019, viewed 23rd May 2021, <http://www.mee.gov.cn/xxgk/2018/xxgk/xxgk01/201907/t20190729_712633.html>

³² *List of Toxic and Harmful Air Contaminants 2018*, MEE, 25th January 2019, viewed 23rd May 2021, <http://www.mee.gov.cn/xxgk/2018/xxgk/xxgk01/201901/t20190131_691779.html>

³³ *Soil Pollution Prevention and Control Law of the People's Republic of China*, MEE, 31st August 2018, viewed 23rd May 2021, <http://www.mee.gov.cn/ywyz/fgbz/fl/201809/t20180907_549845.shtml>





on 6th December 2019.³⁴

Meanwhile, the *Management of the Soil Pollution Control Fund* was jointly published by the MEE and five other departments in March 2020,³⁵ indicating that China is developing systematic financial support for remediation work. The government has started comprehensive documenting of site pollution, while investigation and proactive planning of divestiture requirements is becoming increasingly important.

The Soil Pollution Prevention and Control Law's adoption of the term 'heavy metal' is problematic, as it is not scientifically defined by the law and can therefore 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 over their use 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*.³⁶

It is notable that the MEE has worked with the National Health Commission (NHC) to release the *Framework Guidance on the Technical Approaches for the Environmental Risk Assessment of Chemical Substances (Trial)*,³⁷ which generally recognises specific characteristics of metal content in soil, for example, if it is a natural occurrence, essential to human health or has different valences.³⁸ However, the MEE should also develop some detailed guidance on how to assess the environmental risk of metals and other associated substances.

Recommendations

- Adopt scientific, practical and nationally aligned 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.
- 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.
- Provide financial support for provinces to put in place local soil remediation solutions, thereby providing a more accessible solution for manufacturers.

Abbreviations

3Rs	Reduce, Reuse, Recycle
ADR	Alternative Dispute Resolution
CNY	Chinese Yuan
EPR	Extended Producer Responsibility
EU	European Union
GHG	Greenhouse Gas
MEE	Ministry of Ecology and Environment
MEM	Ministry of Emergency Management
MEP	Ministry of Environmental Protection
MNR	Ministry of Natural Resources
MOU	Memorandum of Understanding
MWR	Ministry of Natural Resources
NDC	Nationally Determined Contributions
NDRC	National Development and Reform Commission
NHC	National Health Commission
PBOC	People's Bank of China
PET	Polyethylene Terephthalate
UN	United Nations

³⁴ *Shandong Province Soil Pollution Control Regulations*, Shandong Province, 6th December 2019, viewed 23rd May 2021, <http://sthj.shandong.gov.cn/trsthjcl/trsthj/201912/t20191206_2468939.html>

³⁵ *Management of the Soil Pollution Control Fund Jointly Issued by Six Departments*, MEE, 28th February 2020, viewed 23rd May 2021, <http://www.mee.gov.cn/ywdt/hjywnews/202002/t20200228_766620.shtml>

³⁶ *Interpretation on Several Issues Concerning Applying Laws in Handling Criminal Cases in Environmental Pollution*, Supreme People's Procuratorate, 27th December 2016, viewed 23rd May 2021, <https://www.spp.gov.cn/zdgz/201612/t20161227_176817.shtml>

³⁷ *Notice on the Framework Guidance on the Technical Approaches for the Environmental Risk Assessment of Chemical Substances (Trial)*, MEE, 3rd September 2019, viewed 23rd May 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk05/201909/t20190910_733204.html>

³⁸ For the same kind of metal, different valences lead to different bio effectiveness and poison levels.





Finance and Taxation Working Group

Key Recommendations

1. Extend the Non-taxable Reimbursement Regime for Foreign Employees

- Extend the existing regime of non-taxable treatment for reasonable cost reimbursements, including education, housing and language training.

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

- Introduce bad debt relief in VAT treatment.
- Clarify the Chinese VAT place of supply rules in the draft VAT Law.
- Include more detailed provisions to define how a supply would be treated as out of scope, VAT exempt or zero-rated.
- Expand the scope of zero-rating and provide clear guidance on the application thereof to mitigate administrative burdens.
- Revise the Chinese export VAT refund system, and allow for VAT exemption on exports.
- Allow taxpayers to claim the input VAT incurred on loan interest.
- Enable non-resident taxpayers to register for VAT in China.
- Allow qualified agencies to issue special VAT invoices.
- Eliminate issues with double VAT taxation for on-balance-sheet asset backed securities.

3. Take Prudent Steps in Consumption Tax Reform

- Involve experts in discussions on standards and measurements and, where necessary, re-determine the scope of taxation.
- Review the applicable tax rates and taxation method to facilitate the macro-development strategies of specific industries and better reflect international best practices (for example, move taxation point to consumer spending).
- Implement a unified direct exemption treatment for all refined oil products (ROP) (including naphtha) purchases, regardless of source (domestic or import), as feedstock to produce chemical products without restrictions.
- Provide financial and tax incentives to encourage companies to invest in chemical recycling, such as exemption from consumption tax on ROP made from recycled waste plastic and full VAT refund on ROP or chemical products made from waste plastics.

4. Introduce Tax and Fiscal Measures to Encourage Automation and Further Develop Digital Infrastructure

- Provide tax incentives for companies to invest in digital infrastructure such as hardware and software, as well as more advanced automation.
- Review tax filings and other financial procedures to focus efforts on the development of the digital economy.
- Accelerate the adoption of electronic invoicing.



5. Take Alternative Steps to Attract Foreign Investment into China 4

- 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 re-investment by replacing it with a WHT exemption plus a minimum holding period requirement (for shares obtained through reinvestment).
- Grant preferential tax policies to European companies that transfer the use right of core intellectual property rights to local firms.
- Harmonise the transfer pricing (TP) evaluation approach adopted by the customs and tax authorities, and issue clear State Administration of Foreign Exchange rules and enable TP adjustments between local and overseas firms, including pay-in and payout.

Introduction to the Working Group

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 are reflected in the World Bank's *Doing Business 2020* report, which states that China has made it easier to pay taxes by implementing a preferential corporate income tax (CIT) rate for small enterprises, reducing the value-added tax (VAT) rate for certain industries and enhancing the electronic filing and payment system.¹

In 2020 and early 2021, the working group engaged with the Chinese authorities on several issues, particularly the implications of the 2018 individual income tax (IIT) reform on foreign expatriates and their employers. On 25th January 2021, the Finance and Taxation Working Group sent an advocacy letter to the Foreign Investment Administration Department of the Ministry of Commerce (MOFCOM), which underscored

the projected impacts of a cancellation of non-taxable allowances on companies employing foreign staff. On 14th April 2021, representatives of the working group met with MOFCOM on the IIT reform.

Key Recommendations

1. Extend the Non-taxable Reimbursement Regime for Foreign Employees 3

Concern

The cancellation of the non-taxable reimbursement regime for foreign expatriate employees, scheduled for 2022, will bring prohibitive extra costs to foreign employees and enterprises, hampering the attraction and retention of foreign talent and negatively impacting foreign investment into China.

Assessment

Subject to reasonable limitations, certain allowances for foreign employees, such as children's education, housing rental and language training, are currently exempt from IIT. This existing policy has been very successful in attracting foreign investment and talent into China. As per *Caishui [2018] No. 164*,² starting from 1st January 2022, foreign employees will no longer receive tax-exemption policies on allowances for housing rental, language training and children's education, but shall follow the "additional special deductions" scheme for all resident taxpayers, which

¹ *Doing Business 2020: Comparing Business Regulation in 190 Economies*, World Bank, 2020, viewed 14th April 2021, <<https://www.doingbusiness.org/en/doingbusiness>>

² *Caishui [2018] No. 164, Notice on the Convergence of Preferential Policies after the Revision of the Individual Income Tax Law*, State Taxation Administration (STA), 27th December 2018, viewed 14th April 2021, <<http://www.chinatax.gov.cn/n810341/n810755/c3978994/content.html>>



(in Chinese yuan (CNY))	Current treatment until 31 st Dec 2021	New treatment starting from 1 st Jan 2022	
		...if additional tax is borne by employee	...if additional tax is borne by employer
Rental fee for apartment, e.g., CNY 25k per month	300,000	300,000	300,000
Tuition fee for international school, e.g., CNY 200k per year per child	400,000	400,000	400,000
Tax borne by employer on behalf of employee	-	-	538,364 ³
Total value of allowances	700,000	700,000	1,238,364
Special additional deduction for rental expense under new tax treatment	-	-18,000	-18,000
Special additional deduction for dependents' education under new tax treatment	-	-24,000	-24,000
Non-taxable portion under current tax treatment	700,000	-	-
Tax base increase	-	658,000	1,196,364
Additional tax burden ...		@45%	@45%
... for employee	-	+296,100⁴ (+42.3% of net package)	-
... for employer	-	-	+538,364⁵ (+76.9% of net package)

only allows a minimal fraction of the actual cost to be deducted.

Terminating the existing regime will bring prohibitive extra costs to European and other foreign employees and enterprises (cost increases up to +76.9 per cent for the employer, see sample calculation). This will not only hamper the attraction and retention of foreign talent, but also negatively impact foreign investment into China.

Most foreign enterprises need high-calibre foreign expatriates to establish and upgrade their operations in China. In over forty years of reform and opening up in China, foreign nationals have brought operational know-how, provided training, set-up research and development (R&D) centres, facilitated technology transfers, developed regional headquarters, promoted cultural exchanges and helped Chinese companies internationalise. In foreign companies, they are an essential link to overseas headquarters as they

can explain the realities of China in an ever more challenging geopolitical environment. They, as well as their children and spouses, are some of China's strongest supporters, serving as goodwill ambassadors to the outside world.

If foreign employers and employees are to bear the costs of the existing non-taxable reimbursements after 2021, many companies will be unable to allocate the resources required to carry their investment plans through. As a consequence, companies might look for alternative investment destinations in neighbouring countries and regions that have more favourable tax treatments, such as Singapore and Hong Kong.

The economic impact of the COVID-19 pandemic will be felt for years to come. With governments around the world, including China's, taking targeted interventions to ease tax burdens and attract foreign investment, adding IIT costs to expatriate assignments in this critical recovery period would send a discouraging signal to the foreign investment community in the country.

China remains committed to advancing the opening

3 CNY 538,364 = {CNY 700,00 – [45% * (CNY 18,000 + CNY 24,000)]} / (1 – 45%) – CNY 700,000

4 CNY 296,100 = 45% * CNY 658,000

5 CNY 538,364 = 45% * CNY 1,196,364



up of its economy, as reflected in a series of important announcements by the central authorities designed to attract foreign investment into Mainland China, including the development of Hainan into a free trade port with foreign direct investment (FDI) incentives similar to those of Hong Kong.

Extending the non-taxable reimbursements would help ensure that capital investments as well as international, highly-skilled talent continue to flow into the country. Such a gesture would help reduce the economic impact of COVID-19, support the internationalisation of companies and cities in China, and help attract quality capital and human investment to China that are essential to its continued commitment to opening up, as stated in the 14th Five-year Plan.

Recommendation

- Extend the existing regime of non-taxable treatment for reasonable cost reimbursements, including education, housing and language training.

2. 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 better align with international norms.

Assessment

Significant changes to the Chinese VAT system have been introduced over the past few years. China's tax system underwent a major overhaul in 2016, and the government has since clarified and updated VAT policies through circulars like *Caishui [2016] No. 36* (Circular 36).⁶ In November 2019, the MOF published a draft VAT Law that aims to consolidate previous measures and further align China VAT practices with international standards.⁷ While a welcome development, this step alone does not suffice to ensure alignment, and measures to encourage the international competitiveness of businesses operating in the Mainland remain necessary. These measures are as follows:

Introduce Bad Debt Relief Treatment for VAT Purposes

The global economic downturn caused by the COVID-19 pandemic has led governments to introduce special tax and fiscal policies to help taxpayers survive and recover. In the spirit of continuing these efforts, the working group recommends the introduction of bad debt treatment for VAT purposes in China's future VAT Law. This would enable taxpayers to reclaim VAT paid on sales. Having a bad debt provision in the VAT Law, similar to the provisions on bad debt losses included in the CIT Law, would align with the principle of fiscal neutrality, as taxpayers will not have to pay VAT when they do not receive payment from their customers.

Clarify the Chinese VAT Place of Supply Rules in the Draft VAT Law

VAT neutrality in cross-border trade follows the 'destination' principle laid out in Organisation for Economic Cooperation and Development (OECD) guidelines, which state that taxes should be collected in the country where the service is consumed. Currently, China 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. However, the draft VAT Law states that services are deemed to take place within the territory of China if the sellers are domestic entities and the services are consumed within the territory of China. The working group therefore recommends a further clarification of the determination of 'consumption' in the draft VAT Law.

Moreover, it is recommended that the place of supply also be clarified and that more detailed provisions be included. For example, the working group suggests that the main place of supply for standard business-to-business (B2B) services be defined as the place where the customer is located. Exceptions should be included for services that are deemed to be consumed in China, such as real estate-related services, transportation services and entertainment services. This would mean that standard services provided by Chinese suppliers to branches based overseas are not subject to Chinese VAT unless an exemption applies.

On business-to-customer (B2C) services, the working group advises that the main place of supply for standard be defined as the place where the supplier is established. Exceptions should be included for services that are deemed to be consumed in the country where

⁶ Notice on Fully Expanding the VAT Pilot Programme, *Caishui [2016] No. 36*, STA, 23rd March 2016, viewed 14th April 2021, <<http://www.chinatax.gov.cn/n810341/n810755/c2043931/content.html>>

⁷ Call for Comments on the Value-added Tax Law of the People's Republic of China (PRC) (Draft for Comments), STA, 27th November 2019, viewed 14th April 2021, <<http://www.chinatax.gov.cn/chinatax/n810356/n810961/c5140207/content.html>>



the customer is located, such as telecommunication services and electronically-provided services, transportation services and entertainment services.

Clarify When Supplies are Treated Out of Scope, Exempt or Zero-rated

There is much uncertainty surrounding the draft VAT Law, including under what conditions supplies are to be treated as out of scope, exempt or zero-rated. The Finance and Taxation Working Group suggests clarifying the input VAT recovery rules associated with the making of out-of-scope supplies.⁸ Current VAT rules, as well as the draft thereof, only imply input VAT recovery treatment, a condition that has caused disputes because tax authorities from different locations have adopted varying interpretations. Based on international VAT standards, out-of-scope supplies should not, in principle, lead to an input VAT recovery limitation, as long as they are closely linked to a taxable activity of the taxpayer.

Expand the Scope of Zero-rating and Provide Clear Guidance on its Application to Mitigate Administrative Burdens

Currently, the rules for zero-rating for services and goods are not applicable for all supplied services and goods. For example, financial services provided overseas are not zero-rated. Furthermore, the zero per cent VAT rate for exports can only be applied by domestic taxpayers. 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.

The working group recommends implementing a zero per cent VAT rate for all services provided overseas, except those consumed inside China (see the earlier recommendation for place of supply). Moreover, the working group recommends implementing a zero per cent VAT rate on all export supplies of goods. Additionally, it is necessary for the respective ministries (the State Taxation Administration (STA), the General Administration of Customs (GAC) and the MOF) to provide clear guidance on the conditions required for applying the zero per cent VAT rate to mitigate the administrative burden for taxpayers.

⁸ Out-of-scope supplies refers to supplies that fall outside the scope of goods and services tax legislations, like sales in third countries or free trade zones, and private transactions.

Of particular importance in China's efforts to better align with international taxation principles, the Chinese export VAT refund system should be revised to allow for VAT exemption on exports, as is the case in most jurisdictions worldwide. This would go hand-in-hand with recently announced changes to Chinese Accounting Standards aimed at bringing them in line with International Financial Reporting Standards and International Accounting Standards.⁹

Integrate the Interactive Systems of Customs and Tax

Applying for export tax rebate is a complex process that entails cooperative work between customs and tax bureaux. In China, however, while the customs system and the tax system are interactive, they operate independently of each other, which hinders a seamless data synchronisation and delays the declaration of export tax refunds.

In keeping with government efforts to optimise the business environment, the working group recommends integrating the interactive systems of customs and tax so as to make export tax refunds more convenient and faster.

Enable Non-resident Taxpayers to Register for VAT in China

At the time of writing, certain services provided by overseas companies to private individuals in China are not subject to Chinese VAT, while the same services provided by Chinese companies are. On one hand, overseas companies are currently unable to reclaim Chinese input VAT, which creates a disadvantage for overseas companies compared to local ones. On the other hand, the current policies create a disadvantage for Chinese companies compared to overseas ones, as they have to pay VAT on the services. To align the VAT position of Chinese companies with overseas companies, the working group recommends allowing non-resident taxpayers to register for VAT in China, including when they do not have a Chinese legal entity. This would enable overseas entities to claim back Chinese input VAT.

Allow Taxpayers to Claim the Input VAT Incurred on Loan Interest

The VAT reductions and preferential tax treatment

⁹ Chinese Accounting Standards for Business Enterprises: Prepare for Changes in 2021, China Briefing, 24th November 2020, viewed 15th April 2021, <<https://www.china-briefing.com/news/chinese-accounting-standards-business-enterprises-prepare-changes-2021/>>



implemented in April 2019¹⁰ 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, enterprises will also be incentivised to increase production and R&D investment.

Allow Qualified Agencies to Issue Special VAT Invoices

Bulletin [2019] No. 39 stipulates that the input VAT associated with passenger transportation can be deducted.¹¹ 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 not only to collect qualified transportation tickets jointly, but also to 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 VAT cost reduction benefits such as streamlining and lowering rates. To mitigate such procedural burdens, service agents should be able to issue special VAT invoices, or e-VAT invoices, for specific passenger transportation.

Eliminate the Double VAT Taxation Issue for On-balance-sheet Asset Backed Securitisation (ABS)

Based on *VAT Issues Related to Asset Management Products* (*Caishui [2017] No. 56*, hereinafter *Circular 56*), starting from 1st January 2018, asset managers shall be the VAT taxpayer in relation to VAT taxable activities that occur during the operation of the asset management products. For on-balance-sheet ABS, interest collected from borrowers whose contracts are the ABS underlying assets is still recognised as revenue on the profit and loss statement of the originator (entities that create a securitised financial asset), and is hence subject to VAT on the originator's side. Meanwhile, when the same interest amount is transferred to the

trust company (assets manager), it will be also subject to VAT from the trust company's side to comply with *Circular 56*. For originators, issuing on-balance-sheet ABS is important to diversify financing methods so as to ensure adequate liquidity under different market conditions. The double VAT taxation has increased funding costs, which has a negative impact on the business development of originators.

Recommendations

- Introduce bad debt relief in VAT treatment.
- Clarify the Chinese VAT place of supply rules in the draft VAT Law.
- Include more detailed provisions to define how a supply would be treated as out of scope, VAT exempt or zero-rated.
- Expand the scope of zero-rating and provide clear guidance on the application thereof to mitigate administrative burdens.
- Revise the Chinese export VAT refund system, and allow for VAT exemption on exports.
- Allow all taxpayers to claim the input VAT incurred on loan interest.
- Enable non-resident taxpayers to register for VAT in China.
- Allow qualified agencies to issue special VAT invoices.
- Eliminate issues with double VAT taxation for on-balance-sheet ABS.

3. Take Prudent Steps in Consumption Tax Reform 8

Concern

Because 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—tax reform should be accelerated.

Assessment

In 1994, China imposed a consumption tax on selected products, many of which were aligned with how excise duty was imposed in other countries.¹² Over the last two decades, consumption tax has been reformed several times to reflect China's economic development and to guide consumer behaviour. For instance, in

¹⁰ *Bulletin of Ministry of Finance, State Administration of Taxation and General Administration of Customs on Policies of Further VAT Reform ([2019] No.39)*, STA, 21st March 2019, viewed 14th April 2021, <<http://www.chinatax.gov.cn/n810341/n810755/c4160283/content.html>>

¹¹ *Ibid.*

¹² *The Interim Regulations on Consumption Tax of the PRC*, State Council, 26th November 1993, viewed 14th April 2021, <<http://www.asianlii.org/cn/legis/cen/laws/irotprocovt606/>>



2015, China introduced consumption tax on certain types of batteries and paint with a view to curb their usage, as these products can have a negative impact on the environment.¹³ In December 2019, the draft Consumption Tax Law was published.¹⁴ While these developments are welcomed by the working group, further reforms should be implemented to adequately reflect China's economic development. Increasing efficiency and equality should be prioritised in these reforms.

The current draft Consumption Tax Law does not include any significant changes compared to existing consumption tax provisional rules, except to indicate that the State Council may implement a pilot reform for consumption tax to adjust the tax scope, tax rates and taxation points.

*Public Notice [2012] No. 47*¹⁵ and *Public Notice [2013] No. 50*¹⁶ 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 (for example, based on sales volume, the tax imposed on naphtha at the time of writing is Chinese yuan (CNY) 2.358 per tonne, including 12 per cent surcharges), but also lowering tax compliance due to rising costs. Expert involvement is necessary in clarifying the principles underpinning consumption tax on ROPs, since it is international practice that hydrocarbons used as feedstock in the production of petrochemical products are consumption-tax exempt.

If the pilot reform is to be introduced by the authorities, the working group recommends that the underlying factors for said reform are addressed in full, and that effective new measures and systems are introduced to collect consumption tax. The current approach of collecting consumption tax at the production/manufacturing stage, rather than at the ultimate retail point, increases production costs, while tending 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 of it when making purchase decisions. Therefore, if the objective of the consumption tax is to discourage the user group from buying it, the retail point might be a more logical point of taxation.

If an item is to be taxed, it is vital for there to be fair tax measurements in place. The same commodity in the same sales channels provided by different companies/taxpayers should be taxed the same. For instance, if a taxation point is considered to be taxed at the retail stage for alcoholic products, supermarkets and small entrepreneurial businesses selling the same products should be taxed equally. High costs for noncompliance (i.e., penalties) by tax-evaders should be introduced.

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 not. This discrepancy in tax treatment affects numerous chemical 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 in the consumption tax regulations, the consumption tax cannot be deducted, meaning that the raw material would then be subject to double consumption tax.

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

Regarding low-carbon and circular economy policies, the working group urges efforts to speed up the implementation of green transformation principles (for example, re-use of plastic waste as a raw material) through tax incentives such as consumption tax exemption on ROPs made from recycled waste plastic;

13 *Notice on New Consumption Tax of Battery Coating*, STA, 26th January 2015, viewed 14th April 2021, <<http://www.chinatax.gov.cn/n810341/n810755/c1489741/content.html>>

14 *Call for Comments on the Consumption Tax Law of the PRC (Draft for Comments)*, STA, 3rd December 2019, viewed 14th April 2021, <<http://www.chinatax.gov.cn/chinatax/n810356/n810961/c5140457/content.html>>

15 *Notice on Consumption Tax-related Policies ([2012] No. 47)*, STA, 6th November 2012, viewed 14th April 2021, <<http://www.chinatax.gov.cn/n810341/n810765/n812151/n812386/c1082513/content.html>>

16 *Notice on Supplementary Provisions on Issues Relating to Consumption Tax Policies ([2013] No. 50)*, STA, 9th September 2013, viewed 14th April 2021, <<http://www.chinatax.gov.cn/n810341/n810755/c1148574/content.html>>



and 100 per cent VAT refunds on ROPs or chemical products made from waste plastics.

Recommendations

- Involve experts in discussions on standards and measurements and, where necessary, re-determine the scope of taxation.
- Review the applicable tax rates and taxation method to facilitate the macro-development strategies of specific industries and better reflect international best practices (for example, move taxation point to consumer spending).
- Implement a unified direct exemption treatment for all ROP (including naphtha) purchases, regardless of source (domestic or import), as feedstock to produce chemical products without restrictions.
- Provide financial and tax incentives to encourage companies to invest in chemical recycling, such as exemption from consumption tax on ROPs made from recycled waste plastic and full VAT refund on ROPs or chemical products made from waste plastics.

4. Introduce Tax and Fiscal Measures to Encourage Automation and Further Develop Digital Infrastructure 2

Concern

Despite the deployment of numerous technology tools over the past few years, the Chinese tax system remains below par in terms of digitisation, particularly as compared to other government departments in China and tax administrations around the world.

Assessment

The Chinese tax authorities have adopted sweeping reforms in recent years and made considerable progress in modernising the national tax system. Nevertheless, efforts to digitise the tax system still lag behind compared to other government departments in China, as well as other jurisdictions. Research has consistently shown a strong link between the adoption of digital technologies and improvements in the overall business environment.¹⁷ In this regard, the digitalisation wave brought by COVID-19 laid bare the role robust digital infrastructures play in enabling operational efficiency and contactless transactions.

¹⁷ *Uncovering the Connection Between Digital Maturity and Financial Performance*, Deloitte, 26th May 2020, viewed 16th April 2021, <<https://www2.deloitte.com/us/en/insights/topics/digital-transformation/digital-transformation-survey.html>>

While the tax authorities have consistently expanded online procedures in recent years, there still remain numerous processes and tasks which require in-person submission or verification. Most local tax offices in China are routinely crowded, leading to inefficiencies and paper-processing delays. Regulators are therefore advised to review the full range of taxation processes and, where possible, adopt interventions to perform current in-person tasks online. For example, hard-copy documents and signature are still often required in fiscal filings, both of which can be replaced by the upload of scanned documents or electronic signatures. The working group recommends that the tax authorities set creating a fully automated system for tax administration processes as a goal, similarly to other government departments in China that are already striving toward digitisation.

China has one of the most standardised invoicing systems in the world (*fapiao*). While this standardisation can create complexities, it also provides opportunities for efficiency and data collection where automation and digitisation are achieved. Electronic invoicing (*e-fapiao*) was introduced into the Chinese tax system in 2015, although currently both paper and e-fapiao co-exist, a hybrid system which leads to inconsistencies.¹⁸ As full adoption of electronic invoicing would allow China to dramatically improve the tax filing environment and create business opportunities, the working group suggests this be implemented as soon as possible.

Recommendations

- Provide tax incentives for companies to invest in digital infrastructure such as hardware and software, as well as more advanced automation.
- Review tax filings and other financial procedures to focus efforts on the development of the digital economy.
- Accelerate the adoption of electronic invoicing.

5. Take Alternative Steps to Attract Foreign Investment into China 4

Concern

China's taxation system still lacks attractiveness and efficiency, which deters foreign companies from making investments into the country.

¹⁸ *China Starts to Issue Special VAT E-invoices to New Taxpayers*, STA, 4th February 2021, viewed 16th April 2021, <<http://www.chinatax.gov.cn/eng/c101269/c5161519/content.html>>



Assessment

To date, relatively high tax rates have made it more difficult for Mainland 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 Finance and Taxation Working Group welcomes the adoption of local policies that encourage FDI—such as the Greater Bay Area incentives, tax subsidies in Hainan and similar policies in Suzhou—yet notes that too often these subsidies are only available to companies that commit a significant amount of capital. While this approach can help attract large manufacturing operations, it is less effective in drawing companies in finance and service sectors or small and medium-sized enterprises. With most large foreign manufacturers already established across the Mainland, it is the service, financial, and emerging technologies that constitute the new growth areas for foreign investment in China. To enhance the effectiveness of local policies, the working group therefore recommends further expanding the qualifying criteria for local subsidies, and that tax subsidy regimes be updated to reflect China's changing economy.

Since the implementation of the 2008 Corporate Income Tax Law,¹⁹ moreover, the Chinese Government has launched several preferential tax policies to encourage the development of high and new-technology enterprises (HNTEs). These policies have reduced tax burdens and improved market competitiveness by allowing CIT super deduction of research and development (R&D) expenses. Typically, foreign-invested enterprises (FIEs) only obtain the right to use core technologies/software through licensing agreements with their parent company; FIEs engaged in R&D activities in China may do so on a contractual basis with their overseas parents and, as such, are often unable to take advantage of the HNTE and super-deduction policies, which require ownership of the intellectual property rights to the technology or software. These policies should be amended to encourage more investment in R&D and through licensing of the world-class technology that Europe has available.

China has a comprehensive network of double taxation agreements that provides flexibility for foreign companies to invest into the country and minimise their withholding tax burden. The Finance and Taxation Working

Group observes that the filing process for withholding tax reductions is overly complex and calls for its simplification—for example, many companies report difficulties in processing payments and performing registration. The working group recommends: considering the legitimate commercial purpose or intention of the foreign entity as a favourable factor for business substance/beneficial ownership; adopting substance reviews from group companies based in the same country; and broadening the 'look-through' approach to shareholding structures with multiple higher-tier parent companies, where higher-tier parent companies individually qualify as beneficial owners (instead of a 100 per cent ownership by one sole shareholder).

Lastly, to encourage further FDI, *Caishui [2017] No. 88* (later replaced by *Caishui [2018] No. 102*)²⁰ introduced a preferential deferral system for dividend withholding tax (WHT) for cases in which the dividend is directly invested in projects in China.²¹ 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.

While China has made considerable advancements in improving tax efficiency and transparency, its taxation administration system remains complex and carries higher compliance burdens relative to many of China's trading partners. For example, it is common for European investors to operate multiple legal entities across China. This enables them to serve different markets but also increases the administrative burden, because foreign investors are required to produce separate tax filings and comply with transfer pricing (TP) monitoring. The ability to file CIT returns on a consolidated, central basis—subject to certain preconditions (such as 100 per cent direct or indirect

¹⁹ *Corporate Income Tax Law of the PRC*, State Council, 16th March 2007, viewed 11th April 2021, <http://www.gov.cn/jffg/2007-03/19/content_554243.htm>

²⁰ *Notice on Widening the Scope of Application of Temporary Waiver for Withholding Income Tax for Overseas Investors Using Distributed Profits for Direct Investment*, STA, 29th September 2018, viewed 16th April 2021, <<http://www.chinatax.gov.cn/n810341/n810755/c3776623/content.html>>

²¹ *Positive Signals to Foreign Investors: China Unveils Withholding Tax Deferral Treatment for Foreign Direct Reinvestment*, PwC, December 2017, viewed 16th April 2021, <<https://www.pwchk.com/en/china-tax-news/dec2017/chinatax-news-dec2017-38.pdf>>



shareholding by the ultimate holding company)—would benefit these firms significantly.

*Huifa [2013] No. 30*²² and *Bulletin [2013] No. 40*²³ also allow Chinese enterprises to remit reimbursements to their overseas affiliates related to expatriates' salaries, welfare, travel and other relevant expenses. In common international tax practice, cost reimbursements between affiliated companies are considered a genuine measure to allocate cost to the appropriate legal entity – these cost reimbursements are non-service in nature, therefore 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. As a result, further technical guidance should be provided to tax bureau staff on the reduction of administrative burdens on enterprises and the treatment of cost reimbursements in accordance with international tax practice.

The working group encourages the GAC to align with STA 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 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.

Recommendations

- Allow companies in China to file CIT 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 reinvestment).

- Grant preferential tax policies to European companies that transfer the use right of core IPR to local firms.
- Harmonise the TP evaluation approach adopted by the customs and tax authorities, and issue clear SAFE rules and enable TP adjustments between local and overseas firms, including pay-in and payout.

Abbreviations

ABS	Asset Backed Securitisation
B2B	Business to Business
B2C	Business to Consumer
CIT	Corporate Income Tax
CNY	Chinese Yuan
FDI	Foreign Direct Investment
FIE	Foreign-invested Enterprise
GAC	General Administration of Customs
HNTE	High and New-Technology Enterprise
IIT	Individual Income Tax
IPR	Intellectual Property Right
MNC	Multinational Corporation
OECD	Organisation for Economic Co-operation and Development
R&D	Research and Development
ROP	Refined Oil Product
SAFE	State Administration of Foreign Exchange
SMB	Small and Medium-sized Business
STA	State Taxation Administration
TP	Transfer Pricing
VAT	Value-added Tax
WHT	Withholding Tax

²² Circular on Printing and Forwarding the Regulations on Foreign Exchange Administration for Trade in Services, SAFE, 18th June 2013, viewed 16th April 2021, <<https://www.safe.gov.cn/en/2013/0724/737.html>>

²³ Announcement of the SAFE and the SAT on Relevant Issues Concerning the Filing of Tax for External Payments for Trade in Services and Other Accounts, SAFE, 9th July 2013, viewed 16th April 2021, <<https://www.safe.gov.cn/en/2013/0724/736.html>>



Human Resources Working Group

Key Recommendations

1. Modernise Chinese Labour Laws and Enhance Workforce Flexibility 7

- Comprehensively modernise and consolidate the Labour Law, the Labour Contract Law, the *Regulations on the Employment of Foreigners* and other relevant laws and regulations.

2. Loosen Cross-border Travel Restrictions

- Enable business trips to China by foreign passport holders.
- Provide transparent policies on the issuance of visas to foreigners.
- Allow foreigners holding valid Chinese visas to enter into China without special visa or PU letter requirements.
- Consider reducing the quarantine period for travellers inoculated against COVID-19 and allow entry into Mainland China to the family members of foreign employees.

3. Support the Development of Practical Knowledge and Soft Skills in the Education System 3

- Support the practical implementation of new pedagogical practices across grade levels to reflect changing economic and employment needs.
- Facilitate the development of soft-skills and cognitive capabilities to meet the labour challenges of the 21st century and prepare a digitally savvy workforce.
- Expand vocational programmes and invest in collaborations between education and business stakeholders, both in China and in Europe, to integrate teaching activities with practical trainings in accordance with China's development goals.

4. Implement a Fairer System to Employ and Include People with Disabilities 4

- Enliven the National Service Platform of Employment of Persons with Disabilities (www.cdpee.org.cn) by duly updating recruitment information and attracting visitors to the official site.
- Organise more job fairs and relevant events aimed specifically at attracting university colleague graduates with disabilities.
- Provide companies with tailor-made training programmes based on specific requirements for enterprises and persons with disabilities.
- Set up a dedicated counsellor system to employ people with disabilities and involve qualified counsellors to help provide disabled persons with employment opportunities.



Introduction to the Working Group

Through nurturing people and effectively managing labour relations, human resources (HR) departments play a critical role in engaging the workforce to increase business capacity, particularly amid major disruptions.

HR departments have also come to play an increasingly important role in such areas as corporate social responsibility, sustainability and workplace ethics. At the same time, today's rapid technological innovation and socio-economic changes require greater adaptability from employees for companies to get ahead in an ever more dynamic work environment, a trend echoed by recent surveys, which found that companies will place a premium on flexibility and empathetic leadership in the post-pandemic era.¹

The Human Resources Working Group represents European companies employing hundreds of thousands of people who contribute to tax and social security funds in China. The working group aims to provide a platform for exchanging information, experiences and best practices among member companies, as well as to promote awareness of HR issues by facilitating an open dialogue with enterprises and relevant Chinese authorities. The working group tracks labour-related policies and advocates for initiatives that advance organisational development, improve the health and well-being of staff, and strengthen stakeholder collaboration, in an effort to contribute to China's development goal of creating more employment opportunities in a stronger national economy.

Recent Developments

International Travel Restrictions

Since China closed its borders to foreigners holding valid visas or residence permits on 28th March 2020 as a coronavirus disease 2019 (COVID-19) prevention and control measure,^{2&3} entry policies have been updated repeatedly to accord with evolving local measures. While international travel restrictions have both enhanced public health protection and enabled

an effective recovery in China, they have also brought unprecedented labour mobility challenges, affecting the operations of foreign-invested enterprises (FIEs) whose employees, stranded overseas, could not return to their China assignments.

This has led to some foreign staff having to be stationed elsewhere by the headquarters or giving up on the possibility of coming back to China altogether—an unfavourable outcome for China and for businesses, considered that many of these talented foreign experts have spent years developing a strong understanding of the language and culture.⁴

On 15th March 2021, several Chinese embassies released the *Notice on Providing Facilitation for Visa Applicants Inoculated with COVID-19 Vaccines (Notice)*,⁵ announcing a relaxation of entry restrictions for foreigners inoculated with Chinese vaccines. According to the *Notice*, travellers who have received Chinese COVID-19 vaccines and obtained the vaccination certificate could now enjoy a facilitated visa application process.⁶

COVID-19 Vaccinations

Since the authorisation of domestically-developed vaccines by the National Medical Products Administration (NMPA),⁷ European businesses have requested greater transparency regarding the inclusion of their foreign staff in China's COVID-19 vaccination implementation programme, as well as if and how vaccinations would impact international travel.⁸

On 22nd March 2021, the Shanghai authorities announced that foreigners could book appointments to receive a domestically developed vaccine, making it the first city

1 2021 Global Talent Trends Study, Mercer, 2020, viewed 14th April 2021, <<https://www.mercer.com/our-thinking/career/global-talent-hr-trends.html>>

2 With the exception of entry with diplomatic, service, courtesy or C visas, as well as legal permanent residents (green card holders).

3 Announcement on the Temporary Suspension of Entry by Foreign Nationals Holding Valid Chinese Visas or Residence Permits, MFA, 26th March 2020, viewed 8th April 2021, <https://www.fmprc.gov.cn/mfa_eng/wjbxw/t1761867.shtml>

4 European Chamber Stance on Further Restrictions on the Return of Legal Residents to China, European Union Chamber of Commerce in China, 3rd November 2020, viewed 14th April 2021, <http://european-chamber.com.cn/en/press-releases/3298/european_chamber_stance_on_further_restrictions_on_the_return_of_legal_residents_to_china>

5 Notice on Visa Facilitation for Applicants Inoculated with Chinese COVID-19 Vaccine, Embassy of the People's Republic of China in the United States of America, 15th March 2021, viewed 10th April 2021, <<http://www.china-embassy.org/eng/visas/t1861379.htm>>

6 Travellers inoculated with Chinese COVID-19 vaccines with previously valid visas would not have to apply for a new visa as a result.

7 State Food and Drug Administration Conditionally Approved Beijing Kexing Zhongwei Biotechnology Co, Ltd New Coronavirus Inactivated Vaccine (Vero Cell) Registration Application, NMPA, 6th February 2021, viewed 10th April 2021, <<https://www.nmpa.gov.cn/yaowen/ypjgyw/20210206154636109.html>>

8 European Chamber Stance on COVID-19 Vaccine, European Union Chamber of Commerce in China, 10th February 2021, viewed 2nd April 2021, <http://european-chamber.com.cn/en/press-releases/3325/european_chamber_stance_on_covid_19_vaccine>





in China to offer its COVID-19 shot to non-Chinese citizens that met the age requirements.⁹ On 26th March, health authorities in Beijing also began allowing local foreign residents to receive vaccination on site through their workplace or local community.¹⁰ In April 2021, Chinese officials also put into motion plans to approve China's first foreign COVID-19 vaccine by July, in a collaboration between German biotechnology company BioNTech and Shanghai Fosun Pharmaceutical Group Co.¹¹ Marking an important achievement in the field of epidemic prevention, on 7th May 2021, the World Health Organization (WHO) approved China's Sinopharm COVID-19 vaccine for emergency use and its inclusion in COVID-19 Vaccines Global Access (COVAX)—the global initiative designed to promote equitable, worldwide vaccine distribution.¹² Following the Sinopharm approval, on June 1st, the WHO validated the Sinovac-CoronaVac COVID-19 vaccine for emergency use.¹³

The 14th Five-year Plan

Released at the National People's Congress plenary session in March 2021, the 14th Five-year Plan (14FYP) indicated a need to deepen industry-education integration, broadening the use of employment subsidies and expanding enrollment in vocational colleges to support the development of talent and provide equitable job opportunities. The *Government Work Report*, which was also released at the plenary session, likewise calls for further educational reform, particularly in reference to developing more equitable and higher-quality education.¹⁴

Key Recommendations

1. Modernise Chinese Labour Laws and Enhance Workforce Flexibility



Concern

Current labour and social insurance laws and regulations are partially outdated and fail to address the modern-day work environment.

Assessment

Home office, delivery and courier work are not sufficiently addressed in China's current labour laws and regulations. This leads to uncertainties, especially in a post-COVID-19 workplace that may witness a long-term shift to remote occupations, faster adoption of automation and demand for new skills to perform future jobs. The working group believes it would be helpful for the Labour Contract Law to expressly allow an employee to have several workplaces (office and home), and for the rules in Article 14 of the *Labour Contract Law Implementing Regulations* and all other relevant laws and regulations to supplement this stipulation.

In addition, current regulations contain misleading wording that does not adequately reflect recent legislative developments. For example, the Labour Law (revised 2008)^{15&16} still refers to a forty-four hour-week in spite of forty hours now being the standard. The Labour Law also stipulates a sixty-day deadline for filing a labour dispute, although the Labour Mediation and Arbitration Law (2008)¹⁷ provides for a one-year deadline.

Interpretation of the Labour Law also differs across cities in China. The Shanghai Higher People's Court, for example, allows an employer termination of employment after the expiry of the second fixed-term contract, whereas the Beijing Higher People's Court

9 *Foreigners in Shanghai May Book for COVID-19 Vaccination*, Foreign Affairs Office of Shanghai Municipality, 23rd March 2021, viewed 20th April 2021, <<http://wsb.sh.gov.cn/n997/20210323/c7d8b70077734e98b096bf1ec8cdeb8d.html>>

10 *Foreigners' Guide to Quarantine and Getting Vaccinated in China*, Nikkei Asia, 1st April 2021, viewed 20th April 2021, <<https://asia.nikkei.com/Spotlight/Caixin/Foreigners-guide-to-quarantine-and-getting-vaccinated-in-China>>

11 *China Plans to Approve First Foreign Covid-19 Vaccine by July*, The Wall Street Journal, 16th April 2021, viewed 20th April 2021, <<https://www.wsj.com/articles/china-plans-to-approve-first-foreign-covid-19-vaccine-by-july-11618574842>>

12 *WHO Lists Additional COVID-19 Vaccine for Emergency Use and Issues Interim Policy Recommendations*, WHO, 7th May 2021, viewed 17th May 2021, <<https://www.who.int/news/item/07-05-2021-who-lists-additional-covid-19-vaccine-for-emergency-use-and-issues-interim-policy-recommendations>>

13 *WHO Validates Sinovac COVID-19 Vaccine for Emergency Use and Issues Interim Policy Recommendations*, WHO, 1st June 2021, viewed 2nd June 2021, <<https://www.who.int/news/item/01-06-2021-who-validates-sinovac-covid-19-vaccine-for-emergency-use-and-issues-interim-policy-recommendations>>

14 *Report on the Work of the Government*, State Council, 5th March 2021, viewed 4th April 2021, <http://english.www.gov.cn/premier/news/202103/13/content_WS604b9030c6d0719374afac02.html>

15 *Labour Law of the People's Republic of China*, Ministry of Commerce, 5th July 1994, viewed 19th April 2021, <<http://english.mofcom.gov.cn/article/lawsdata/chineselaw/200211/20021100050875.shtml>>

16 Ying Wang, *China Employment Law Update April 2018*, Bird & Bird, 25th April 2018, viewed 19th April 2021, <<https://www.twobirds.com/en/news/articles/2018/china/china-employment-law-update-april-2018>>

17 *Law of the People's Republic of China on Labor-Dispute Mediation and Arbitration*, International Labour Organization, 29th December 2007, viewed 19th April 2021, <<https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/78743/108018/F-268983075/CHN78743%20Eng.pdf>>





expressly denies the employer this very right.^{18&19}

The Human Resources Working Group notes that foreign employees are not treated equally as their Chinese counterparts in certain aspects of the regulations and by People's Courts in cases of disputes with the employing company. For example, the *Foreigner Employment Regulations* (revised 2017)²⁰ only mention that the employer of a foreigner must follow regulations regarding working hours, rest time, vacation, workplace safety and health as well as social security. This leads to instances like the Shanghai People's Courts refusing to grant certain statutory rights to foreign employees if not expressly mentioned in the employment contract (see *Andy Pan v. General Mills (China) Investment Co Ltd* (2018)),²¹ while Chinese employees can simply enjoy their rights based on the statutory law.

In light of the significant average salary increase in China over the past few years,²² and to avoid unfair economic results in certain cases, the Human Resources Working Group recommends that the 12-year cap on severance payments in the Labour Contract Law (revised 2013) be applied to all salary levels, and that the calculation of severance payment upon termination of employment be unified nationwide. The working group advises to extend this to dispatch workers as well so as to reduce the incidence of dispatch work-related disputes.

Recommendation

- Comprehensively modernise and consolidate the Labour Law, the Labour Contract Law, the Regulations on the Employment of Foreigners and other relevant laws and regulations.

18 *Circular on Printing and Distributing the Opinions on Several Issues on the Application of the Labour Contract Law*, Higher People's Court of Shanghai, 3rd March 2009, viewed 21st June 2021, PDF file.

19 *Minutes of the Seminar of the Beijing Municipal High People's Court and the Beijing Municipal Arbitration Committee of Labour Dispute on Issues Concerning the Application of Laws for the Trial of Labour Dispute Cases (II)*, Beijing Municipal High People's Court and Beijing Municipal Arbitration Committee of Labor Dispute, 7th May 2014, viewed 21st June 2021, PDF file.

20 *Administrative Provisions on Employment of Foreigners in China (Revision 2017)*, Ministry of Human Resources and Social Services, 13th March 2017, viewed 19th April 2021, <http://www.mohrss.gov.cn/SYrlzyhshbzb/zcfg/fffg/gz/201703/t20170315_267970.html>

21 *Andy Pan v. General Mills (China) Investment Co Ltd*, Shanghai First Intermediate People's Court Civil Judgment, 23rd July 2018, PDF document shared by working group members.

22 Estimated to range between six and nine per cent (2010–2020); compiled from Mercer Total Remuneration Surveys and notices released by municipal authorities.

2. Loosen Cross-border Travel Restrictions

Concern

The international travel restrictions imposed to prevent the spread of COVID-19 have greatly affected global mobility and business recovery for FIEs, and at the time of writing no clear timeline is provided on when the travel ban can be lifted.

Assessment

To curb the spread of COVID-19, the Chinese Government temporarily suspended entry into China by foreign nationals holding valid visas and residence permits starting from 28th March 2020 (with exceptions for travellers with diplomatic, service, courtesy or C visas, as well as foreign citizens coming to China for necessary economic, trade, scientific or technological activities, or out of emergency humanitarian needs).²³ Under the policy, foreign nationals are required to obtain an invitation letter (a so-called PU letter) and provide detailed travel reasons to apply for a special visa at Chinese embassies or consulates. Issued by the local Foreign Affairs Offices (FAO) in China, the PU letter is an official letter by a registered company in China inviting a foreign passport holder into the country for work and business purposes.

From 28th September 2020, the Ministry of Foreign Affairs (MFA) and the National Immigration Administration (NIA) adjusted their entry-restriction policies, allowing foreign nationals into the country without special visa and PU letter requirements provided that they hold valid residence permits for work, personal matters, and reunion purposes.²⁴ Despite this positive development, other foreign nationals and their families still face travel restrictions and are not able to enter China.

Unfortunately, policies regarding the application of PU letters and the issuance of visas have not been transparent and their implementation inconsistent, leaving foreigners unsure as to whether they could successfully obtain a PU letter and when the Chinese embassy or consulate would issue all necessary paperwork. The inability for employees and their

23 *Announcement on the Temporary Suspension of Entry by Foreign Nationals Holding Valid Chinese Visas or Residence Permits*, MFA, 26th March 2020, viewed 14th April 2021, <https://www.fmprc.gov.cn/mfa_eng/wjbxw/t1761867.shtml>

24 *Announcement on Entry by Foreign Nationals Holding Valid Chinese Residence Permits of Three Categories*, MFA, 23rd September 2020, viewed 14th April 2021, <https://www.fmprc.gov.cn/mfa_eng/wjbxw/t1817370.shtml>





dependents to return to China has brought considerable challenges to FIEs, many of which have had to suspend cross-border projects in light of China's business travel restrictions. The working group further notes that, under the COVID-19 travel ban, foreign nationals stranded overseas could not resume work in Mainland China with the expiration of their residence permits, and that family members of foreign staff in China have been unable to enter into the country for family reunion purposes. At the time of writing, the Chinese Government has yet to provide a clear timeline indicating when international travel can resume.

Despite more recent adjustments to enable a partial facilitation of the entry of certain categories of foreigners into China, upon arrival, international travellers—including those that are fully vaccinated—are still subject to mandatory quarantine at designated facilities for a minimum period of 14 days—with some local governments requiring up to 21 to 28 days. Having to stay isolated in a small hotel room for the entire length of the quarantine has amounted to uncomfortable experiences for many foreigners, particularly those unfamiliar with China.

Recommendations

- Enable business trips to China by foreign passport holders.
- Provide transparent policies on the issuance of visas to foreigners.
- Allow foreigners holding valid Chinese visas to enter into China without special visa or PU letter requirements.
- Consider reducing the quarantine period for travellers inoculated against COVID-19 and allow entry into Mainland China to the family members of foreign employees.

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

Concern

China's education system does not adequately encourage the development of soft skills and practical knowledge.

Assessment

Access to skilled labour remains a key challenge

for foreign businesses in China, as several reports and surveys carried out by the European Chamber have shown.²⁵ The availability of qualified talent is indeed vital to China's internationalisation and for global companies to expand their economic footprint. Education plays a critical role in nurturing such high-skilled talent and unlocking the knowledge and capabilities to meet the labour challenges of the 21st century. While China has made significant efforts to modernise its curricula,²⁶ the importance the Chinese education system attaches to written examinations, as well as a heavy focus on quantitative testing and competitive ranking—best exemplified by the National College Entrance Examination (*gaokao*)—leave little space for local educators to instill the critical thinking and soft skills necessary to thrive in today's increasingly digital workplace.

Against this backdrop, the Human Resources Working Group advises Chinese policymakers to equip future leaders with the cognitive competencies and entrepreneurial mindset to navigate the future of work and solve the complex, fast-changing challenges of today. It is therefore with renewed optimism that the working group welcomes the remarks made by President Xi Jinping at the annual Two Sessions, in which he stressed pushing forward educational reforms in the wake of the pandemic, and building a “balanced basic public education service system to contribute to the country's high-quality development”.²⁷ These commitments echo the policy actions urged by the World Bank in December 2020 to support efforts to accelerate learning by investing in the equitable development of human capital, new pedagogical practices and personalised learning.²⁸

25 *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2020, <https://www.europeanchamber.com.cn/en/publications-archive/917/Business_Confidence_Survey_2021>; *European Business in China Shanghai Position Paper 2020/2021*, European Union Chamber of Commerce in China, 2nd November 2020, <http://europeanchamber.com.cn/en/publications-archive/867/European_Business_in_China_Shanghai_Position_Paper_2020_2021>; *South China Position Paper 2019/2020*, European Union Chamber of Commerce in China, 9th April 2019, <https://www.europeanchamber.com.cn/en/publications-archive/661/South_China_Position_Paper_2019_2020>

26 For more information, see *Education in China: A Snapshot*, OECD, 2016, <<https://www.oecd.org/education/Education-in-China-a-snapshot.pdf>>

27 *Xi Focus: Xi's "Two sessions" Messages Point Way for China at Historic Development Juncture*, State Council, 10th March 2021, viewed 21st April 2021, <http://english.www.gov.cn/news/topnews/202103/07/content_WS60440f48c6d0719374afa496.html>

28 *Realising the Future of Learning: From Learning Poverty to Learning for Everyone, Everywhere (English)*, World Bank, 2nd December 2020, viewed 21st April 2021, <<https://documents.worldbank.org/en/publication/documents-reports/documentdetail/250981606928190510/realizing-the-future-of-learning-from-learning-poverty-to-learning-for-everyone-everywhere>>





The new catalogue of vocational majors released by the Ministry of Education (MOE) in March 2021 constitutes an encouraging step in supporting the industrial modernisation of China through the development of human capital.²⁹ The catalogue, which features programmes catering to China's modern industrial systems, is expected to advance the integration of entrepreneurial practice into curricula. Together with local regulations aimed at facilitating internship programmes for practical training, vocational programmes are critical tools to help transform China's labour force into a new generation of industrial workers with the skills needed to succeed across emerging sectors of strategic significance to the country's development goals. In this context, Sino-European cooperative programmes, such as the Sino-German *Bildungswerk der Wirtschaft* initiative in Suzhou and the Sino-French training center in Haining's industrial park are compelling examples of vocational hubs that blend hands-on education with industry placement, mutually benefitting students as well as enterprises.^{30&31}

The Human Resources Working Group views the proposal by Chinese lawmakers to remove English language from compulsory curricula as a major step back in China's pursuit of greater integration into the international business community where English is used as the *lingua franca*.³² The proposal could also worsen inequalities among jobseekers because opportunities to join global companies on the lookout for English-speaking talent would only become accessible to candidates with advanced proficiency in the language, denying students from less affluent backgrounds access to opportunity. Hiring English-speaking talent not only promotes effective communication across multicultural teams, it also enables European employers in China to fully involve the local workforce in global operations.

Recommendations

- Support the practical implementation of new pedagogical practices across grade levels to reflect changing economic and employment needs.

29 China Updates Vocational Majors, Pivoting to Modern Industries, Xinhua, 22nd March 2021, viewed 10th April 2021, <http://www.xinhuanet.com/english/2021-03/22/c_139827362.htm>

30 BBW Suzhou, Bildungswerk der Wirtschaft (BBW) Suzhou, viewed 25th May, 2021, <<http://www.bbw-suzhou.com/en/>>

31 Le Projet de Haining une Opportunité Exceptionnelle pour Votre Implantation en Chine, Energie7, viewed 25th May 2021, <<https://www.energie7.com/nos-services/le-projet-de-haining/>>

32 Debate Rages Over Proposal to Ax English, China Daily, 8th March 2021, viewed 15th April 2021, <<https://www.chinadaily.com.cn/a/202103/08/WS60457153a31024ad0baad756.html>>

- Facilitate the development of soft skills and cognitive capabilities to meet the labour challenges of the 21st century and prepare a digitally savvy workforce.
- Expand vocational programmes and invest in collaborations between education and business stakeholders, both in China and in Europe, to integrate teaching activities with practical trainings in accordance with China's development goals.

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



Concern

It remains difficult for companies to hire the mandatory quota of people with disabilities, and the resulting fines are an added burden.

Assessment

In 2007, China adopted a mandatory, *pro rata* system for hiring people with disabilities, whereby companies are obliged to proportionally hire disabled individuals so that they constitute no less than 1.5 per cent of total staff. Enterprises unable to meet the quota must make contributions to the Disabled Persons' Employment Security Fund (Fund) in accordance with the law.³³

Since its introduction, the system has contributed to promoting the employment of individuals with disabilities by China-based companies. However, most businesses continue to find it difficult to hire the mandatory quota of people with disabilities and are left with few options other than to make contributions to the Fund, a situation which has brought additional financial burdens to employers. The Human Resources Working Group acknowledges that, in recent years, the Chinese Government has made efforts to reduce the levy of the Fund and optimise the use thereof to support the employment of disabled individuals. For example, following the *Overall Plan* jointed issued by the China Disabled Persons' Federation (CDPF) and five ministries in December 2019, the CDPF released the *Implementing Opinions on the Overall Plan (Opinions)*.³⁴ In the *Opinions*, the CDPF commits

33 *Methods on Levying, Use and Management of the Disabled Persons' Employment Security Fund*, STA, 9th September 2015, viewed 15th April 2020, <<http://www.chinatax.gov.cn/n810341/n810755/c1810262/content.html>>

34 *Overall Plan for Improving the Employment Security System for Disabled Persons to Promote the Employment of People with Disabilities*, State Council, 27th December 2019, viewed 14th April 2020, <http://www.gov.cn/zhengce/zhengceku/2019-12/30/content_5465191.htm>





to taking measures aimed at integrating disabled persons into the workforce, including the creation of a national database for employing people with disabilities and the establishment, as well as strengthening, of an employment-orientated training mechanism for companies. The working group is monitoring the implementation of these measures.

At the same time, the working group observes that the recruitment information published on the National Service Platform of Employment of Disabled Persons (www.cdpee.org.cn) is outdated and that companies committed to hiring people with disabilities are unable to get effective support from the government on the occupational integration of disabled persons. It is therefore recommended that the regulators feed up-to-date information onto the official site for disabled jobseekers, and that they add specificity to the training programme requirements provided by the relevant local Disabled Persons' Federation to people with disabilities.

Recommendations

- Enliven the National Service Platform of Employment of Persons with Disabilities (www.cdpee.org.cn) by duly updating recruitment information and attracting visitors to the official site.
- Organise more job fairs and relevant events aimed specifically at attracting university colleague graduates with disabilities.
- Provide companies with tailor-made training programmes based on specific requirements for enterprises and persons with disabilities.
- Set up a dedicated counsellor system to employ people with disabilities and involve qualified counsellors to help provide disabled persons with employment opportunities.

Abbreviations

14 th Five-year Plan	14FYP
CDPF	China Disabled Persons' Federation
COVAX	COVID-19 Vaccines Global Access
COVID-19	Coronavirus Disease 2019
FAO	Foreign Affairs Offices
FIE	Foreign-invested Enterprises
HR	Human Resources
MFA	Ministry of Foreign Affairs
NIA	National Immigration Administration
NMPA	National Medical Products Administration
SME	Small and Medium-sized Enterprise
STA	State Taxation Administration
WHO	World Health Organisation





Intellectual Property Rights Working Group

Key Recommendations

1. Patents

1.1 Accept Post-filing Data for Patent Filing, Patent Invalidation and Judicial Proceeding 2

- Modify the *Guidelines* to clarify that the technical effect to be proven by the post-filing data is directly disclosed or implied in the original patent application documents, or can be expected based on the original patent application documents or prior art documents by a person skilled in the art.
- Apply the new standard to all pending applications, administrative and judicial review of patent validity disputes (including those pending).
- Ask the Supreme People's Court (SPC) to issue juridical interpretation to codify the standard, especially Article 10 in the latest SPC's juridical interpretation regarding post-filing data.

1.2 Exclude Chinese Patent Applications or Patent Assignments from Technology Exports and Simplify the Procedures 2

- Amend the *Regulations on the Administration of the Import and Export of Technology* (Article 2.2) to exclude Chinese patent application or patent assignment from technology export by deleting "patent assignment" and "patent application assignment".
- Amend the CNIPA's *Guidelines for Patent Examination* (Part I, Chapter 1, Section 6.7.2.2) to exclude the Chinese patent application or patent assignment from technology export.

1.3 Issue Detailed Implementation Regulations Pursuant to the New Patent Law, and Ensure That Administrative Authorities Receive Sufficient Training on Enforcement

- Set out in detail in regulations to be issued under the Patent Law how the administrative enforcement provisions will work in practice.
- Ensure that administrative authorities receive sufficient training to confidently enforce the new Patent Law.

2. Trademarks

2.1 Consider Internet Activity and Accessibility by the Chinese Market in the Determination of Pre-emptive Registration in Bad Faith 2

- Consider internet activity and accessibility by the Chinese market in determining pre-emptive registration in bad faith.

2.2 Lower the Burden of Proof Required to Show Bad Faith in Accordance with the Degree of Distinctiveness of the Trademark to be Protected

- Lower the burden of proof required to show bad faith in accordance with the degree of distinctiveness of the trademark to be protected.

2.3 Create a Mechanism to Stay Proceedings until Invalidations, Oppositions and Non-use Cancellations are Dealt With 2

- Create a procedure to stay trademark application examination procedures until all oppositions, cancellations and invalidations are dealt with.
- Alternatively, create a procedure to handle applications for review of refusal in the presence of the cited prior trademarks.





3. Access to Law

3.1 Retain the Focus on Intellectual Property (IP) Protection and Enforcement, Irrespective of Nationality of the IP Right (IPR) Holders

- Retain the focus on IP protection and enforcement, irrespective of nationality of the owners of such IPR.
- Instruct IPR protection bodies to act dispassionately in relation to foreign applicants.

3.2 Simplify Procedures for the Provision of Formality Material from Overseas in Cases with no Credible Probity Concerns

- Adopt the online legalisation of power of attorney (POA) solution recently proposed by the SPC for civil cases and extend this solution to all administrative cases.

3.3 Implement a System that Privileges Proportionate Compensations Rather than Statutory Damages

- Ensure application of a mechanism that prioritises the awarding of proportional compensation over statutory damages in cases of IPR infringement.
 - Issue further opinions and guidelines to ensure a more uniform application of the compensations system based on damages as suffered, and guide and assist courts in applying the same principles.
 - Issue measures to facilitate reimbursement and compensation of reasonable expenses for legal assistance, investigation and evidence collection activities as incurred to "curb the infringement".
- Enhance statutory damages compensations in case of serious, repeated, or extensive violations.
 - Revise provisions on statutory damages to establish a system based on multiples of the determined amount in cases of serious, repeated or extensive violations when circumstances are met (e.g allow courts to liquidate "two, three, or five times" the amounts of statutory damages currently provided by law).
 - Issue relevant opinions and guidelines to define fixed criteria for courts to determine the "extent of the infringement" in order to uniformly award more adequate compensations.

3.4 Issue Judicial Rules for People's Courts Regarding the Use of Electronic Evidence Authenticated by Technical Means

- Issue judicial rules, interpretations and documentation regarding the recognition of electronic evidence authenticated by blockchain, timestamp or similar technologies in all kinds of civil litigation proceedings and not limited to cases heard by Internet Courts.

4. Online IP Protection

4.1 Clarify Liability for E-commerce Platforms on IPR Infringement through Legislation 4

- Outline the liabilities of e-commerce platform operators to provide necessary shop/person information regarding infringers and infringing activity 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 exempt from the liability of displaying a business licence.
- Stipulate in the interpretation for Article 42 the procedures and requirements when filing complaints against online stores with the competent administrative authorities.
- Set up criteria that identify the operator of an infringing online store on the public credit system.
- Allow only one shop under one identification per person/company, which will be responsible for proving that there is no IP infringement history.



- Require e-commerce platforms to establish an infringer blacklist, and to ban such infringers from re-opening shops.

4.2 Encourage E-commerce Platforms to Allow Proof of IP Other than Chinese IP Certificates



- Accept IPR-related documents formed outside of China that can be obtained through official or other public channels as sufficient proof of IPR ownership in e-commerce IPR infringement procedures.
- Allow an IPR established in one infringement case to be used across all other cases immediately.

5. Trade Secrets

5.1 Clarify the Standard for 'Prima Facie Evidence' in Civil Litigations under the Anti-Unfair Competition Law

- Provide guidance to clarify the standards of *prima facie* evidence and rules of burden of proof transfer through judicial interpretation and sample cases.

5.2 Encourage the Public Security Bureau (PSB) to Take Active Measures against Trade Secrets Infringement and Allocate More Resources to the PSB for Such Cases

- Launch special action projects annually within the law enforcement authority to investigate and crack down on trade secrets infringement crimes.
- Allocate more resources to the PSB to process trade secret infringement reports, especially in cases involving a former employee.

Introduction to the Working Group

The Intellectual Property Rights (IPR) Working Group represents a wide range of European interests in China's intellectual property (IP) regulatory framework and its enforcement of intellectual property rights (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

IP protection was raised to the central level on 30th November 2020 as President Xi Jinping stressed strengthening IPR protection in a speech to the Political Bureau of the Party Central Committee: "Innovation is the first driving force for development and protecting IPR protects innovation".¹

On 17th October 2020, the National People's Congress (NPC) passed the fourth revision of the Patent Law, which went effect on 1st June 2021.² The working group welcomes the amendment and hope to soon see the issuing of supporting regulations to ensure its effective enforcement. Also effective since 1st June 2021, the amended Copyright Law introduces some significant wording changes as well as an increase in the penalties in cases of infringement.³

Throughout 2020 and early 2021, the Supreme People's Court (SPC) published several judicial interpretations and opinions which provided much needed clarifications to relevant laws and regulations, such as: *Interpretation of the Supreme People's Court on the Application of Punitive Damages in the Trial of Intellectual Property Infringement Civil Cases*,⁴ *Implementation Plan for the Enforcement of Intellectual Property Rights Judgments*,⁵

¹ Xi Jinping: Innovation is the first driving force for development, and protecting intellectual property rights means protecting innovation, Xinhua, 1st December 2020, viewed 6th May 2021, <<https://baijiahao.baidu.com/s?id=1684858162785555843&wfr=spider&for=pc>>

² Patent Law, Ministry of Justice (MOJ), 19th November 2020, viewed 6th May 2021, <http://www.moj.gov.cn/Department/content/2020-11/19/592_3260623.html>

³ Copyright Law, MOJ, 19th November 2020, viewed 6th May 2021, <http://www.moj.gov.cn/Department/content/2020-11/19/592_3260621.html>

⁴ Interpretation of the SPC on the Application of Punitive Damages in the Trial of IP Infringement Civil Cases, SPC, 3rd March 2021, viewed 6th May 2021, <<http://www.court.gov.cn/zixun-xiangqing-288861.html>>

⁵ The Implementation Plan for the Enforcement of IPR Judgments, SPC, 10th December 2020, viewed 6th May 2021, <<http://www.court.gov.cn/zixun-xiangqing-278231.html>>





and *Several Issues Concerning the Specific Application of Law in Deciding Criminal Cases Involving IPR*,⁶ among others.

Key Recommendations

1. Patents

1.1 Accept Post-filing Data for Patent Filing, Patent Invalidation and Judicial Proceedings



Concern

China's patent office has very strict criteria for accepting post-filing data submitted by applicants, making it much more difficult to obtain a patent right if the data was not included in the original specification compared to other countries/regions.

Assessment

Patent applicants in the pharmaceutical industry rely heavily on data to satisfy patentability requirements, including sufficiency of disclosure and inventive steps during patent examination proceedings, patent invalidation proceedings and judicial proceedings.

The China National Intellectual Property's (CNIPA's) attitude towards post-filing data, reflected in the *Patent Examination Guidelines*, has been inconsistent.⁷ The current requirement for acceptance of post-filing data is much stricter compared to other countries/regions like the European Union (EU) or the United States (US). Although the latest version of the *Guidelines* recommends considering post-filing data, in practice, such data is rarely accepted in patent examination proceedings, patent invalidation proceedings or judicial proceedings.⁸ Consequently, it is very difficult for applicants in the pharmaceutical industry to obtain patent protection if the data is not recorded in the original specification. This also leads to an abnormally high success rate of invalidation proceedings on patents that were filed and granted a long time ago when the patentability requirement for data was lower,

which in turn will discourage patent owners from making further innovations. On 11th September 2020, the SPC issued the *Provisions on Several Issues Concerning the Trial of Administrative Cases with Respect to Granting and Confirmation of Patent Rights (I)*, in which Article 10 states that the court should examine post-filing data; however it is still silent on the standard for the acceptance of those data.^{9&10}

Recommendations

- Modify the *Guidelines* to clarify that the technical effect to be proven by the post-filing data is directly disclosed or implied in the original patent application documents, or can be expected based on the original patent application documents or prior art documents by a person skilled in the art.
- Apply the new standard to all pending applications, administrative and judicial review of patent validity disputes (including those pending).
- Request the SPC to issue juridical interpretation to codify the standard, especially Article 10 in the latest SPC's juridical interpretation regarding post-filing data.

1.2 Exclude Chinese Patent Applications or Patent Assignments from Technology Exports and Simplify the Procedures

Concern

Chinese patent applications or patents assignments are categorised as technology exports when the assignor includes a Chinese individual or entity and the assignee includes a foreign individual or entity, and thus requires permission from the authorities for export, which creates a huge burden for parties assigning Chinese patents.

Assessment

According to Article 2.1 of the *Regulations on the Administration of the Import and Export of Technology*, technology export means transfer of technology from China to overseas, through trade, investment, or economic and technical cooperation. Chinese patent applications or patents assignments are currently dealt with by the authorities as a technology export, despite

⁶ *Interpretation on Several Issues Concerning the Specific Application of Law in Criminal Cases of Infringement of IPR (3)*, SPC and Supreme People's Procuratorate (SPP), 13th September 2021, viewed 6th May 2021, <<http://www.court.gov.cn/zixun-xiangqing-254891.html>>

⁷ *Announcement on Amending the Patent Examination Guidelines (No. 3391)*, CNIPA, 11th December 2020, viewed 27th June 2021, <https://www.cnipa.gov.cn/art/2020/12/14/art_74_155606.html>

⁸ For instance, post-filing data is not accepted if the technical effect demonstrated by such data is not fully described in the original specification, or such data, as evidence at court, has only formality deficiencies (like unconsularised foreign evidence), which is unfair for innovative multinational companies.

⁹ *Provisions on Several Issues Concerning the Trial of Administrative Cases with Respect to Granting and Confirmation of Patent Rights (I)*, SPC, 10th September 2020, viewed 27th June 2021, <<https://www.chinacourt.org/article/detail/2020/09/id/5453569.shtml>>

¹⁰ Especially clarify the standard cited in Section 2, Chapter 10, Article 3.5.1 of the *Patent Examination Guidelines* that the technical effect of the post-filing data should be obtainable by a skilled person from the disclosure of the patent application.





the fact that when a Chinese patent is transferred from a Chinese company to a foreign company based outside China, it is still a Chinese patent valid only within the territory of China and is not transferrable overseas. The assignment of a Chinese patent does not result in a foreign patent based on the assigned patent, because the foreign filing must comply with the confidentiality examination regulated for in Article 20 of the Patent Law. It is not necessary to set barriers for the assignment of a Chinese patent in addition to this confidentiality examination in order to regulate filing a foreign patent application based on the technology of a Chinese patent.

Furthermore, the Chinese patent assigned from a foreign individual or entity to a Chinese individual or entity is not considered a technology import. This non-equivalence causes confusion on technology export and import.

Recommendations

- Amend the *Regulations on the Administration of the Import and Export of Technology* (Article 2.2) to exclude Chinese patent application or patent assignment from technology export by deleting “patent assignment” and “patent application assignment”.
- Amend the CNIPA’s *Guidelines for Patent Examination* (Part I, Chapter 1, Section 6.7.2.2) to exclude the Chinese patent application or patent assignment from technology export.

1.3 Issue Detailed Implementation Regulations Pursuant to the New Patent Law, and Ensure That Administrative Authorities Receive Sufficient Training on Enforcement

Concern

Enforcement of patents via administrative authorities is relatively weak, resulting in a disproportionate burden falling on the already overloaded courts.

Assessment

While earlier drafts of the new Patent Law (in force since 1st June 2021) granted far-reaching powers to administrative authorities to enforce patents, the final version does not contain such clear powers.

Most patents are enforced through patent infringement civil litigation. Given the growth of civil litigation and a

subsequently over-burdened judicial system, without additional and efficient means of enforcing patents, the security of patents could be jeopardised. Administrative enforcement by way of provincial regulations or local practice offers an efficient and cost-effective alternative to civil litigation. Under the previous legislation, while local patent authorities can determine infringement, their powers of enforcement are limited. As a result, potentially stronger enforcement powers envisaged in earlier drafts of the new Patent Law were welcomed. In the final version of the law, enforcement powers are less clearly enumerated. Without clear and effective enforcement powers set out in the Patent Law, effective patent enforcement will be difficult to achieve.

Recommendations

- Set out in detail in regulations to be issued under the Patent Law how the administrative enforcement provisions will work in practice.
- Ensure that administrative authorities receive sufficient training to confidently enforce the new Patent Law.

2. Trademark

2.1 Consider Internet Activity and Accessibility by the Chinese Market in the Determination of Pre-emptive Registration in Bad Faith 2

Concern

It is difficult to prove the ‘reputation’ and ‘fame’ of a trademark when this trait is developed overseas, as only Chinese sources are used during registration examination, even in cases of webpage contents.

Assessment

Under Article 32 of the Trademark Law, a trademark application should be rejected if applying for a trademark identical with or similar to other trademarks with a ‘certain reputation’.¹¹ In practice, the CNIPA only considers ‘certain reputation’ in China. During opposition or cancellation of pre-emptive trademarks, it is difficult for the right holder to convince the CNIPA a trademark has a ‘certain reputation’ when this reputation is held overseas, but not in the Chinese market so far, even if Chinese consumers can access the brand online.

In many cases, proving use in China can be difficult,

11 Trademark Law, CNIPA, 22nd November 2019, viewed 6th May 2021, <http://sbj.cnipa.gov.cn/zcfg/sbfftg/201911/t20191122_308740.html>





Taking the case of MUJI in 2019 as an example,¹² MUJI's lack of trademark registration and prior use in Mainland China of 无印良品—the Chinese version of 'MUJI'—was key to the failure of their lawsuit against Hainan Nanhua. According to Article 13.2 of the Trademark Law, a trademark that is well-known in China shall also be protected (both against unfair registrations by others and from infringements) in respect to goods and kinds of goods not directly and explicitly designated in the trademark application.

If the definition of 'certain reputation' in Article 4 of the Trademark Law could be enlarged to include the Internet as accessed by the Chinese market, many bad faith registrations could be successfully dealt with.

Recommendation

- Consider internet activity and accessibility by the Chinese market in determining pre-emptive registration in bad faith.

2.2 Lower the Burden of Proof Required to Show Bad Faith in Accordance with the Degree of Distinctiveness of the Trademark to be Protected

Concern

While bad faith is increasingly cited by the administrative and judicial authorities as grounds for refusal to grant trademarks, it remains a very difficult fact to prove.

Assessment

There are two situations that may involve the issue of bad faith: (1) where a foreign unregistered trademark has been registered in China by a third party in bad faith, and (2) where the right holder of a registered trademark initiates an invalidation or cancellation proceeding against a similar trademark registered in bad faith.

If a trademark is not registered, the risk of pre-emptive filing by a 'trademark squatter' is high. In such cases, it is not always possible to prove sufficient prior use in China and related 'prior influence', even if internet access to the mark can be established. In the working group's opinion, the examiner should take into account the degree of distinctiveness of the foreign trademark,

i.e., how original and how unrelated it is to the products concerned. If it is highly distinctive, the act of filing the same mark, without being able to explain how this specific name or design has been chosen, can be a presumption of bad faith on the part of the applicant. The above reasoning is increasingly used by the examiners of the Trademark Office, who cite Article 7 of the Trademark Law (TML) (principle of good faith) and the first sentence of Article 30.¹³

If the trademark to be defended is registered in China, it is often obliged to file oppositions or invalidation against similar trademark applications. It is necessary to prove the likelihood of confusion caused by these new applications. According to Article 12 of the *Provisions of the SPC on Several Issues concerning the Trial of Administrative Cases involving Trademark Authorisation and Confirmation*, the court shall examine the extent of similarity of the trademarks, the goods concerned, the distinctiveness of the trademark that requires protection, the degree of attention of the general public, and the "intention of the trademark applicant...may also be taken into consideration."¹⁴ Hence, for example, if the disputed mark consists of the names of the real right holders, which are not familiar to Chinese consumers, only the bad faith filer can explain how the disputed mark was created.

Recommendation

- Lower the burden of proof required to show bad faith in accordance with the degree of distinctiveness of the trademark to be protected.

2.3 Create a Mechanism to Stay Proceedings until Invalidations, Oppositions and Non-use Cancellations are Dealt With

Concern

The registration time for trademark applications has been accelerated, whilst the time for invalidations/cancellations of prior trademarks cited as reason to refuse a new application has not, and, as the CNIPA does not stay the application revision until

¹² In the MUJI case, the court did not protect the MUJI trademark because it ruled that, when Hainan Nanhua filed a similar trademark in 2000, MUJI was not well-known in China.

¹³ Article 30: "Where a trademark to be applied for registration is in nonconformity with the relevant provisions of the Law, or it is identical with or similar to the trademark of another person that has, in respect of the same or similar goods, been registered or preliminarily approved, the Trademark Office shall refuse the application without announcement."

¹⁴ *Provisions of the SPC on Several Issues concerning the Trial of Administrative Cases involving Trademark Authorisation and Confirmation*, SPC, 11th January 2017, viewed 6th May 2021, <<http://www.court.gov.cn/zixun-xiangqing-34732.html>>



the invalidation/ cancellation has been finalised, the applicant is forced to file an appeal, which increases procedure time and costs.

Assessment

In October 2019, the CNIPA announced that the average length of examination for trademark registration has been shortened to five months, compared to the original nine months provided for by Article 28 of the Trademark Law.^{15&16} Speeding up this process has caused complications for companies that want to register trademarks. For example, when a company applies for a trademark, it will at the same time file for oppositions, non-use cancellations and/or invalidations against trademarks that could potentially block the registration. When the examination time for registration was nine months, these actions would be dealt with around the same time as the trademark examination. However, the shorter trademark examination is forcing companies to file a rejection appeal and possibly a lawsuit in order keep their application alive until any blocking trademark has been successfully opposed, cancelled or invalidated. This increases costs for registrants and places a heavy burden on their resources.

The working group advocates for a procedure to be introduced into the Trademark Law that can stay the application examination procedure until all oppositions, cancellations and invalidations have been dealt with. This will reduce the workload for both the CNIPA and trademark registrants, thus benefiting the Chinese trademark landscape significantly.

An alternative solution for the CNIPA would be, when a trademark is the subject of an application for review of refusal, to summon the owner(s) of the cited prior trademarks to appear in the review procedure and submit their evidence of use (if requested), arguments or agreement. This would serve to deal with all connected cases at the same time.

Recommendations

- Create a procedure to stay trademark application examination procedures until all oppositions,

¹⁵ Remarkable Reform Results: The Average Period of Trademark Registration Examination has been Shortened to 5 Months, CNIPA, 18th October 2019, viewed 15th May 2020, <http://sbj.cnipa.gov.cn/gzdt/201910/t20191018_307457.html>

¹⁶ Trademark Law, SAMR, 20th April 2019, viewed 15th May 2020, <http://gkml.samr.gov.cn/nsjg/tssps/202004/t20200420_314426.html>

cancellations and invalidations are dealt with.

- Alternatively, create a procedure to handle applications for review of refusal in the presence of the cited prior trademarks.

3. Access to Law

3.1 Retain the Focus on IP Protection and Enforcement, Irrespective of Nationality of the IPR Holders

Concern

In times of challenging economic climate and trade disputes, protection and enforcement of IP rights are at risk of being less prioritised than more immediate concerns such as pressures on the local economy and reciprocal actions in trade disputes and, as a result, the effective enforcement of IP rights may be impeded.

Assessment

The coronavirus disease 2019 (COVID-19) had a major impact on global trade and activity in 2020. While China has dealt with the pandemic well, other nations still continue to struggle with the fallout. In addition, trade disputes—including between the US and China, and the EU and China—have cast a shadow over international relations. Working group members have reported incidents that could be associated with rising levels of protectionism and bias by bodies responsible for ensuring IPR security in China. Examples include notaries in certain regions refusing to notarise evidence for "foreign" companies, citing international trade tensions as the reason they cannot provide such services to foreign applicants.

Recommendations

- Retain the focus on IP protection and enforcement, irrespective of nationality of the owners of such IP rights.
- Instruct IPR protection bodies to act dispassionately in relation to foreign applicants.

3.2 Simplify Procedures for the Provision of Formality Material from Overseas in Cases with no Credible Probiy Concerns

Concern

Meeting the requirements for proving the content of formality material (materials, documents, and other evidence) for the purposes of civil litigation has always been arduous for parties litigating in China, particularly





for foreign entities and others who rely on evidence from abroad, challenges amplified by the pandemic.

Assessment

The status quo for formality material sourced overseas is that, after the initial notarisation has taken place (to this point there is no difference to evidence secured within China), the process for relevant formality material is 'legalised'. This usually involves having the notarisation attested by the responsible court, and then having the court's certification attested at the foreign office, which in turn is attested at the Chinese embassies or consulates in the country of origin (CoO) of the material. This process constitutes a substantial hurdle to working group members' effective IPR enforcement. Meanwhile, on 3rd February 2021, the Supreme People's Court issued provisions on the online legalisation of power of attorney (POA) for civil cases.¹⁷ The burden has also been worsened by COVID-19 health-safety measures of some CoOs. Due to local 'lock-down' requirements, Chinese missions have not been able to keep pace with formalisation demands for formality material, leading to backlogs (where Chinese courts have extended submission deadlines) or missed deadlines (where such extensions have not, or could not be granted). This has had an adverse impact on working group members' ability to effectively protect, enforce, and even defend, their IPR in China.

Recommendation

- Adopt the online legalisation of power of attorney (POA) solution recently proposed by the SPC for civil cases and extend this solution to all administrative cases.

3.3 Implement a System That Privileges Proportionate and More Adequate Compensation For IPR Infringement

Concern

Compensation awarded for IPR infringement is often not proportional to the damages or the loss caused.

Assessment

According to China's current legislation regarding IPR infringement, compensation should be awarded in consideration of the actual damages as suffered by

the right holder, or alternatively compensation based on the illicit profits and/or illegal gains of the infringer. Compensation should only be based on statutory damages in cases where it is difficult to determine the actual losses suffered by the right holder. However, in practice, compensation that is liquidated is often much lower than the damages caused by the violations, and generally not satisfactory, even after several positive developments in increasing damages, such as in the amendments of the Copyright Law, the Patent Law and the Trademark Law. In the working group's opinion, enforcement of the above-mentioned principles should be ensured nationwide at all levels.

In addition, even if the role of evidence collection activities is fundamental to obtain a proportionate and adequate compensation, currently several related expenses are not covered. The working group suggests that expenses for legal assistance, pre-trial investigation, and generally those incurred to curb the infringement should be borne by the infringer and better defined in relevant regulations.

Furthermore, when it is difficult to determine the actual loss and obtain compensation based on damages, right holders rarely receive sufficient statutory damages. This could be resolved by providing more uniform criteria to liquidate compensations, with particular attention to extensive, repeated and malicious infringements. The working groups recommends that revision of the legislation and relevant regulations include a system providing for multiples in awarding statutory damages upon serious, repeated or extensive violations, to standardise with fixed criteria determination of compensations.

Recommendations

- Ensure application of a mechanism that prioritises the awarding of proportional compensation over statutory damages in cases of IPR infringement.
 - Issue further opinions and guidelines to ensure a more uniform application of the compensations system based on damages as suffered, and guide and assist courts in applying the same principles.
 - Issue measures to facilitate reimbursement and compensation of reasonable expenses for legal assistance, investigation and evidence collection activities as incurred to 'curb the infringement'.
- Enhance statutory damages compensations in cases of serious, repeated or extensive violations.

¹⁷ China Spring Newsletter 2021: Dispute Resolution, E-commerce and Securities, The National Law Review, 25th May 2021, viewed 29th June 2021, <<https://www.natlawreview.com/article/china-spring-newsletter-2021-dispute-resolution-e-commerce-and-securities>>





- Revise provisions on statutory damages to establish a system based on multiples of the determined amount in case of serious, repeated or extensive violations when circumstances are met.
- Issue relevant opinions and guidelines to define fixed criteria for courts to determine the “extent of the infringement” in order to uniformly award more adequate compensations.

3.4 Issue Judicial Rules for People’s Courts Regarding the Use of Electronic Evidence Authenticated by Technical Means

Concern

It is becoming more common for China’s People’s Courts and administrative authorities to accept evidence in the form of electronic data authenticated by blockchain, timestamp or similar technologies, but apart from the three Internet Courts in Beijing, Guangzhou and Hangzhou, there is no official document (interpretation, judicial rules, guidelines) regulating the authenticity and defining the scope of such forms of evidence in court proceedings.

Assessment

The continuously growing importance of the Internet as a source of information, an entertainment medium and a direct product and service purchase channel for consumers in China has led to a shift of IPR infringement activities to the cyberspace realm in recent years. With regard to the production of evidence in civil litigation, China has, to a certain extent, reacted to this development by adopting new or amending existing rules regarding electronic data as evidence, such as *Several Provisions of the Supreme People’s Court on Evidence in Civil Litigation Involving Intellectual Property Rights*, *Provisions of the Supreme People’s Court on Evidence in Civil Litigation*, or *Provisions of the Supreme People’s Court on Several Issues Concerning Trial of Cases by the Internet Courts*. It is, however, only the *Provisions* for the Internet Courts that explicitly stipulate: “Where the authenticity of the electronic data provided by the parties concerned can be proved through electronic signature, trusted timestamp, hash check, blockchain or any other technical means of collection, fixation and tamper-proofing of evidence or be authenticated through the platform for electronic collection and storage of evidence, the Internet Courts

shall confirm the authenticity of such electronic data.”¹⁸ It can be observed throughout the country that People’s Courts at all levels are gradually acknowledging the authenticity of electronic evidence generated through one or more of the means mentioned above. Therefore, there is no substantive reason to limit the recognition of such evidence to allegedly better-equipped Internet courts.

A formalisation of this nationwide recognition practice by means of SPC rules and interpretations would provide significant clarity and security for IPR holders to choose this comparatively cheap, fast and convenient way of authenticating electronic evidence. Moreover, judicial guidance in this regard would also have beneficial effects for the quality of IPR protection in China in general, given that involving public notaries to authenticate evidence can in many cases become a practical as well as economic obstacle in IPR enforcement, leading to the inability for crucial evidence to undergo notarisation, which puts the data at higher risk of being contested by the infringer.

Recommendation

- Issue judicial rules, interpretations and documentation regarding the recognition of electronic evidence authenticated by blockchain, timestamp or similar technologies in all kinds of civil litigation proceedings and not limited to cases heard by Internet Courts.

4. Online IP Protection

4.1 Clarify Liability for E-commerce Platforms on IPR Infringement Through Legislation

Concern

E-commerce platforms face little liability when dealing with IPR infringement, which obstructs legal actions and enables infringers to easily (re-)open multiple infringing stores.

Assessment

Article 42 of the E-commerce Law entitles IPR holders to notice and takedowns with e-commerce platforms in cases of infringement on their platforms.¹⁹ However, Article 43 heavily reduces the liability of the platforms

¹⁸ *Provisions of the Supreme People’s Court on Several Issues Concerning Trial of Cases by the Internet Courts*, SPC, 6th September 2018, viewed 23rd June 2021, <<http://lawinfochina.com/display.aspx?lib=law&id=28927>>

¹⁹ *E-commerce Law*, MOFCOM, 31st August 2019, viewed 15th May 2019, <http://www.mofcom.gov.cn/article/zt_dzswf/deptReport/201811/20181102808398.shtml>





– the e-commerce platform's obligation is only passing on the information between both parties during an infringement complaint.²⁰ Once the infringer submits a counter notice, the right holder needs to proceed with formal actions against the infringer within 15 days or the case will be terminated. Considering the large number of infringing stores online, right holders do not have the time or budget to take legal actions against each one within 15 days if the procedures and requirements for filing complaints against online stores are the same with those involving physical stores or factories.

In addition, Article 9 of the E-commerce Law outlines the liabilities of e-commerce business operators to display their business licence information, while Article 10 exempts individuals conducting small deals from this liability. Article 17 outlines the responsibilities of e-commerce business operators to provide comprehensive and accurate information of the goods and services they provide. 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. By profiting from illegal goods sold on their platforms, e-commerce platforms should be more liable for dealing with IP infringement requests from rights holders. For more information on online IP protection, please also refer to the *Fashion and Leather Working Group Position Paper 2021/2022* on page 233.

Recommendations

- Outline the liabilities of e-commerce platform operators to provide necessary shop/person information regarding infringers and infringing activity 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 exempt from the liability of displaying a business licence.
- Stipulate in the interpretation for Article 42 the procedures and requirements when filing

complaints against online stores with the competent administrative authorities.

- Set up criteria that identify the operator of an infringing online store on the public Social Credit system.
- Allow only one shop under one identification per person/company, which will be responsible for proving that there is no IP infringement history.
- Require e-commerce platforms to establish an infringer blacklist, and to ban such infringers from re-opening shops.

4.2 Encourage E-commerce Platforms to Allow Proof of IP Other Than Chinese IP Certificates



Concern

E-commerce platforms require Chinese IP certificates for enforcement, which is cumbersome for foreign rights holders.

Assessment

E-commerce platforms in China do not accept copyright or trademark infringement cases if there is no Chinese copyright registration certificate or Chinese trademark certificate. European right holders with an international trademark registration, designating China, often do not have Chinese trademark certificates.²¹

Copyright, according to the Berne Convention, exists the moment a work is made. China has created a copyright registration system in order to declare the holders of copyright recognised by the Chinese authorities, the China Trademark Office and the Trademark Review and Adjudication Board, which do not have a list of requirements regarding proof of copyright. Therefore, e-commerce platforms should not act as courts, but instead should uphold the right of the copyright owner in notice and takedown cases.

Furthermore, requesting IP certificates issued in China has no legal basis neither in the E-commerce Law nor in the *Reply of the SPC on Several Issues concerning the Application of Law to IPR Infringement Disputes Involving the Internet*. Both sets of rules only require "preliminary evidence of infringement" without limiting the scope of admissible evidence to Chinese IPR certificates. E-commerce platform operators should not be granted powers to set up higher requirements

²⁰ Article 43: "Upon receipt of the forwarded notice, operators on the platform may submit a statement of no infringement to the e-commerce platform operator. Such statement shall include *prima facie* evidence on no act of infringement. Upon receipt of such statement, the e-commerce platform operator shall forward such statement to the IPR holder that issued the notice and inform the IPR holder of their right to file a complaint with the relevant competent authority or bring a lawsuit before a People's Court. If the e-commerce platform operator has not received any notice within 15 days, it shall immediately stop the measures it has taken."

²¹ Chinese trademark certificates must be applied for separately after the trademark has officially already been registered in China.





than those existing in civil litigation. In fact, Article 8 No. 3 of the SPC's *Reply* allows IPR holders to submit publications, patent documents, and so on, that are formed outside of China and can be obtained through official or other public channels without having to undergo notarisation and legalisation. Article 8 No. 4 furthers the scope of admissible evidence to evidence formed outside of China that can be authenticated by other evidence. Extending these efforts to e-commerce IPR infringement procedures would be perfectly coherent with other recent attempts to restrain the negative aspects of the growing influence of e-commerce platforms.

Recommendations

- Accept IPR-related documents formed outside of China that can be obtained through official or other public channels as sufficient proof of IPR ownership in e-commerce IPR infringement procedures.
- Allow an IPR established in one infringement case to be used across all other cases immediately.

5. Trade Secrets

5.1 Clarify the Standard for 'Prima Facie Evidence' in Civil Litigations under the Anti-unfair Competition Law 2

Concern

The vagueness of '*prima facie* evidence' leaves great discretion to the court, increases the burden of producing evidence for trade secret owners and hinders innovation.

Assessment

Article 32 of the amended Anti-unfair Competition Law provides the transfer of burden of proof, where as long as a right holder provides "*prima facie* evidence", the burden can be transferred. However, "*prima facie* evidence" is yet to be clarified and has been subject to different interpretation by different courts and judges.²² The *Provisions of the SPC on Several Issues Concerning the Application of Law in the Trial of Civil Cases Involving Trade Secret Infringement* does not provide a detailed standard for "*prima facie* evidence".²³

²² Anti-unfair Competition Law, NPC, 7th May 2019, viewed 12th May 2021, <<http://www.npc.gov.cn/npc/c30834/201905/9a37c6ff150c4be6a549d526fd586122.shtml>>

²³ *Provisions of the SPC on Several Issues Concerning the Application of Law in the Trial of Civil Cases Involving Infringements upon Trade Secrets*, SPC, 12th September 2020, viewed 6th May 2021, <<http://www.court.gov.cn/zixun-xiangqing-254751.html>>

In practice, the trade secrets owner may only be able to provide limited clues, such as the digital copy of the infringer's tender document to demonstrate a possibility of trade secret infringement, and the legality of such clues is dubious. In reality, trade secret owners still face great difficulties in providing evidence to prove the infringement.

Recommendation

- Provide guidance to clarify the standards of *prima facie* evidence and rules of burden of proof transfer through judicial interpretation and sample cases.

5.2 Encourage and Allocate More Resources to the Public Security Bureau (PSB) to Take Active Measures Against Trade Secrets Infringement 2

Concern

The lack of stringent criminal liabilities leads to the absence of sufficient deterrent effect on infringers, which discourages innovation and creates dishonest working ethics.

Assessment

Before the PSB can accept a crime report on an alleged trade secret theft, right owners are usually required to provide information on where the suspected infringer stores the trade secrets, which can be very difficult to prove. The working group recommends PSB special action projects be launched frequently to assist right owners in accessing such information. Furthermore, the PSB often delays or is reluctant to accept cases due to the complexity of trade secrets infringement case and its lack of resources.

The theft and misuse of trade secrets can lead to huge losses for the right owners, whom mainly base their business on know-how. Such cases usually involve a former employee of the right owner. The lack of stringent criminal liabilities will not only cause infringers to disrespect the authority of the law, but also discourage innovation and create dishonest working ethics in society.

Recommendations

- Launch special action projects annually within the law enforcement authority to investigate and crack down on trade secrets infringement crimes.
- Allocate more resources to the PSB to process trade





secret infringement reports, especially in cases involving a former employee.

Abbreviations

CNIPA	China National Intellectual Property Administration
CoO	Country of Origin
COVID-19	Coronavirus Disease 2019
EU	European Union
IP	Intellectual Property
IPR	Intellectual Property Rights
MOJ	Ministry of Justice
NPC	National People's Congress
POA	Power of Attorney
PSB	Public Security Bureau
SPC	Supreme People's Court
SPP	Supreme People's Procuratorate
US	United States



Inter-chamber Small and Medium-sized Enterprise Working Group

Key Recommendations

1. Provide European Small and Medium-sized Enterprises (SMEs) in China with Better Access to Financing 7

- Enhance the implementation of lending strategies to assist all SMEs—both European and Chinese—operating in China.
- Increase incentives that encourage 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.
- Develop a regulatory framework that encourages innovative financing support for SMEs, while limiting potential financial risks.
- Encourage China to establish national funds for financing partnerships between European and Chinese SMEs.
- Relax foreign exchange debt quota requirements to remove regulatory obstacles that limit SMEs', especially foreign-invested enterprises', access to credit financing.

2. Promote Coordination Between Different Administrative Departments and Improve the Transparency, Clarity and Integrity of All Relevant Regulations for SMEs 7

- Implement a 'one-stop-service' system in provincial/regional administrative departments to support all SMEs, both foreign 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.
- Ease COVID-related travel restrictions to allow foreign nationals to return to China, while upholding all necessary health and safety measures.

3. Reduce the Financial Burden of SMEs to the Greatest Extent Possible, Including Through Measures Like Ensuring Reasonable Payment Terms and Enforcing Timely Payments 7

- 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 that have reasonable payment terms with SMEs.





- Improve legal debt collection procedures.
- Develop and implement measures to encourage banks to provide financing solutions to SMEs based on accounts receivable.
- Continue to develop targeted measures that reduce the financial burden of SMEs, such as reducing social welfare costs and using a step approach for the allocation of corporate income tax rates.

4. Promote the Value of Intellectual Property Rights (IPR) Protection and Enforcement Mechanisms at the Consumer, Business and Local Government Levels 6

- Involve the general public and business community in awareness-raising campaigns to promote respect for IPR.
- Increase the State Administration for Market Regulation's (SAMR) power to enforce the European Union-China Agreement on Geographical Indications (GI).
- Strengthen enforcement and consistency with regard to notice-and-take-down procedures.
- Engage local enforcement agencies, customs authorities and 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.

Introduction to the Working Group

The Inter-Chamber Small and Medium-sized Enterprise (SME) Working Group was established in 2014 as a new advocacy element of the European Union (EU) SME Centre (Phase Two),¹ with the objective of strengthening advocacy for European SMEs in China. The working group is based on the European Chamber's Small and Medium-sized Enterprise Forum. As SMEs are key contributors to the overall economic development and social welfare of countries, the working group aims to bring together European SMEs to create a strong channel through which concerns over the business challenges they face in China can be expressed.² The working group regularly organises meetings that provide practical solutions and policy advice to European SMEs and their stakeholders.³

Definition of SMEs in Europe and China

The European definition of an SME is an enterprise that employs less than 250 people and has an annual turnover not exceeding euro (EUR) 50 million, or total

assets no greater than EUR 43 million.⁴

In China, SMEs are defined according to the SME Promotion Law as companies that "have a relatively small size in personnel and scope of business".⁵ 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.⁶

EU SME Projects in China Implemented by the European Chamber

The EU SME Centre (Phase Three) started in October 2020, and will run until April 2022. Its main objectives are: assisting European SMEs to establish and develop a commercial presence in the Chinese market by providing EU added-value support services; improving corporate

1 *About EU SME Centre*, EU SME Centre, viewed 25th April 2021, <<http://www.eusmecentre.org.cn/about-centre>>

2 The *Inter-chamber SME Working Group Position Paper 2021/2022* presents the recommendations of SMEs from all EU Member States, regardless of the enterprises' membership status with the European Chamber.

3 Stakeholders include EU SME Centre implementation partners and EU Member State embassies, <www.eusmecentre.org.cn>

4 *Commission Recommendation of 6 May 2003 Concerning the Definition of Micro, Small and Medium-sized Enterprises (C(2003) 1422)*, European Commission, 20th May 2003, viewed 27th April 2021, <<http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>>

5 *Law of the People's Republic of China on the Promotion of Small and Medium-sized Enterprises*, National People's Congress, 2017, viewed 26th April 2021, <http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-09/01/content_2027929.htm>

6 *Statistical Criteria for the Classification of Large, Medium, and Small Micro-enterprises (2017)* [CN], National Bureau of Statistics, 1st March 2018, viewed 22nd April 2021, <http://www.stats.gov.cn/tjsj/tjbz/201801/t20180103_1569357.html>





synergies and increasing best practice-sharing at the national and regional EU business association levels, with the ultimate goal of benefitting European SMEs intending to do business in China; and strengthening advocacy efforts on behalf of the European business community to help create a better business environment in China.⁷

Another notable EU SME project in China is the China IPR SME Helpdesk, which supports European SMEs in both protecting and enforcing their intellectual property rights (IPR) in or relating to Mainland China, Hong Kong, Macao and Taiwan, through the provision of free information and services.⁸

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 gross domestic product. 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.⁹ Of the European SMEs either investing, exporting or operating in China (or planning to do so), most are from the food and beverage, commercial services, education, information and communication technologies (ICT) and healthcare sectors.

Recent Developments

The SME Promotion Law and Subsequent Developments

The SME Promotion Law was officially published on 1st September 2017, and came into force on 1st January 2018.¹⁰ A number of supporting regulations have since emerged. Additionally, in early 2019, stock-taking exercises on the implementation and enforcement of the SME Promotion Law were launched by both the Ministry of Industry and Information Technology (MIIT) and the National People's Congress (NPC). A resulting special inquiry took place on 28th June 2019, with commitments

made to work on outstanding issues.¹¹

COVID-19 and Policies to Support SMEs

The outbreak and spread of COVID-19 dominated 2020, and the impact is still being felt in 2021. The containment efforts carried out by China and other countries, particularly in early 2020, led to a number of unintended negative consequences, including supply chain disruptions, decreases in demand and forced interruption of production, among others. Predictably, SMEs were among the hardest hit groups.

European SMEs consulted in mid-February 2020 as part of a wider survey on the impact of COVID-19 on SMEs reported that their main problems included reductions in client orders, supply chain disruptions (especially with smaller suppliers) and liquidity/financing issues.¹² Foreign SMEs faced the additional challenge of travel restrictions, which left a significant number of foreign professionals stranded outside of China, and companies unable to recruit much-needed foreign talent. This remains an issue for many at time of writing. Surveys by Tsinghua and Peking universities in February and April 2020 conducted on a wider sample of companies also painted a bleak picture for smaller companies.¹³ As the months went by, SME recovery was consistently slower than that of multinational companies.¹⁴

Throughout the crisis, the Chinese Government released a host of measures aimed at minimising the damage caused by the outbreak, and, later on, at facilitating work resumption. At the national level, a number of general measures in areas like taxation, human resources (HR) and financial support were rolled out and implemented through corresponding measures at the local level. The government also released SME-focussed regulations such as the MIIT's *Notice on Responding to the Novel Coronavirus Epidemic Situation and Assisting SMEs to Resume Work, Re-produce and Resolve*

7 *About Us*, EU SME Centre, viewed 12th April 2021, <<http://www.eusmeccentre.org.cn/about-centre>>

8 *About Us*, China IPR SME Helpdesk, viewed 18th April 2021, <<http://www.china-iprhelpdesk.eu/content/about-hd>>

9 Guo, Linmao, and Ma, Xianghui (Editors), *Small and Medium-sized Enterprises Promotion Law: Guidebook*, China Democracy and Legal System Publishing House, Beijing, 2017, pp. 15–19.

10 *Promotion of Small and Medium-sized Enterprises Law*, Duxiu Baidu, 2017, viewed 26th April 2021, <https://dunixiaofa.baidu.com/detail?searchType=statute&from=alad_din_28231&originquery=per%20centE4%20per%20centB8%20per%20centAD%20per%20centE5%20per%20centB0%20per%20cent8F%20per%20centE4%20per%20centBC%20per%20cent81%20per%20centE4%20per%20centB8%20per%20cent9A%20per%20centE4%20per%20centBF%20per%20cent83%20per%20centE8%20per%20centBF%20per%20cent9B%20per%20centE6%20per%20centB3%20per%20cent95&count=61&cid=e0cb18d6b080a77aeebbbf1e431447_law>

11 *Special Inquiry on the Report on Implementation of the SME Promotion Law*, NPC, 26th June 2019, viewed 26th April 2020, <<http://www.npc.gov.cn/npc/c30834/201906/58bef89b23b5468e8c647197365ba66c.shtml>>

12 *Notice on launching a questionnaire survey on the impact of the new coronavirus epidemic on small and medium-sized enterprises*, State Council, 2nd February 2020, viewed 26th April 2021 <http://www.gov.cn/zhengce/zhengceku/2020-02/04/content_5474542.htm>

13 Zhu Wuxiang, Liu Jun and Wei Wei, *Tsinghua University and Peking University Jointly Investigate 995 Small and Medium-sized Enterprises and How They Cross the Line of Life and Death in Three Months*, MBA China, 25th February 2020, viewed 22nd April 2021, <<https://www.mbachina.com/html/tsinghua/202002/214377.html>>

14 *Coronavirus: Getting China Back to Work*, Trivium China, last updated 3rd June 2020, viewed 21st April 2021, <<https://triviumchina.com/2020/03/07/coronavirus-getting-china-back-to-work/>>



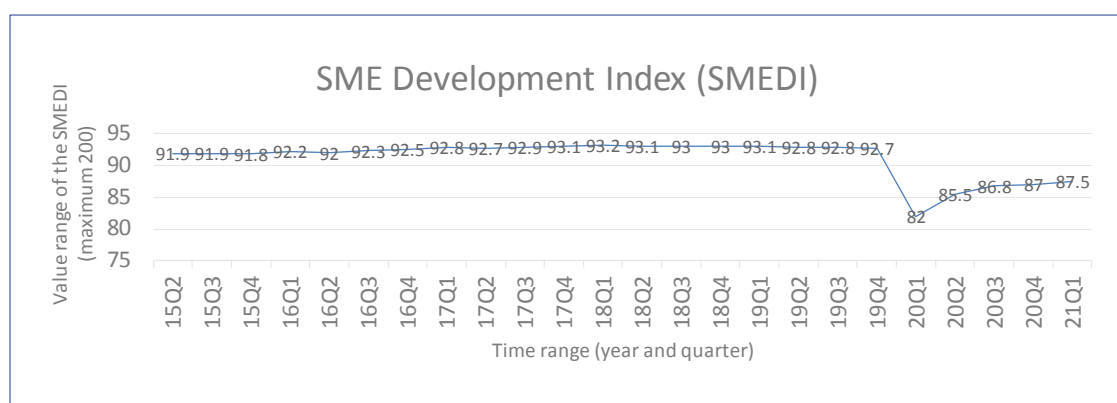


Figure 1 Sources: CASME, European Chamber

Common Problems,¹⁵ which covered areas like financing, digitalisation and innovative development, and public support initiatives for smaller businesses. Measures to reduce the administrative and financial burden of SMEs were particularly important in helping these enterprises weather the pandemic.

Data from the China Association for SMEs' (CASME) SME Development Index (SMEDI) shows that these government initiatives have been relatively successful. However, by the first quarter of 2021, numbers had still not returned to 2019 levels, showing that there is still a need for policies that support SME recovery in the short to mid-term.¹⁶

The working group is pleased to observe that a number of relevant measures to provide continuity in terms of reducing financial burdens, streamlining administrative procedures and financing were announced in the 2021 Government Work Report.¹⁷

The 14th Five-year Plan (14FYP) and SME Policy

The 2021 plenary sessions of the National People's Congress and the Chinese People's Political Consultative Conference (Two Sessions) took place from 4th to 11th March. During the Two Sessions, the 14FYP and the long-

term goals for 2035 were released.¹⁸ Although a dedicated plan for SME development has yet to be promulgated, the 14FYP includes commitments to improve the business and innovation environment for small companies, and to support the development of SMEs in the context of strengthening China's middle-income group.

Key Recommendations

1. Provide European SMEs in China with Better Access to Financing 🌐 7

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 enterprises' development, and it is well-known that SMEs in China face different challenges when accessing financing compared to larger companies. According to data from the *2020 Environmental Assessment Report for the Development of Small and Medium-sized Enterprises*, which assesses the development levels of SMEs in 36 major cities in China, the quality of the financing environment is the indicator that has the highest impact on the overall development of small businesses.¹⁹ While China successfully managed the

¹⁵ Notice on Responding to the Novel Coronavirus Epidemic Situation and Assisting SMEs to Resume Work, Re-produce and Resolve Common Problems, State Council, 9th February 2020, viewed 22nd April 2021, <http://www.gov.cn/zhengce/zhengceku/2020-02/10/content_5476684.htm>

¹⁶ The SME Development Index in the first quarter of 2021 continues to rise, reaching the highest level since the first quarter of last year, fully demonstrating the effectiveness of this year's epidemic prevention and control to stabilise the economy, CASME, 9th April 2021, viewed 14th April 2021, <<http://www.ca-sme.org/content/Content/index/id/31568>>

¹⁷ Government Work Report, State Council, 12th March 2021, viewed 14th April 2021, <http://www.gov.cn/premier/2021-03/12/content_5592671.htm>

¹⁸ The 14th Five-year Plan for the National Economic and Social Development of the People's Republic of China and the Outline of the Long-term Goals for 2035, State Council, 13th March 2021, viewed 15th April 2021, <http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm>

¹⁹ 2020 Environmental Assessment Report for the Development of Small and Medium-sized Enterprises released, MIIT, 31st March 2021, viewed 15th April 2021, <https://www.miit.gov.cn/xwdt/gxdt/sjdt/art/2021/art_8bda8de5bf1f477bbcdce54101b7d3cc.html>



COVID-19 crisis, the impact of the outbreak was still felt in all sectors of the economy, particularly by SMEs. In the wake of this crisis, financing now plays an even larger role in the business operations of companies. Although Chinese policy-makers have repeatedly tried 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 that domestic companies tend to be preferred because of their closer relationships with local banks.

This contrasts with SMEs' perception of financing in Europe—even during the height of the COVID-19 crisis—as highlighted in the latest *Survey on the Access to Finance of Enterprises*,²⁰ published by the European Central Bank in June 2021. Despite a steep decline in turnover and profits, access to financing remained among the lowest-ranked concerns for SMEs in Europe. Moreover, they reported experiencing a slight increase in the availability of bank loans and an improvement in access to public financial support.²¹

In addition to SMEs' difficulties in accessing financing in China, the options available are simply more limited compared to the variety of financial tools available in the EU. For instance, according to the Organisation for Economic Cooperation and Development's (OECD's) report *Financing SMEs and Entrepreneurs 2020*, out of the seven specified policy instruments for SME and start-up financing support, China has so far implemented four, while at the European level there is an average of six.²² For foreign SMEs in China, these tools are considerably reduced despite the theoretical availability of funds back in their home countries. For example, bank loans for foreign-invested enterprises (FIEs) are generally obtained against guarantees from banks outside of China, which typically require further risk assessment by European headquarters. However, foreign exchange loans, which should be easier for FIEs to access, are limited by the so-called 'borrowing gap' – the difference between the total amount invested and the minimum amount of required capital that corresponds to the

investment. Borrowing from domestic Chinese banks, though possible in theory, is extremely difficult for FIEs. In addition, although the EU and China maintain regular exchanges on SME policies, bilateral financial support schemes are generally channelled through other sector or topic-specific programmes.

The working group is aware of the recent steps taken by the Chinese authorities to tackle issues with SMEs' access to financing. Measures include: stipulating an increase of loans to SMEs by 30 per cent in 2021, and generally improving SME access to credit loans; postponing principal and interest repayments on loans;²³ targeted cuts to reserve requirements for banks that are lending to SMEs; expanding the scope of refinancing policies; and increasing the tolerance for non-performing loans.^{24&25} However, these measures have achieved very limited success in the case of foreign SMEs.

One area where China does excel globally, and which could potentially ease the financing difficulties of SMEs operating in the country, is alternative online financing. An International Monetary Fund (IMF) study on fintech credit risk assessments shows that not only are potential loan defaults from small companies predicted with higher accuracy with fintech—which goes some way towards addressing Chinese banks' concerns that loans to SMEs are inherently riskier—but also that the approach benefits smaller SMEs in third- and fourth-tier cities, as it fosters more inclusive financing.²⁶

Aside from the damage caused by the COVID-19 crisis, there is also a need to increase SMEs' access to financing in order to help realise China's mid- and long-term goals of increasing its middle-income population and of boosting innovation. Therefore, existing measures and channels to support SMEs' access to financing should be improved, and the development of new methods considered.

20 *Survey on the Access to Finance of Enterprises*, October 2020 to March 2021, European Central Bank, 1st June 2021, viewed 16th July 2021, <https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/index.en.html>

21 Ibid.

22 *Financing SMEs and Entrepreneurs 2020: An OECD Scoreboard*, OECD, 22nd April 2020, viewed 23rd April 2021, <https://www.oecd-ilibrary.org/finance-and-investment/financing-smes-and-entrepreneurs-2020_95dfdf1e-en>

23 *Government Work Report*, State Council, 12th March 2021, viewed 14th April 2021, <http://www.gov.cn/premier/2021-03/12/content_5592671.htm>

24 *Guiding Opinions on Promoting the Healthy Development of Small and Medium-sized Enterprises*, State Council, 7th April 2019, viewed 28th April 2021, <http://www.gov.cn/zhengce/2019-04/07/content_5380299.htm?mc_cid=9c9e233ad4&mc_eid=51671cb827>

25 *New Measures to Ensure Meaningful Reduction in SMEs' Financing Costs*, State Council, 17th April 2019, viewed 22nd April 2021, <http://english.gov.cn/premier/news/2019/04/17/content_281476614548532.htm?mc_cid=d7c9acefac&mc_eid=51671cb827>

26 Huang, Yiping; Zhang, Longmei; Li, Zhenhua; Qiu, Han; Sun, Tao; Wang, Xue, *Working Paper: Fintech Credit Risk Assessment for SMEs: Evidence from China*, IMF, 25th September 2020, viewed 15th April 2021, <<https://www.imf.org/en/Publications/WP/Issues/2020/09/25/Fintech-Credit-Risk-Assessment-for-SMEs-Evidence-from-China-49742>>





Recommendations

- Enhance the implementation of lending strategies to assist all SMEs—both European and Chinese—operating in China.
- Increase incentives that encourage 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.
- Develop a regulatory framework that encourages innovative financing support for SMEs, while limiting potential financial risks.
- Encourage China to establish national funds for financing partnerships between European and Chinese SMEs.
- Relax foreign exchange debt quota requirements to remove regulatory obstacles that limit SMEs', especially FIEs', access to credit financing.

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—is still extremely burdensome for international SMEs in China, which impairs their development.

Assessment

Thanks to a number of measures aimed at improving the business environment rolled out over the past few years, foreign SMEs have reported advancements in areas such as a reduction in the time required for registering or closing down operations. These efforts have been acknowledged through China's rise in the ranks of the World Bank's index on the ease of doing business.²⁷ However, there is still a considerable gap across the board between the performance of first-tier cities and lower-tier cities with regard to the business environment, as illustrated in the *2020 Environmental Assessment Report for the Development of Small and Medium-sized*

Enterprises.²⁸ Given the key role these lower-tier cities will play in China's future economic development, it is essential to improve this situation.

In addition, although the efficiency of China's registration processes has generally improved, according to feedback from working group members, the time required to set up a business is still longer than the targets set by the Chinese Government. The approval of the business scope for FIEs is subject to extensive scrutiny from the Administration of Market Regulation, the Ministry of Commerce, and additional specific departments if special licensing is required. This process is especially difficult for smaller enterprises to navigate and can create additional costs for them, such as having to pay for office rental while licence applications are still pending.

Furthermore, while some licences, such as the Human Resources Operator Licence (HR Licence) or the School and the Training Facility Operation Permit, can theoretically be obtained by FIEs, in practice the departments responsible for examination and approval refuse to approve or support applications from foreign firms (see Case study: HR Licence for more details).

Case study: HR Licence in South China

The application process for the HR Licence constitutes a clear example of the need for transparency, clarity and integrity in administrative processes in China. The HR Licence allows enterprises in China to conduct services such as recruitment, personnel management and outsourced HR services, among others. However, according to the regulation in place before the Ministry of Human Resources and Social Security (MOHRSS) published the *Decision on the Revision of Several Regulations (2019)* on 31st December 2019, it was almost impossible for a foreign-invested SME to apply for a HR Licence, as one of the requirements was that five employees of the applying enterprise need to undergo a professional examination for the HR Intermediary Qualification Certificate, which can no longer be taken.²⁹ The *Decision* is supposed to lower entry

²⁷ *Doing Business in China*, World Bank, viewed 26th April 2021, <<https://www.doingbusiness.org/en/data/exploreconomies/china>>

²⁸ *2020 Environmental Assessment Report for the Development of Small and Medium-sized Enterprises released*, MIIT, 31st March 2021, viewed 15th April 2021, <https://www.miit.gov.cn/xwdt/gxdt/sjdt/art/2021/art_8bda8de5bf1f477bbcdce54101b7d3cc.html>

²⁹ *Decision of the Ministry of Human Resources and Social Security on Amending Some Regulations*, State Council, 31st December 2019, viewed 22nd April 2021, <http://www.gov.cn/gongbao/content/2020/content_5488914.htm>





barriers for wholly foreign-owned enterprises to obtain HR licences. However, enquiries with relevant authorities in Shenzhen revealed that no authority is currently implementing this regulation.

To deal with such licensing issues, a number of measures should be taken. First, more hotlines for public consultation should be opened. These hotlines must be operational, and the operator familiar with the formalities or be able to redirect enquiries to relevant counterparts. Furthermore, an online application system that is mature, stable and responsive could facilitate and accelerate the process. The requirements and checklists published online should be consistent with the actual requirements of government officials when companies submit documents on-site. A unified management standard for corporate applications across the whole municipal level would also ease the burden for SMEs.

The HR Licence case study reflects the need for effective implementation of measures that can cut red tape, especially given the challenges the business community has faced and will continue to face as a result of COVID-19.

Not only did the pandemic bring to light inefficiencies in areas like administrative procedures that in the past might have gone unnoticed, it also added to difficulties for foreign companies. A case in point is the inability of many SMEs' employees to return to China due to travel restrictions that were imposed as pandemic control measures, a situation that is still problematic as of May 2021. The lack of key personnel has caused a host of operational challenges for SMEs, and certain administrative procedures that require the physical presence of a legal representative or signatory have been rendered impossible. The inability to use certain online tools that are blocked in China only aggravates the situation. As a result, a sizeable number of European SMEs have been forced to close down their China operations. The working group therefore encourages the Chinese Government to work with the European business community to find solutions to administrative challenges faced by SMEs—some of them specific to foreign companies—derived from or intensified by COVID-19, and find ways to prevent such situations from arising in the future.

Recommendations

- Implement a 'one-stop-service' system in provincial/regional administrative departments to support all SMEs, both foreign 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.
- Ease travel COVID-related travel restrictions to allow foreign nationals to return to China, while upholding all necessary health and safety measures.

3. Reduce the Financial Burden of SMEs to the Greatest Extent Possible, Including Through Measures Like Ensuring Reasonable Payment Terms and Enforcing Timely Payments 🕒 7

Concern

It has become increasingly challenging for European SMEs to shoulder the financial burdens associated with doing business in China, with difficulties exacerbated by liquidity problems arising from an absence of maximum contractual payment terms, non-negotiable payment terms with 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 their business operations in China. Usually, SMEs have limited bargaining power during negotiations for payments, which often result in customers imposing onerous contractual payment terms. In addition, many customers simply do not comply with these terms and pay late.

In China, most industries lack guidelines to ensure that market players respect contractual payment terms, and so enterprises set a maximum payment term to be included in contracts. 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,³⁰

³⁰ *Contract Law of the People's Republic of China*, Central People's Government of the People's Republic of China, 29th July 2007, viewed 19th April 2021, <http://www.gov.cn/jrzq/2007-06/29/content_667720.htm>





the Supreme Court's *Interpretation on the Adjudication of Contract Disputes*,³¹ and the Civil Procedure Law³²). Debt collection services are available, but are often not practical given the length of time and, most importantly, the high costs involved.

While in the past, articles in laws and regulations such as the SME Promotion Law would include provisions prescribing that state organs, public institutions and large enterprises shall not default on the payment of goods, services and projects to SMEs, these provisions had until very recently not been accompanied by specific implementing measures. This goes towards explaining why, according to the OECD's *SME Financing Scoreboard*, China ranked third from last among 19 countries surveyed in terms of payment delays. In fact, according to the Atradius Payment Practices Barometer 2021, China respondents reported that 46 per cent of the total value of business-to-business invoices issued by them remained unpaid at the due date, and none reported a speeding up of invoice payments in China, although this was recorded by 6 per cent of businesses across Asia.³³

However, it is hoped that Premier Li Keqiang's announcement on 1st July 2020 that the State Council had approved a regulation aimed at tackling the issue of late payments will change the situation. Among other things, the regulation sets standardised requirements on the payment period; specifies conditions that cannot justify refusing or delaying payments; establishes deadlines for the provision of confirmation of the creditor's rights and debt relationship when SMEs apply for financing through accounts receivable; and addresses issues like contract signing, funding provision and means of payment for government departments, public institutions and large enterprises when dealing with SMEs. Additionally, the regulation also provides for the establishment of a public information disclosure system for late payments to SMEs.³⁴

31 *Supreme Court's Interpretation on the Adjudication of Contract Disputes*, Hualv.com, 10th January 2019, viewed 19th April 2020, <<https://www.66law.cn/laws/131741.aspx>>

32 The major flaw is that while the debtor may not dispute the debt, they may refuse to pay and bring any claim that does not have to be substantiated in order for the court to dismiss the case, which leaves the creditor to pursue their claim through regular court proceedings. *Civil Procedure Law of the People's Republic of China*, Ministry of Justice, 25th December 2018, viewed 15th June 2021, <http://www.moj.gov.cn/Department/content/2018-12/25/357_182594.html>

33 *China: use of credit insurance on the rise*, Atradius Collections, 16th June 2021, viewed 13th July 2021 <<https://group.atradius.com/publications/payment-practices-barometer/china-2021-use-of-credit-insurance-on-the-rise.html>>

34 *Regulations on Protecting Payments for Small and Medium-sized Enterprises*, State Council, 3rd July 2020, viewed 14th April 2021, <http://www.moj.gov.cn/government_public/content/2020-07/14/593_3252509.html>

The working group welcomes this positive development in terms of developing a regulatory framework to address late payments, but notes that effective implementation to accompany clear and well-developed regulations will be key.

European SMEs report that actions taken by the Chinese Government to reduce the financial burden on small businesses—especially during the outbreak—such as the temporary suspension of enterprise charges, reductions or exemptions for tax payments and social welfare, and the extension of social insurance payment periods, have been beneficial.

The working group welcomed the announcement in the *2021 Government Work Report* that the value-added tax (VAT) threshold for small-scale taxpayers is increased from Chinese yuan (CNY) 100,000 to CNY 150,000 in monthly sales.

An area where room for improvement remains is social welfare. Now that temporary COVID-19 suspensions and/or reductions have stopped, the overall cost burden of social welfare has once again become a pressing concern for SMEs. For instance, in the case of a person hired on a gross salary of CNY 15,000 per month in Beijing, the Chinese social welfare on this salary would be:

Company housing fund policy	Cost to the company in CNY	Cost to the individual in CNY	Total cost in CNY	Percentage of salary
5 per cent (minimum)	4,743	2,328	7,071	47.14 per cent
12 per cent (maximum)	5,792	3,378	9,171	61.14 per cent

By comparison, the percentage cost in Ireland is 9.25 per cent, in Portugal 34.75 per cent and in Spain 18.29 per cent). On top of this, in the EU, healthcare is free, while in China companies normally need to take out top-up health insurance (which is taxed as income) at an additional cost.

The working group also welcomed the announcement of a corporate income tax (CIT) reduction for SMEs,





from five per cent down to 2.5 per cent for profits up to CNY 1 million, and the continuation of the 10 per cent bracket from CNY 1 million to CNY 3 million. However, when profits go above CNY 3 million, the tax rate jumps to 25 per cent of total profits, instead of having a step approach (whereby only profit above CNY 3 million is subject to the 25 per cent tax rate).

Given the current challenges small companies are facing and will continue to face in the foreseeable future due to the uncertain economic situation, the working group encourages the Chinese authorities to continue developing SME-specific measures aimed at reducing their financial burden, particularly in the above-mentioned areas.

Recommendations

- 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 that have reasonable payment terms with SMEs.
- Improve legal debt collection procedures.
- Develop and implement further measures to encourage banks to provide financing solutions to SMEs based on accounts receivable.
- Continue to develop targeted measures that reduce the financial burden of SMEs, such as reducing social welfare costs and using a step approach for the allocation of CIT rates.

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.³⁵

Assessment

Despite a number of encouraging regulatory and

enforcement-related developments in recent years, challenges related to protecting IP and the generally negative international perception associated with IPR in China still deter many European SMEs from entering the Chinese market. In spite of improvements in legislation and enforcement, difficulties related to navigating the Chinese IP system still pose a challenge for European companies.³⁶ For many European SMEs, these hurdles are further exacerbated by their lack of knowledge on how China's IPR system operates and their relatively limited resources.

One of the more positive developments related to IP in recent years was the establishment and subsequent expansion of the specialised IP Courts 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), with jurisdiction over appeals involving patent infringement/invalidation and other high-technology or antitrust IP disputes.³⁷

The internet courts in Hangzhou, Beijing and Guangzhou—which are able to process cases in connection with internet copyright ownership and infringement disputes—also have the potential to facilitate some IP-related dispute processes. In June 2018, the Hangzhou Internet Court for the first time accepted blockchain as a way of fixing copyright,^{38&39} and on 6th September 2018, the SPC confirmed that blockchain can be used—along with other means like electronic signatures—to validate evidence.⁴⁰ In April 2019, the first blockchain-enabled notary opened in Beijing.⁴¹ These developments are especially significant for SMEs, as they have the potential to considerably reduce the costs associated with IP dispute processes.

36 *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, viewed 17th June 2021, <<https://www.eurochamber.com.cn/en/publications-business-confidence-survey#>>

37 Ni, Zhenhua, *China Established a Centralized IP Appellate Tribunal*, China Law Insight, 15th January 2019, viewed 26th April 2021, <<https://www.chinalawinsight.com/2019/01/articles/intellectual-property/china-established-a-centralized-ip-appellate-tribunal/>>

38 Tang, Shihua, *Hangzhou Court Uses Blockchain-based Evidence for First Time*, Yicai Global, 30th June 2018, viewed 26th April 2021, <<https://www.yicai.com/news/hangzhou-court-uses-blockchain-based-evidence-for-first-time>>

39 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.

40 *Understanding and Application of the Provisions of the SPC on Several Issues Concerning the Trial of Cases in Internet Courts*, ChinaCourt.org, 8th September 2018, viewed 22nd April 2021, <<https://www.chinacourt.org/article/detail/2018/09/id/3489797.shtml>>

41 *China's First Blockchain Notary Opens in Beijing*, China Daily, 19th April 2019, viewed 2nd May 2021, <<http://tech.chinadaily.com.cn/a/201904/19/WS5c5a56daa310e7f8b1577bf4.html>>

35 For more information on IP issues affecting European businesses, please refer to the *Intellectual Property Rights Working Group Position Paper 2021/2022*, p. 76..





On the political front, there have been a number of high-level statements regarding IP protection in China and, more concretely, the condemnation of unfair technology transfers. For instance, the Foreign Investment Law (FIL) stipulates that “no administrative agency or its employees may force the transfer of any technology by administrative means”.⁴² The *Implementing Measures for the FIL*, promulgated in December 2019, broaden the definition of an administrative body to include any “organisation empowered by any law or regulation to administer public affairs”.⁴³ In addition, the recently-concluded, albeit currently frozen and yet-to-be ratified, EU-China Comprehensive Agreement on Investment included clauses defining and prohibiting forced technology transfers.⁴⁴ The working group expects that such high-level statements will be followed by effective enforcement.

The EU-China Agreement on Geographical Indications (GIs), concluded in November 2019 and in force since March 2021, marked an important step for the protection of GIs within the Chinese market, covering 100 key EU GIs, and with 175 more to be included over the next four years. However, the consultation mechanism included within the United States (US)-China Trade Agreement signed in January 2020 gives the US scrutiny over new GIs prior to protection, which means that a number of European GIs could be affected by the US-China deal.⁴⁵ This concern is justified taking into consideration that, 10 days after the signature of the EU-China GI agreement, the China National Intellectual Property Agency issued the *Provisions on the Protection of Geographical Indications* for public consultation. These draft *Provisions* adopt the US-China Trade Agreement rule whereby no protection is granted to GIs that are or have become the “generic name of the product” (i.e., claims outside of the EU that ‘feta’ has become the generic name for a white cheese aged in brine) or “names already registered as a trademark”. These two exceptions can potentially endanger the success of future EU GIs registrations.

Therefore, strengthening the State Administration of Market Regulation’s (SAMR’s) powers to enforce the EU-China GI Agreement will be crucial to the success of the deal.

China’s E-commerce Law, which came into effect on 1st January 2019, strengthens IPR enforcement on e-commerce platforms by imposing joint liability on operators for failing to take necessary measures after they become aware (or if they should have been aware) that a seller on their platform has infringed others’ IP rights.⁴⁶ However, the role of voluntary copyright registration certificates in the notice-and-take-down procedures remains inconsistent, as some e-commerce platforms do not consider the certificate as basis to commence procedures, while in some cases bad faith copyright registration certificates in fact facilitate trademark infringements. Furthermore, the procedures allow bad faith online sellers to provide a statement of not having committed an offence. While not being problematic *per se*, such statements mandate the platforms to end the measures taken against the seller unless the claimant starts administrative or legal actions within 15 days, which imposes significant costs on rights holders. These issues have been further exacerbated by consumers’ and sellers’ increased reliance on e-commerce in the wake of COVID-19.

Trademark protection has been strengthened by the Trademark Law, which came into force on 1st November 2019 and bans bad faith applications.⁴⁷ However, as legislation evolves, infringers have become more sophisticated, highlighting the need for more effective enforcement at both national and local government level.

Copyright and patent protection are also to be strengthened with the new Copyright Law and new Patent Law,^{48&49} both of which came into force in June 2021. These significantly adjust the amount of damages infringers must pay: the maximum amount for statutory damages—that is, the damages the court can exercise its discretion in awarding—was

42 *Foreign Investment Law*, NPC, 18th March 2019, viewed 19th April 2021, <<http://www.npc.gov.cn/npc/c30834/201903/61017a8cf4d045ca9796990106b4406c.shtml>>

43 *Regulation for Implementing the Foreign Investment Law*, pkulaw.com, 31st December 2019, viewed 26th April 2020, <https://www.pkulaw.com/en_law/bb7e08ee6f9a35f4bdfb.html>

44 *EU-China Comprehensive Agreement on Investment – Section II: Liberalisation of Investment*, European Commission, 22nd January 2021, viewed 21st April 2021, <https://trade.ec.europa.eu/doclib/docs/2021/january/tradoc_159343.pdf>

45 GIs identified as potentially problematic: Perigord, Szegedi teliszalami/Szegedi szalami, Prosciutto Toscano, Fontina, Munster, Nurnberger Bratwurst, Jambon de Bayonne and Beaufort; Hu, Weinian, *Dinner for Three: EU, China and the US Around the Geographical Indications Table*, Centre for European Policy Research, April 2020, viewed 28th April 2021, <https://www.ceps.eu/wp-content/uploads/2020/04/PI2020-07_EU-China-and-the-US-around-the-geographical-indications-table.pdf>

46 *E-Commerce Law*, NPC, 31st August 2018, viewed 25th April 2021, <http://www.npc.gov.cn/zgrdw/npc/fzt/rlwy/2018-08/31/content_2060827.htm>

47 *Trademark Law*, NPC, 7th May 2019, viewed 25th April 2021, <<http://www.npc.gov.cn/npc/c30834/201905/dacf65eec798444e821a1e06a347f3ee.shtml>>

48 *Decision of the Standing Committee of the National People’s Congress on Amending the Copyright Law of the People’s Republic of China*, NPC, 11th November 2020, viewed 12th April 2021, <<http://www.npc.gov.cn/npc/c30834/202011/272b72cdb759458d94c9b875350b1ab5.shtml>>

49 *Decision of the Standing Committee of the National People’s Congress on Amending the Patent Law of the People’s Republic of China*, NPC, 18th October 2020, viewed 12th April 2021, <http://www.gov.cn/xinwen/2020-10/18/content_5552102.htm>





increased ten-fold (to CNY 5 million). Furthermore, punitive damages were incorporated in both legislative texts for the first time in order to sanction parties that commit serious and wilful copyright or patent infringements. A guilty party may face a fine one to five times higher than the damages awarded up to now.

These modifications are similar to those implemented in the Trademark Law, as well as in the new Civil Code. In March 2021, the Supreme Court settled the rules about how to implement and interpret them in future cases.⁵⁰

Recommendations

- Involve the general public and business community in awareness-raising campaigns to promote respect for IPR.
- Increase the SAMR's power to enforce the GI Agreement.
- Strengthen enforcement and consistency with regard to notice-and-take-down procedures.
- Engage local enforcement agencies, customs authorities and 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.

Abbreviations

14FYP	14 th Five-year Plan
CASME	China Association for SMEs
CIT	Corporate Income Tax
EU	European Union
EUR	Euro (currency)
FIE	Foreign-invested Enterprise
FIL	Foreign Investment Law
GI	Geographical Indication
ICT	Information and Communication Technology
IMF	International Monetary Fund
IP	Intellectual Property
IPR	Intellectual Property Rights
MIIT	Ministry of Industry and Information Technology
MOFCOM	Ministry of Commerce
NPC	National People's Congress
OECD	Organisation for Economic Co-operation and Development

SAMR	State Administration of Market Regulation
SME	Small and Medium-sized Enterprise
SMEDI	SME Development Index
SOE	State-owned Enterprise
SPC	Supreme People's Court
US	United States
VAT	Value-added Tax

⁵⁰ Interpretations on the Application of Punitive Damages in the Trial of Civil Cases of Intellectual Property Infringement, Supreme Court, 3rd March 2021, viewed 16th June 2021, <<http://www.court.gov.cn/fabu-xiangqing-288861.html>>





Investment Working Group

Key Recommendations

1. Deliver Consistent and Proper Implementation of the New Foreign Investment Regime and Adhere to the Principle of National Treatment Across Government Levels 🌐 2

- Continue to reduce the number of industry sectors on the negative list in which foreign investment is either restricted or prohibited.
- Implement and adhere to the principle of national treatment across government levels and nationwide (in particular in the area of government procurement).
- Ensure a workable and efficient complaint and remedy system for foreign investors in cases of investment discrimination.
- Abolish specific laws and regulations imposing investment restrictions only on foreign investors.
- Abolish laws and regulations restricting the financing capacities of foreign-invested enterprises (FIEs).
- Define a clear scope for the National Security Review (NSR) to prevent it from becoming a market access barrier at the discretion of government authorities, and increase the transparency of the NSR process by creating a public record of NSR cases being undertaken.

2. Enhance Market Competitiveness and Further a Level Playing Field with State-owned Enterprises (SOEs) 🌐 5

- Afford national treatment to all enterprises established in China, regardless of ownership and company type.
- Reduce complexities around business licenses and permits, and improve transparency in the application of risk/return guidelines for SOE financing.

3. Streamline the Mergers and Acquisitions (M&A) Process 🌐 2

- Formulate national-level guidance aimed at providing automatic, fast-track licensing for asset deals that adequately reflect business transfers.
- Allow FIEs access to China's capital market on an equal basis with local players.
- Adhere to a strict application of bankruptcy laws and eliminate arbitrary considerations in decisions involving informal reorganisation arrangements.
- Continue to harmonise the treatment of FIEs and domestic companies as per the new Foreign Investment Law (FIL) and eliminate remaining barriers to foreign investment by creating a level playing field.

4. Further Open China's Capital Market to Foreign-invested Enterprises 🌐 8

- Expand FIEs access to China's capital market.
- Improve market regulation by the China Securities Regulatory Commission 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' on the Shanghai Stock Exchange to allow international enterprises to achieve a secondary listing of their equity securities in China's A-share market.
- Simplify the rules for foreign investors selling shares of listed joint ventures as per the principle of national treatment highlighted by the FIL and its abolition of the former foreign investment regime.
- Remove the additional disclosure requirements on investments by foreign investors in listed companies so as to correspond to the principle of national treatment.

Introduction to the Working Group

The Investment Working Group advocates for improvements in China's investment environment in terms of market access and regulatory environment. The working group's membership is comprised of service providers, including investment consultants, law firms, private equity and venture capital firms, and banks, as well as a range of large European manufacturers. The working group seeks to achieve a level playing field for foreign investors through the notion of reciprocity. It further provides a platform for knowledge exchange and expertise sharing among professional investment advisors in China.

Recent Developments

In the wake of the outbreak of coronavirus disease 2019 (COVID-19), global foreign direct investment (FDI) fell 42 per cent in 2020 to an estimated United States dollars (USD) 859 billion, down from USD 1.5 trillion in 2019, a drop exceeding that experienced during the 2008 global financial crisis.¹

In the first half of 2020, China's total deal value saw a record dip of almost 70 per cent.² Yet while outbound Chinese investment plunged to a ten-year low, domestic merger and acquisition (M&A) transactions, fueled by strong state support, gathered momentum in the second half of 2020, reaching USD 478.5 billion.³ The volume of Chinese company acquisitions by foreign firms also saw a year-on-year increase of 4.3 per cent, the highest

level of Chinese inbound M&A activities since 2018.⁴ China's economic restart accelerated into 2021, thanks to government relief measures and capital injections. As China's recovery from the COVID-19 pandemic continues, foreign investment will play a critical role in advancing both cutting-edge innovation and the transition towards a consumption-driven economy.

14th Five-year Plan (14FYP)

Approved in early March 2021 by the National People's Congress (NPC), the 14FYP sets out China's key development goals for 2021–2025.

The 14FYP does not have a specific growth target, focussing instead on high-quality development and sustainability.⁵ Under the plan's 'dual circulation' framework guiding core national priorities, the Chinese Government aims to boost domestic demand, and to increase economic self-sufficiency amid a tougher external environment. The 14FYP further seeks to accelerate indigenous innovation through increased investment in core technologies and new infrastructure.⁶ To meet these goals, state leaders committed to offering greater market access to foreign companies by further cutting the *Negative List for Foreign Investment*,⁷ and highlighted the importance of foreign investment in

1 *Investment Trends Monitor*, UNCTAD, January 2021, viewed 7th March 2021, <https://unctad.org/system/files/official-document/diaeiainf2021d1_en.pdf>

2 *Coronavirus Epidemic Hits China Dealmaking and IPOs*, Financial Times, 11th February 2020, viewed 7th March 2021, <<https://www.ft.com/content/bbcec94e-4c98-11ea-95a0-43d18ec715f5>>

3 *China M&A Surges on Covid Recovery as Focus Shifts Inwards*, Financial Times, 9th March 2021, viewed 7th March 2021, <<https://www.ft.com/content/e4d0516e-cddc-44e7-8ea6-ea66c7e78b15>>

4 *Wisdom to Nurture Ambition, Data to Enable the Future – 2021 China Financial Market Forecast*, Refinitiv, 10th February 2021, viewed 7th March 2021, <<https://www.refinitiv.com/perspectives/future-of-investing-trading/wisdom-to-nurture-ambition-data-to-enable-the-future-2021-china-financial-market-forecast/>>

5 *Li Keqiang Discusses Expected Economic Growth Target of Above 6 Per Cent*, China News Service, 11th March 2021, viewed 7th April 2021, <<https://www.chinanews.com/gn/2021/03-11/9430103.shtml>>

6 *The 2021 Two Sessions: A New Pattern for China's Development*, APCO Worldwide, March 2021, viewed 7th April 2021, <<https://apcoworldwide.com/statistics/6433ac37c2cfaab82afc930fae43a68b/APCO-Worldwide-2021-Two-Sessions-Report.pdf>>

7 *Negative List for Market Access (2020 Version)*, National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM), viewed 25th June 2021, <https://www.ndrc.gov.cn/xxgk/zcfb/gxwj/202012/t20201216_1252897_ext.html>





promoting technological advancement.⁸

The working group welcomes the 14FYP commitments aimed at opening more sectors of the domestic economy to foreign investment (particularly in the manufacturing and service sectors), yet also sees them as only a small step forward in China's reform and opening up agenda. For any opening to be meaningful, other deeper, systemic reforms are needed that can bring new opportunities for European companies to enter the Chinese market and expand local operations.

Comprehensive Agreement on Investment (CAI)

On 30th December 2020, EU-China leaders agreed in principle to the conclusion of negotiations on the CAI.⁹ Covering market access, level playing field and sustainable development issues, the agreement is intended to improve market access for EU investors in China and guarantee transparency regarding the governance of state-owned enterprises.¹⁰

On 20th May 2021, the European Parliament voted to freeze any considerations on the ratification of the CAI while sanctions imposed by Chinese authorities on European individuals and entities are in place.¹¹ The working group hopes to see decision-makers return to the same spirit of engagement in the near future and that any final agreement constitutes a healthy step closer to achieving reciprocity.

Regional Comprehensive Economic Partnership (RCEP)

On 15th November 2020, China, the ten members of the Association of Southeast Asian Nations (ASEAN), Japan, South Korea, New Zealand and Australia signed the RCEP agreement. The agreement covers a market of 2.2 billion people (approximately 30 per cent of the world's population) and constitutes the world's largest free trade agreement in terms of gross domestic

product (GDP).¹²

The RCEP aims to establish a modern, comprehensive, high-quality, and mutually beneficial economic partnership that facilitates the expansion of trade and investment in the Asia-Pacific region while contributing to global economic growth and development.¹³

Although approval of RCEP's reduced tariffs and standardised regulations is widespread among the economies involved, some investors have questioned whether the deal is ambitious enough to generate a demand boost for trade, given that most reductions in tariffs on goods have already been provided for under existing trade agreements, and that the planned liberalisation of services trade is limited.

Key Recommendations

1. Deliver Consistent and Proper Implementation of the New Foreign Investment Regime and Adhere to the Principle of National Treatment Across Government Levels

Concern

Enforcement of the new Foreign Investment Law falls short of expectations, and restrictions imposed on foreign-invested enterprises (FIEs) under special laws remain in place, leading to continued unequal treatment.

Assessment

China's Foreign Investment Law went into effect on 1st January 2020, superseding a foreign investment regime in place for nearly 40 years and establishing a regulatory framework conceived to usher in a new era of foreign investment in China.

Despite this encouraging development, China continues to differentiate between foreign and Chinese companies in the field of investment. The new legal regime does not fundamentally abolish the distinction between foreign and domestic investment, casting doubt on whether genuine national treatment and a level playing field for European business can be guaranteed in the

⁸ *The 2021 Two Sessions: A New Pattern for China's Development*, APCO Worldwide, March 2021, viewed 7th April 2021, <<https://apcoworldwide.com/statistics/6433ac37c2cfaab82afc930fae43a68b/APCO-Worldwide-2021-Two-Sessions-Report.pdf>>.

⁹ *EU-China Comprehensive Agreement on Investment - The Agreement in Principle*, European Commission, 30th December 2020, viewed 30th April 2021, <https://trade.ec.europa.eu/doclib/docs/2020/december/tradoc_159242.pdf>

¹⁰ *EU and China Reach Agreement in Principle on Investment*, European Commission, 30th December 2020, viewed 7th April 2021, <https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2541>

¹¹ *MEPs Refuse Any Agreement with China Whilst Sanctions are in Place*, European Parliament, 20th May 2021, viewed 21st May 2021, <<https://www.europarl.europa.eu/news/en/press-room/20210517IPR04123/meps-refuse-any-agreement-with-china-while-sanctions-are-in-place>>

¹² *ASEAN Hits Historic Milestone with Signing of RCEP*, RCEP, 15th November 2020, viewed 7th April 2021, <<https://rcepsec.org/2020/11/26/asean-hits-historic-milestone-with-signing-of-rcep/>>

¹³ *Summary of the Regional Comprehensive Economic Partnership Agreement*, RCEP, 15th November 2020, viewed 7th April 2021, <<https://rcepsec.org/wp-content/uploads/2020/11/Summary-of-the-RCEP-Agreement.pdf>>





country. The Investment Working Group maintains that no compelling reasons exist to regulate companies differently based on ownership structure or investor nationality, and notes that EU market economies do not have any special laws treating foreign capital differently.

Furthermore, China continues to adopt a negative list system, which either prohibits or restricts foreign investment in certain sectors. Although the Chinese Government has once again demonstrated its resolve to ease market access by shortening the negative list as recently as March 2021, investors are concerned about how these changes will indirectly affect existing investments.¹⁴ The Investment Working Group would therefore welcome more clarity regarding the interpretation and implementation of such administration systems by individual ministries, and on avenues of recourse for foreign companies if subjected to unfair treatment.

It is encouraging that the Foreign Investment Law and its *Implementing Regulations* adopt the principle of granting national treatment in all major investment areas. In practice, however, FIEs still encounter unequal treatment compared to their domestic competitors, particularly in government funding, land supply and public procurement areas. The working group considers it necessary to reinforce the principle of national treatment across all investment areas, and to open a functioning remedy and appeal system to foreign investors in case of discrimination.

In addition, while the Investment Working Group acknowledges that the *Implementing Regulations* have clarified some of the questions raised by the working group during public consultation on the Foreign Investment Law, several uncertainties remain. For example, certain laws under the old foreign investment regime have yet to be repealed or amended, such as: (i) the *Regulation on Foreign Investment in Holding Companies*; (ii) the *Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors*, which govern foreign acquisition of Chinese companies; (iii) the *Administrative Measure on Strategic Investment by Foreign Investors in Listed Companies*, and (iv) various other regulations administering the foreign exchange handling, financing, total investment

and registered capital of FIEs.

It is also unclear whether current rules imposing a debt-to-equity ratio still apply when FIEs procure debt financing from overseas. Likewise, the working group recommends that the authorities clarify whether foreign investors are allowed to use or increase the registered capital in their existing FIEs in order for those enterprises to invest in domestic companies.

Most importantly, the Investment Working Group remains concerned over the ways in which the restrictions to foreign investment discussed herein are to be interpreted *vis-à-vis* the new foreign investment regime, which leads to a state of uncertainty that risks eroding confidence in China as an attractive investment destination.

National Security Review (NSR)

Since the State Council introduced a national security review (NSR) regime in 2011, only a few cases have been publicly reported and no official information has been published as of mid-2021 on projects pending review.¹⁵

On 19th December 2020, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) issued the *Measures for Security Review of Foreign Investment (Measures)*, stepping up efforts to provide a clearer framework for NSR. The *Measures* took effect on 18th January 2021, and introduced significant developments; most notably, the *Measures* apply to both direct and indirect foreign investment in Mainland China, including the pilot free trade zones.¹⁶ The *Measures* also establish a joint working mechanism led by the NDRC and MOFCOM to process security review filings submitted by investors.¹⁷

As a result of these developments, the number of potential FDI transactions that could become subject to NSR looks likely to increase in the future. This has European investors concerned that China may

¹⁴ Premier Li Keqiang Meets the Press: Full Transcript of Questions and Answers, Ministry of Foreign Affairs, 12th March 2021, viewed 7th April 2021, <https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1860396.shtml>

¹⁵ Simple Guide to Deal with the National Security Review Procedure in China, Dentons, 14th February 2020, viewed 13th April 2021, <<https://www.dentons.com/en/insights/articles/2020/february/14/simple-guide-to-deal-with-the-national-security-review-procedure-in-china>>

¹⁶ Measures for Security Review of Foreign Investment, NDRC, 19th December 2020, viewed 7th April 2021, <<https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202012/P020201219582032130362.pdf>>

¹⁷ China's New Measures on Security Review of Foreign Investment, Norton Rose Fulbright, 19th December 2020, viewed 7th April 2021, <<https://www.nortonrosefulbright.com/en/knowledge/publications/7a5d9cc7/chinas-new-measures-on-security-review-of-foreign-investment>>





reintroduce new market entry restrictions through the back door.

The working group also notes that the scope of the NSR is currently very broad and provides no clear guidance on what elements the regulators will consider to ascertain whether a given transaction constitutes national security risk and is subject to review. Furthermore, the authorities are under no obligation to disclose what specific security concerns they might have about foreign transactions; unlike merger filings, the NSR process is not transparent due to its sensitive nature and no public record of NSRs that were undertaken in the past exists. This leaves great discretion to the NDRC and creates considerable uncertainty for foreign investors facing self-assessment and self-reporting obligations under the NSR regime.

Recommendations

- Continue to reduce the number of industry sectors on the negative list in which foreign investment is either restricted or prohibited.
- Implement and adhere to the principle of national treatment across government levels and nationwide (in particular in the area of government procurement).
- Ensure a workable and efficient complaint and remedy system for foreign investors in cases of investment discrimination.
- Abolish specific laws and regulations imposing investment restrictions only on foreign investors.
- Abolish laws and regulations restricting the financing capacities of FIEs.
- Define a clear scope for the NSR to prevent it from becoming a market access barrier at the discretion of government authorities, and increase the transparency of the NSR process by creating a public record of cases being undertaken.

2. Enhance Market Competitiveness and Further a Level Playing Field with State-owned Enterprises (SOEs)

Concern

China's SOEs continue to enjoy preferential treatment, to the detriment of privately-owned competitors and Chinese consumers.

Assessment

Although SOEs constitute one strategic pillar of the Chinese economy, achieving long-term, sustainable

development entails the creation of an efficient domestic market in which participation by all players is enabled and fair competition for the benefit of consumers ensured. Findings from the *European Business in China Business Confidence Survey 2021* reveal that unequal treatment persists for 47 per cent of respondents, highlighting once again the need for SOE reform.¹⁸

New Industries

The 14FYP sets environmental protection and technological advancement as top national priorities for the next five years. European companies are eager to support China in this pursuit, yet face barriers that risk impairing their ability to contribute to the investment goals in new industries. In the absence of fair competition, access to markets like green energy generation is limited for foreign companies, if not outright restricted in areas such as carbon capture and storage (CCS), and power generation and distribution.

This situation is worsened by restrictive regulations that widen the gap between FIEs and local players. For example, data localisation requirements, although applicable to both local and foreign companies alike, affect foreign players the most and result in a duplication of data storage and management assets and processes.

A similar situation affects data-driven technology industries, including cloud computing and information and communications technology (ICT).¹⁹ Here, the impact of a regulatory-induced market segmentation for foreign players is even more concerning, given that project success is closely tied to the ability to offer service bundling and data monetisation across service lines. Current limitations in digital industries not only add complexity to any M&A investment but also prevent FIEs from deploying synergetic strategies that generate wealth and growth for domestic subsidiaries.

SOE Reform

Central SOEs have grown to become heavyweights in strategic industries, making government-led attempts to reform their structure especially challenging. Over the past few decades, most efforts have been directed toward reforming these SOEs. As a result, explicit

¹⁸ *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, <<https://european-chamber.com.cn/documents/signup/en/pdf/917>>

¹⁹ See the *Information and Communications Technology Working Group Position Paper 2021/2022*, p. 327, for more information.





and implicit barriers to competition remain pervasive at the local level, where SOEs are less spread out geographically than their central counterparts. The working group expects more focus on continuing SOE reform in a deeper, systematic fashion that could lead to tangible improvements in the local business environment.

Recommendations

- Afford national treatment to all enterprises established in China, regardless of ownership and company type.
- Reduce complexities around business licenses and permits, and improve transparency in the application of risk/return guidelines for SOE financing.

3. Streamline the M&A Process

Concern

M&A activity in China continues to be hindered by regulatory and bureaucratic requirements that make investment into China comparatively more expensive than in competing geographies.

Assessment

Regulatory Burdens Affecting Inbound Investment

The legal regime governing acquisitions in China remains complicated and restrictive, and its application mostly unpredictable. Foreign investors have to overcome a number of restrictions under the *Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors (M&A Rules)* along with additional challenges, such as merger control filing and NSR. A typical inbound M&A investment, for example, can take anything between ten weeks, in the absence of special approvals, and several years for transactions that require reapplication for certain permits.

Moreover, foreign M&As are regulated by a dedicated set of rules issued by the MOFCOM as well as regulations applicable to general FDI in China, such as the negative lists and the Foreign Investment Law. The working group believes that foreign investors already established in China should not be subject to such dedicated rules, and that foreign entrants as well as domestic companies should be able to compete on a level playing field.

With regard to the regulatory burden for foreign investment into China, structural elements exist that make inbound M&As more resource-intensive and

uncertain than in other legal systems. Among the structural elements most cited by European investors are unclear guidelines and uncertainty surrounding the implementation of regulations on bankruptcy, court disputes, and permit granting and renewal, which often vary from region to region and city to city. In consequence, many European companies estimate a higher risk premium for investments into China.

European investors also worry this comparative disadvantage will intensify in the near future, as investment progressively shifts towards a greater focus on technology-intensive assets, in particular those related to decarbonisation and overall environmental sustainability. In the green economy, an area where European companies have much to offer to China, complexities in the context of permit granting, coupled with uncertainties surrounding standard setting, remain significant and risk hampering inbound investment - battery manufacturing is one compelling example of how standards keep changing almost on an annual basis, adding layers of difficulty for foreign investors.²⁰

Access to Capital Markets and Financing

Foreign entities in China often complain of a less-than-level playing field when it comes to access to capital markets and financing of M&A transactions. For example, current rules prevent the controlling shareholder of a listed company from owning 'competing' business outside of China, effectively requiring that entire global operations be listed in the country, not just the Chinese subsidiaries. The unclear legal status of board members and top management in listed companies is also a concern for multinationals that would otherwise list domestic operations in Chinese stock markets. Further, capital endowment requirements and exchange controls place limitations on the ability of European companies investing into China to fund operations and capital investments through debt.

Foreign inbound M&A are still unlikely to obtain funding domestically in China. Most MNCs use off-shore funds in their acquisitions; risk management by domestic Chinese banks generally hinges on the value of hard assets in the balance sheet, such as land and machinery. In fact, M&A funding by Chinese financial institutions is subject to hard assets pledge. This practice inevitably penalises MNCs that are looking

²⁰ See the *Automotive Working Group Position Paper 2021/2022* on page 184 for more information.





to enter China with less tangible assets onshore than their domestic counterparts. And in the rare instances where leveraged buy-out funding is provided in China, it is extended on the basis of parent companies' guarantees. This constraint has become ever more critical with the emergence of new drivers of growth and further rebalancing of the Chinese economy: contrary to a decade ago, inbound European investment is now mostly aimed at China's value chains; new investment opportunities are also opening up in capital intensive growth areas, including decarbonisation and the green economy. Such new areas of investment are expected, to a large extent, to compete with SOEs, which already have advantages in the capital allocation of domestic funds. *Vis-à-vis* these developments, the working group urges regulators to expand foreign investors' access to financing on market-consistent terms.

Recommendations

- Formulate national-level guidance aimed at providing automatic, fast-track licensing for asset deals that adequately reflect business transfers.
- Allow FIEs access to China's capital market on an equal basis with local players.
- Adhere to a strict application of bankruptcy laws and eliminate arbitrary considerations in decisions involving informal reorganisation arrangements.
- Continue to harmonise the treatment of FIEs and domestic companies as per the new Foreign Investment Law and eliminate remaining barriers to foreign investment by creating a level playing field.

4. Further Open China's Capital Market to FIEs

Concern

There are still many restrictions hampering FIEs' access to China's capital markets in their entirety, including equity, debt and structured products, which is detrimental to the Chinese 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, for it contributes to the continued underdevelopment of the domestic capital market.

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 that FICLS and their investors must satisfy are more stringent than those that apply to domestic companies. Some examples, according to China's Company Law, include requiring at least half of the promoters to be domiciled in China 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.²¹

Even if it were possible to list WFOEs, regulations by the China Securities Regulatory Commission (CSRC) would require the listed entity to own its own intellectual property rights (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 as well as control and operate a locally-listed company without its global business being required to become a domestic public entity. In the reform of China's capital markets, the working group recommends that access be made available to all economic actors, including foreign investors operating successful local subsidiaries in Mainland China.

The working group suggests that any additional requirements which apply to FICLS and their investors 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 and international entities, and the removal of many filing requirements in the field of FDI. It would also encourage foreign private equity investment in domestic companies, by facilitating foreign investors' 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

²¹ Emilia Shi, *Establishing a Business in China: Overview*, Thomson Reuters, 1st July 2019, viewed 14th April 2021, <[https://uk.practicallaw.thomsonreuters.com/1-623-4945?transitionType=Default&contextData=\(sc.Default\)](https://uk.practicallaw.thomsonreuters.com/1-623-4945?transitionType=Default&contextData=(sc.Default))>





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.

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 (MOF) jointly published new interim administrative rules for bond issuance by foreign entities,²² which clarify and simplify a number of issues and delegate registration for nonfinancial enterprises to the National Association of Financial Markets Institutional Investors (NAFMII). According to these administrative rules, panda bonds should be filed with the NAFMII, 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',²³ allowing enterprises reporting under non-Chinese 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.

In 2019, the PBOC took additional steps to open China's financial sector and improve the rating quality of the bond industry by allowing foreign rating companies to conduct bond rating in the interbank bond market, which is hoped will boost industry credibility as well as strengthen compliance awareness by domestic rating companies.^{24&25}

At present, the relevant rules do not list specific requirements on the use of proceeds from a panda bond issuance, instead referring to relevant regulations by the PBOC and the State Administration of Foreign

Exchange (SAFE) as far as account openings and foreign remittances are concerned.²⁶ That said, while the remittance of panda bond proceeds is in principle allowed, there still appears to be a strong preference for the onshore use of said funds (e.g., for funding shareholder loans to domestic subsidiaries). Although existing PBOC guidelines indicate that issuers can transfer the proceeds overseas using non-resident accounts, additional implementation guidelines shall bring greater clarity and transparency to the process.

Inclusion into Global Bond Indices

Important steps have been taken to internationalise China's debt capital markets through the inclusion of Chinese bonds into global indices.²⁷ The working group approves of this inclusion as it will bring more overseas inflows into China, pushing the country's markets further into the mainstream for foreign investors.

Recommendations

- Expand FIEs access to China's capital market.
- 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.
- Establish an 'international board' on the Shanghai Stock Exchange to allow international enterprises to achieve a secondary listing of their equity securities in China's A-share market.
- Simplify the rules for foreign investors selling shares of listed joint ventures as per the principle of national treatment highlighted by the Foreign Investment Law.
- Remove the additional disclosure requirements on investments by foreign investors in listed companies so as to correspond to the principle of national treatment.

22 *Announcement [2018] No.16 of the PBOC and the MOF on Interim Administrative Measures for Bond Issuance by Overseas Institutions in the China Interbank Bond Market*, PBOC, 8th September 2018, viewed 15th April 2021, <<http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3634126/index.html>>

23 *Ibid.*

24 *NAFMII Issues Guidelines on Debt Financing Instruments of Overseas Non-Financial Enterprises (for Trial Implementation)*, NAFMII, 17th January 2019, viewed 15th April 2021, <http://www.nafmii.org.cn/english/lawsandregulations/selfregulatory_e/201902/t20190201_75773.html>

25 *China Opens to Foreign Credit Raters to Boost Bond Credibility*, Bloomberg, 27th February 2019, viewed 15th April 2021, <<https://www.bloomberg.com/news/articles/2019-02-27/china-opens-to-foreign-credit-raters-to-boost-bond-credibility>>

26 *Announcement [2018] No.16 of the PBOC and the MOF on Interim Administrative Measures for Bond Issuance by Overseas Institutions in the China Interbank Bond Market*, PBOC, 8th September 2018, viewed 7th April 2021, <<http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3634126/index.html>>

27 *Index Inclusion May Boost China Bonds Flows to USD140bln in 2021 - Goldman Sachs*, Nasdaq, 15th January 2021, viewed 7th April 2021, <<https://www.nasdaq.com/articles/index-inclusion-may-boost-china-bonds-flows-to-%24140bln-in-2021-goldman-sachs-2021-01-15>>





Abbreviations

14FYP	14 th Five-year Plan
ASEAN	Association of Southeast Asian Nations
CAI	Comprehensive Agreement on Investment
CCS	Carbon Capture and Storage
COVID-19	Coronavirus Disease
CPPCC	Chinese People's Political Consultative Conference
CSRC	China Securities Regulatory Commission
EU	European Union
FDI	Foreign Direct Investment
FICLS	Foreign-invested Company Limited by Shares
FIE	Foreign-invested Enterprises
FIL	Foreign Investment Law
ICT	Information and Communications Technology
IFRS	International Financial Reporting Standards
IPR	Intellectual Property Rights
M&A	Mergers and Acquisitions
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
NPC	National People's Congress
NSR	National Security Review
PBOC	People's Bank of China
RCEP	Regional Comprehensive Economic Partnership
RMB	<i>Renminbi</i>
SAFE	State Administration of Foreign Exchange
SOE	State-owned Enterprise
UNCTAD	United Nations Conference on Trade and Development
USD	United States Dollars
WFOE	Wholly Foreign-owned Enterprise



Legal and Competition Working Group

Key Recommendations

1. Continue to Strengthen the Rule of Law 9

- Continue to focus on advancing the rule of law and implement a fair competition review system to create and maintain a market-based business environment.
- Continue to standardise the judicial decision-making process to eradicate the application of discretion and ensure equitable, transparent, predictable and impartial implementation and enforcement of laws and regulations nationwide.
- Ensure the full and sufficient implementation of the Civil Code, especially in contract and property areas, to improve business conduct.
- Continue to provide clarifications and standards to enable companies to comply with national security-related laws and regulations.
- Enhance the protection of trade secrets and continue lowering the prerequisite with regard to loss estimation when initiating legal proceedings for infringements.
- Ensure prompt, comprehensive and correct enforcement of judicial decisions and arbitral awards by providing enforcers and right owners with relevant information.
- Enhance compliance with terms and deadlines in court and administrative procedures.
- Standardise the public consultation process.
- Permit foreign nationals to attend civil and commercial hearings in the People's Courts.
- Support and promote the role of domestic and foreign lawyers in China's legal system.

2. Ensure Smooth Implementation of the Foreign Investment Law (FIL) and Its Implementing Regulations, and Minimise Potential Negative Impacts on Foreign Business 3

- Formulate in a timely manner necessary implementation rules to clarify the uncertainties and ambiguities caused by the launch of the FIL, particularly the gaps created by abolishing old laws.
- Clarify national security-related concerns at the working level.
- Adjust and consolidate all other pertinent laws and regulations to maintain alignment of the whole legal framework in the field of foreign investment, including greenfield investment and mergers and acquisitions activities.
- Ensure transparency in the process by presenting to the public a clear enactment and public consultation 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 regime so that there is no longer differentiation between Chinese and foreign investment, so as to ensure a level playing field and non-discriminatory market access.



3. Develop an Export Control Regulatory Framework that is Clear, Proportionate and Aligned with Global Practices

- Exempt commercial mass market products from export controls, focussing the export control system instead on items that have a direct and strategic bearing on China's national security.
- Define the terms 'end-use' and 'end-user' in such a way that they are clear and consistent with international standards.
- Adopt a flexible regulatory approach by requiring the proof of end-user and end-use statement/certificate from exporters where applicable and available.
- Establish a clear and fair enforcement process, as well as necessary safeguards, for exporters under investigation.
- Ensure a practical and user-friendly licensing system featuring bulk and general licensing and licensing exceptions for intra-company transfers.
- Consider updating the current dual-use control list with designations based on the nature of controlled items.
- Narrowly define the scope of 'deemed exports' subject to licensing, and introduce reasonable export thresholds and exemption arrangements.
- Encourage voluntary disclosure by non-compliant exporters.

4. Eliminate Restrictions on the Legal Services that Foreign Law Firms can Provide 🗳️ 10

- Allow foreign law firms to fully practise People's Republic of China (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 firms to practice 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.

5. Adopt Regulations that Encourage Fair Enforcement of the Anti-monopoly Law (AML) 🗳️ 14

- Ensure that the AML is implemented and enforced equally among all companies, domestic or foreign, including in the area of merger control enforcement and conduct issues.
- Ensure that all notified transactions are reviewed on a timely basis, particularly high-profile transactions notified under the standard case procedure.
- Ensure that the application and enforcement of the AML is consistent with the policy objectives of the fair competition review mechanism.
- Adopt centralised publication channels, such as websites, for all information relevant to AML enforcement, including new measures and decisions both from the State Administration for Market Regulation and local Administrations for Market Regulation.
- Clarify further and refine the conditions of AML enforcement and judicial practice.



Introduction to the Working Group

A sound, business-friendly legal environment is of interest to all businesses operating in China. 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 businesses' better access to the Chinese market, including the legal services market. It is now comprised of approximately 480 individuals that represent over 270 member companies.

Recent Developments

There were a number of welcome developments carried out by the legislative, regulatory and judicial bodies in China in 2020. The working group noted positive updates to legislation and regulations for foreign investments in specific areas of China, such as the Hainan Free Trade Port, and in several intellectual property rights (IPR) laws and judicial practices.

Civil Code

The working group welcomes the enactment—after several years of work and drafting—of the People's Republic of China (PRC) Civil Code, which came into effect on 1st January 2021.¹ The groundwork for the Civil Code comes from the General Principles of Civil Law, dated 1986.² The Civil Code solves several overlapping and/or contradictory provisions of existing laws by amalgamating them in one code, and expands also to the protection of privacy and personal information, the use of artificial Intelligence (AI), e-commerce and environmental protection. It has also incorporated past judicial interpretations from the Supreme People's Court (SPC) to allow for more uniform judgements. Changes to the previous system are to be noted in, for example, mortgage, and contract termination provisions.

Foreign Investment Security Review Measures

On 20th December 2020, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) jointly issued the *Foreign Investment Security Review Measures*.³ Both foreign

and Chinese investors expect the regulations in the review and approval process for cross-border investments to be clearly expressed and transparently applied, so that the politicisation of business can be avoided and a predictable environment for global investors ensured.

Export Control Law

On 17th October 2020, the Standing Committee of National People's Congress (NPCSC) passed the Export Control Law, which took effect on 1st December 2020.⁴ The Export Control Law establishes China's first comprehensive framework for restricting exports of military and dual-use products and technology due to national security and public policy reasons. There are numerous unknowns the upcoming implementation regulations need to address, as the Export Control Law provides a regulatory framework substantially different from the current regime. More detailed requirements are needed in future implementation rules and regulations to better guide companies' compliance efforts.

Key Recommendations

1. Continue to Strengthen the Rule of Law



Concern

Despite China's efforts to improve the statutory system and law enforcement, European companies operating in China still struggle to understand and comply with relevant laws and regulations due to inconsistencies within the legal framework, an absence of implementation procedures/standards, and discretionary and non-transparent law enforcement, all of which hinder the implementation of a fair and non-discriminatory market environment.

Assessment

Since becoming a member of the World Trade Organization (WTO), China has improved its implementation of the rule of law and convergence with international standards, thus contributing to a legal system that supports a fair and just market environment. At the same time, a lack of transparency and impartiality in law enforcement remains in certain areas of trade and investment. The Legal and Competition Working Group expects further improvements in the following areas:

¹ Civil Code, NPCSC, 2nd June 2020, viewed 28th June 2021, <<http://www.npc.gov.cn/npc/c30834/202006/75ba6483b8344591abd07917e1d25cc8.shtml>>

² *General Principles of Civil Law*, NPCSC, 2nd April 1986, viewed 28th June 2021, <http://www.npc.gov.cn/zgrdw/huiyi/lftz/swmsgxflsyf/2010-08/18/content_1588304.htm>

³ *Foreign Investment Security Review Measures*, NDRC & MOFCOM, 19th December 2020, viewed 28th June 2021, <https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202012/t20201219_1255025.html>

⁴ Export Control Law, NPCSC, 17th October 2020, viewed 6th May 2021, <<http://www.mofcom.gov.cn/article/zwgk/zcfb/202010/20201003008925.shtml>>





1) Strengthening fair competition reviews to improve the overall market mechanism

Regulations, procedures and enforcement play critical roles in realising the kind of market that state laws and policies are aimed at building. The working group acknowledges the reforms of China's legal environment that have taken place since the printing of *Opinions of the State Council on Establishing a Fair Competition Review System in the Development of the Market System* in 2016.⁵ However, discrimination towards different types of companies is still not uncommon, which can prevent full participation of foreign-invested enterprises (FIEs) in China's economic activities, such as government procurement, and erodes overall business confidence. The working group therefore calls for full and systematic implementation of a level playing field in regulatory and administrative actions to enhance fair competition overall.

2) Full and consistent implementation of the Civil Code

The working group welcomes the promulgation of the Civil Code. As an amalgamation of existing laws and relevant judicial interpretation, the Civil Code provides a comprehensive and consistent legal basis for business and civil operations of European companies in China. Hence, the working group hopes that the SPC will publish judicial and regulatory documents to facilitate implementation of the Civil Code, and that clarity and precision will be built into the whole statutory system to enable the courts to make consistent and predictable verdicts.⁶

3) Enhancing trade secret protection

The working group saw significant developments in laws addressing trade secrets in 2020,⁷ in particular, the punitive damages rules, the shifting of the burden of proof of non-violation onto the infringer, and a more precise scope of what constitutes as 'trade secrets'. The working group expects the continuous improvement of trade secrets protection by allowing right holders to use

remedial costs instead of established actual losses to initiate criminal proceedings for an infringement, as well as permitting an individual to be held liable for trade secrets misappropriation. Once fully implemented, the improved intellectual property (IP) protection regime with respect to trade secrets is expected to increase the safety and sustainability of foreign investment, especially for those devoted to generating innovative products. For more information on trade secrets, please refer to the *Intellectual Property Rights Working Group Position Paper 2021/2022* on page 76.

4) Compliance with terms and deadlines in court and administrative procedures

Stipulated terms and deadlines in court and administrative procedures are crucial for companies to know when they can seek legal recourse and damages during complex disputes. The current uncertainty of judicial and administrative proceedings may cause companies to doubt their ability to obtain procedural justice, while seeing their costs increase. Thus, the working group hopes that necessary measures will be taken by the relevant authorities to strengthen the adherence to terms and deadlines, and make available a recourse/appeals mechanism to resolve non-compliance issues.

5) Enforcement of judgments and awards

Problems related to the enforcement of judgments and arbitral awards in China are still quite common, as 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.

6) Access to judicial judgments and participation in court hearings

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,^{8,9} through which a growing selection of court judgments has now been made available, pursuant to Article 156 of the Civil Procedure Law. This is a positive development to the extent that it expressly guarantees the public the right to check and review effective civil

5 *Opinions of the State Council on Establishing a Fair Competition Review System in the Development of the Market System*, State Council, 1st June 2016, viewed 12th April 2021, <http://www.gov.cn/zhengce/content/2016-06/14/content_5082066.htm>

6 The SPC has issued sequential judicial interpretations regarding the validity of time, property rights, marriage and guarantees, and the working group expects a continuation of these efforts to amend any inconsistencies.

7 For instance, the SPC has issued the *Provisions of the Supreme People's Court on Several Issues Concerning the Application of Law in the Trial of Civil Cases Involving Infringements upon Trade Secrets*, SPC, 11th September 2020, viewed 8th May 2021, <<http://www.court.gov.cn/zixun-xiangqing-254751.html>>

8 For example, the website of the SPC has special sections for publishing court decisions and judicial enforcement, See: SPC website, viewed 8th May 2021, <<http://www.court.gov.cn/>>

9 For example, Beijing local court's website, viewed 21st May 2020, <<http://bjgy.chinacourt.org/>>



judgments and rulings.¹⁰ The publication of guiding cases by the SPC was also a welcome step towards developing a comprehensive approach to jurisprudence and should contribute to more consistent interpretation and implementation of laws and regulations throughout the country's courts.¹¹ In addition to this, European business would expect that—as is common practice in European jurisdictions—foreign nationals could also have full public access to commercial and civil hearings in the People's Courts without the need to pre-register or be specially authorised.

7) Standardise the enforcement of laws and regulations

Despite the significant improvements already achieved by China, European companies still encounter inconsistencies in the application and enforcement of laws and regulations. This is often due to discretionary implementation, which can vary depending on the parties involved, the location or the sector. The working group expects the government to continue standardising all judicial and administrative proceedings to create a more predictable, transparent and impartial legal system. To achieve this, the working group would recommend reducing the adopting and applying open clauses in legislation, publishing enforcement details and related decision-making processes, and enhancing and expanding existing law enforcement monitoring and reporting systems, among other methods.^{12&13}

8) Improve the 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 ensures better legislation. Despite efforts to improve transparency and the Ministry of Justice's (MOJ's) work to maintain its public consultation website, many other 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. Failure to do so is also contrary to commitments made in the *Interim Regulation on Major Administrative Decision-making Procedures*.¹⁴ In addition, the public consultation process should be made more transparent by sharing a working plan with enough lead time, and providing alerts of forthcoming public consultation exercises. The working group would also like to encourage legislators to publish major contributions received from stakeholders, together with feedback from regulators on the stakeholders' comments, in a manner similar to the European Commission website.¹⁵

9) Promote the role of domestic and foreign lawyers

Legal professionals—including private practice lawyers and in-house counsels, domestic and foreign lawyers—play a pivotal role in enhancing and strengthening the rule of law in its formal, procedural and substantive aspects, both domestically and at an international level. Therefore, the working group expects recognition and support for legal professionals, in view of their centrality to cooperation in various areas of business.

Recommendations

- Continue to focus on advancing the rule of law and implement a fair competition review system to create and maintain a market-based business environment.
- Continue to standardise the judicial decision-making process to eradicate the application of discretion and ensure equitable, transparent, predictable and impartial implementation and enforcement of laws and regulations nationwide.
- Ensure the full and sufficient implementation of the Civil Code, especially in contract and property areas, to improve business conduct.
- Continue to provide clarifications and standards to enable companies to comply with national security-related laws and regulations.
- Enhance the protection of trade secrets and continue

10 *Civil Procedure Law of the People's Republic of China (2012 Amendment)*, NPCSC, 31st August 2012, viewed 8th May 2021, <http://www.npc.gov.cn/wxzl/gongbao/2012-11/12/content_1745518.htm>

11 Please see the 'Guiding Cases' section on the China Courts' website, viewed 28th June 2021, <<https://www.chinacourt.org/article/index/id/MzAwNDAwMjAwMSACAAA.shtml>>

12 Since the beginning of 2021, regulatory documents and drafts aimed at improving the law enforcement quality in environmental protection areas have been released, such as *Guidance for Improvement of Law Enforcement Effectiveness in Ecosystem and Environment Protection*, Ministry of Ecology and Environment (MEE), 6th January 2021, viewed 12th April 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk03/202101/t20210114_817353.html>; *Guidance for Differentiated Law Enforcement based on Affirmative List in Ecosystem and Environment Protection (Draft for Comment)*, MEE, 30th January 2021, viewed 12th April 2021, <http://www.gov.cn/zhengce/zhengceku/2021-02/12/content_5586892.htm>. Both these documents emphasise restricting and standardising the application of discretion during regulatory activities.

13 One example of good practice is a compliant system set up by the MOJ for the public to report law enforcement issues, China Legal Service Network, viewed 12th April 2021, <<http://www.12348.gov.cn/sfbxzzf/#/suggestion/suggestion>>

14 *Interim Regulation on Major Administrative Decision-making Procedures*, State Council, 8th May 2019, viewed 8th May 2021, <http://www.gov.cn/zhengce/content/2019-05/08/content_5389670.htm>

15 For example, the Public Consultation Section of the European Commission website, viewed 8th May 2021, <https://ec.europa.eu/info/consultations_en>





- lowering the prerequisite with regard to loss estimation when initiating legal proceedings for infringements.
- Ensure prompt, comprehensive and correct enforcement of judicial decisions and arbitral awards by providing enforcers and right owners with relevant information.
 - Enhance compliance with terms and deadlines in court and administrative procedures.
 - Standardise the public consultation process.
 - Permit foreign nationals to attend civil and commercial hearings in the People's Courts.
 - Support and promote the role of domestic and foreign lawyers in China's legal system.

2. Ensure Smooth Implementation of the Foreign Investment Law (FIL) and Its Implementing Regulations, and Minimise Potential Negative Impacts on Foreign Business

Concern

Although the Foreign Investment Law and its implementing regulations have been effective since 1st January 2020, there is still room for improvement in China's legal regime for foreign investment in terms of creating a level playing field.

Assessment

The European Chamber places high expectations on the continuous reform of China's legal regime for foreign investment in terms of transparency, fair competition, and expanding market access and opening-up. It has been a constant position of the European Chamber to support the needs of FIEs in order to avoid any discrimination between domestic and foreign players.

The Foreign Investment Law addresses many key concerns of foreign investors, such as IPR protection, equal support policies, participation in government procurement, and pre-establishment national treatment and negative-list management. However, many regulations under the Foreign Investment Law—and to some extent substantiated by its implementing regulations—still require more detailed 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 in 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 (JV) Law. It is also notable that the *Regulations on Optimising the Business Environment* explicitly oblige governmental agencies at all levels to treat all market entities in a non-discriminatory way, regardless of whether they are domestic or foreign. The working group encourages and expects more, similar efforts from relevant stakeholders to facilitate successful implementation of the Foreign Investment Law.

Despite abolishing the previous three foreign direct investment laws, the Foreign Investment Law is silent regarding the validity of other foreign investment regulations, rules and policies that impose restrictions on only foreign investors (for example, in the area of foreign exchange and financing). Such other regulations focus on areas including re-investment of FIEs based in 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 Foreign Investment Law, such restrictions under these other regulations will be also abolished to create a truly level playing field for foreign investors. The working group further hopes that transparency in the implementation process will be maintained by presenting to the public a clear enactment timeframe, including information on the respective stakeholders responsible for rule-making, and allow sufficient time throughout the process for public comments to reflect business concerns.

Although the Foreign Investment Law reiterates the concept of national treatment for foreign companies, it still does not fundamentally abolish the distinction between foreign and domestic investment, which means that a level playing field cannot be achieved in practice. The European Chamber believes there are no compelling reasons to regulate companies differently due to their ownership structure or by the nationality of their investors. To do so creates unnecessary complexities in practice, as there are always cases where differentiating foreign investment from domestic investment is very difficult (such as 'variable interest entity structure' cases). By contrast, the European Union (EU) and EU Member States have adopted market economies that do not have a special law specifically treating foreign capital differently. Considering China is now the world's second largest



economy, and is increasingly sharing and leading international responsibilities in more and more areas, real consideration should be given to fundamentally changing the existing foreign investment management regime in favour of a more confident and open attitude. In particular, this should entail ceasing to differentiate between Chinese and foreign investment.

The working group has a particular concern regarding the national security review (NSR) mechanism within the Foreign Investment Law framework. This mechanism has the potential to negatively impact the investment activities of European companies operating in China, as it could be influenced by global political tensions. In addition, on 20th December 2020, the NDRC and the MOFCOM jointly issued the *Foreign Investment Security Review Measures (Review Measures)*.¹⁶ Although the *Review Measures* provide more detail on the NSR mechanism, the list of sensitive areas that could potentially trigger a NSR remains quite vague and general. In addition to efforts made by the NDRC (for example, on 30th April 2019, it published a contact point for NSR-related consultancy), the working group would like to encourage additional relevant stakeholders to provide companies with more clarity on this topic.

Recommendations

- Formulate in a timely manner necessary implementation rules to clarify the uncertainties and ambiguities of the Foreign Investment Law, particularly the gaps created by abolishing old laws.
- Clarify national security-related concerns at the working level.
- Adjust and consolidate all pertinent laws and regulations to maintain alignment of the whole legal framework in the field of foreign investment, including greenfield investment and M&A activities.
- Ensure transparency in the process by presenting to the public a clear enactment and public consultation 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 regime so that there is no longer differentiation between Chinese and foreign investment, to ensure a level playing field and non-discriminatory market access.

¹⁶ *Foreign Investment Security Review Measures*, MOFCOM & NDRC, 20th December 2020, viewed 6th May 2021, <<http://www.mofcom.gov.cn/article/j/yjylj/202012/20201203024706.shtml>>

3. Develop an Export Control Regulatory Framework that is Clear, Proportionate and Aligned with Global Practices

Concern

China's Export Control Law needs implementation regulations that are clear, proportionate and aligned with global practices in order to minimise disruption to business operations.

Assessment

The Legal and Compliance Working Group recommends that China's export control authorities involve the industry more in discussions about the forthcoming rules on the Export Control Law, and looks forward to continuing to provide feedback and recommendations with regard to the following aspects:

1) Scope of control

The scope of items subject to control under the draft Export Control Law remains broad, particularly 'dual-use' items, i.e. those that can be used for both civil and military activities. The Export Control Law places a great emphasis on 'safeguarding China's national security and interests', however, 'interests' is a very vague and broad term that may result in ambiguities in certain practices. The working group is concerned about industrial policy elements being incorporated into a national security-orientated Export Control Law, and recommends that the proposed export control system focus on only items that have direct and strategic significance to national security. Globally, a very small fraction of goods and technology are subject to export controls, as the number of commercial mass market items dwarfs those narrow set of technologies with significant, strategic security interests. The proposed Chinese system should not attempt to restrict commercial mass market items that, by volume or distribution, are not susceptible to control, and should instead provide for licensing exceptions, including intra-company transfers.

2) End-use and end-user

When applying to export items controlled under the Export Law, exporters are required to provide documentation issued by the end-user or the government of the end-user's destination to establish the intended end-use and end-user. End-users are required to commit to not change the end-use or





transfer the item to any third-party without authorisation from China's export control authorities. Exporters and importers are further obliged to report any potential change in the end-use or end-user. In addition, the Export Control Law directs the State export control authorities to develop risk management systems for monitoring end-users and end-uses of controlled items.

The working group recommends that the terms 'end-use' and 'end-user' be clearly defined to ensure corporate compliance, with all definitions harmonised with international standards. Unique definitions would only serve to complicate compliance and implementation for exporters. The working group recommends that state export control authorities allow more flexibility in the implementation rules by only requiring proof of end-user and end-use statement/certificate 'where applicable' and 'where available' from exporting entities. Such an approach, which requires the furnishing of a statement or certificate only for specific transactions that are strategic in nature with no national security concern involved, rather than for every single export or re-export, would be more practical. The working group suggests applying this to the End-user Certificate requirement for re-export control. Regarding the end-users and end-uses inspection, the working group recommends establishing a clear enforcement process, detailing the conditions that would justify such enforcement measures, and whether exporters can refuse unreasonable requests. Additionally, the working group recommends that future regulations include protection measures for the rights and interests of the companies being investigated.

3) Export licence mechanism

The working group recommends that the state export control authorities implement a practical and user-friendly licensing system, including leveraging procedures, such as special bulk and general licensing mechanisms with multi-year expirations, licence exceptions (such as intra-company licence exceptions), and other implementation and management methods. A flexible licensing system could minimise uncertainty over control status, thereby reducing unnecessary regulatory burdens for companies. For example, general licences or licence exceptions would authorise exporters to export dual-use items and technology to a specific destination based on clearly defined parameters. This would have a positive impact on business, while limiting the administrative burden for

both exporters and the Chinese authorities. The working group also recommends that licence requirements be based on classification level, not product level, given the export volume and scale of companies.

Regarding export control classification and determination, working group members have identified a common challenge with regard to the current MOFCOM dual-use control list. The list is a combination of descriptive list and Chinese Harmonised Systems code. In practice, as the descriptive list is too generic, inconsistencies between the judgements of competent authorities and of enterprises can arise. The working group recommends considering establishing designations based on the nature of the item, similar to those utilised by other major trading partners, such as aligning with the Wassenaar Arrangement nomenclature.¹⁷ Doing so will reduce regulatory burdens and better harmonise China's proposed system with those of its major trading partners.

4) Deemed export

Under the Export Law, China is entitled to control the release of technical data (i.e., algorithms, source codes) from a Chinese national to a foreign national within China. These kinds of control measures may trigger concerns for multinational companies (MNCs) in China when they conduct research and development (R&D) activities in the country. An export is 'deemed' to be taking place since the data is released to a foreign national, despite their physical presence in China. The working group recommends narrowly defining the export licences' application scope with reasonable Chinese export thresholds, and establishing certain exemption arrangements to allow MNCs to apply for an automatic general licence or facilitative licence.

5) Penalty and voluntary disclosure

Based on the Export Control Law, even an unintentional or minor error may result in a minimum fine. The working group would recommend that the relevant authorities consider including administrative penalties or fines to distinguish between accidental non-compliance versus intentional non-compliance. In addition, there are no self-disclosure provisions or processes for the exporter to disclose errors voluntarily. The working group therefore further recommends that voluntary

¹⁷ Please refer to the Wassenaar Arrangement website, viewed 28th June 2021, <<https://www.wassenaar.org/>>



disclosure be encouraged and facilitated in order to allow companies to avoid potential prosecution and to face reduced punishment, similar to other global export regulations.

Recommendations

- Exempt commercial mass market products from export controls, focussing the export control system instead on items that have a direct and strategic bearing on China's national security.
- Define the terms 'end-use' and 'end-user' in such a way that they are clear and consistent with international standards.
- Adopt a flexible regulatory approach by requiring the proof of end-user and end-use statement/certificate from exporters where applicable and available.
- Establish a clear and fair enforcement process, as well as necessary safeguards, for exporters under investigation.
- Ensure a practical and user-friendly licensing system featuring bulk and general licensing, and licensing exceptions for intra-company transfers.
- Consider updating the current dual-use control list with designations based on the nature of controlled items.
- Narrowly define the scope of 'deemed exports' subject to licensing, and introduce reasonable export thresholds and exemption arrangements.
- Encourage voluntary disclosure by non-compliant exporters.

4. Eliminate Restrictions on the Legal Services that Foreign Law Firms can Provide

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 and/or hiring of Chinese 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, M&A, competition law, banking

and finance law, and capital markets law (i.e., 'non-contentious areas')—is an increasingly significant issue when it comes to fostering economic progress and working relationships between EU Member States and China. 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 afford Chinese clients and companies with better access to the guidance of international laws and practices. It would also support international clients in their investments into China, through provision of integrated Chinese and international legal advice.

1) Employment of Chinese-licensed lawyers by European law firms and foreign partners of Chinese firms

Currently, when European law firms operating in Mainland China hire licensed PRC lawyers, those individuals' qualifications and licences to practice PRC law in non-contentious areas are suspended. At the same time, foreign lawyers are not allowed to become partners of Chinese firms. Allowing Chinese-licensed lawyers to practice in foreign law firms operating in Mainland China and EU-licensed lawyers to become partners in PRC firms will provide clients—both Chinese and foreign—with faster, more cost-effective and efficient access to legal advice, both locally and in the international arena. This will also broaden the career prospects of both PRC and EU lawyers, allowing them to grow and gain expertise in local and international environments, which will benefit cross-border investors from both China and the EU.

2) Participation of lawyers from foreign law firms in Chinese government meetings

Appearance, participation and representation by lawyers from foreign law firms (including PRC-licensed lawyers) before Chinese government authorities and other public, non-judicial, authorities on behalf of their clients are only permitted occasionally and on a case-by-case basis. The 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 authorities and European investors. As a result, it is often difficult for foreign investors to understand the Chinese



Government's proceedings.

3) Developing relationships and dialogues with supervising authorities

In almost all jurisdictions, lawyers and firms are registered as 'special professionals', with stricter conduct codes and special requirements for practice. As registered lawyers and representatives of firms that are registered in the EU, working group members value very much the guidance of, and the dialogues with, EU supervision authorities at the central level. The working group would like to have such exchanges with the MOJ and other competent departments at the central level in China. The working group deems such open channels vital to the legal profession, to enable valuable exchanges among professionals that are practicing law in different areas, including private practitioners, in-house counsels, public administration and legislative bodies, either foreign or Chinese.

4) Access to JV firms

Commitments between Mainland China and the Hong Kong and Macao special administrative regions,^{18&19} and for pilot plans of JVs between domestic and foreign law firms,²⁰ indicate that China is looking at opening at least part of its legal market. While a few pilot JV firms have been established since 2015, existing rules have not yet been deployed nationally, and only allow a 'one office, two teams' model, not a 'fully integrated JV model' that would combine the strengths of the Chinese and foreign firms' partners.

5) 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 more stringent than immigration requirements for foreign representatives working in other sectors, and are very burdensome when compared to international practices.

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 practice 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.

5. Adopt Regulations that Encourage Fair Enforcement of the Anti-monopoly Law (AML)

Concern

Although the revised draft of the AML was published for consultation and comments, and certain enforcement issues have been clarified, the draft still includes ambiguities that require further clarification.

Assessment

The Legal and Competition Working Group welcomes the proposed amendment of the AML, as it highlights the Chinese Government's commitment to promote market-orientated reforms and safeguard fair competition in line with China's reform agenda, as laid down in the third and fourth plenums of the 18th Communist Party of China (CPC) Congress. The State Administration for Market Regulation (SAMR) initiated the public consultation on the *Draft Amendments to the AML (Draft for Comments) (Draft)* on 2nd January 2020.²¹ The *Draft* does not envisage wholesale revision of the AML and, therefore, uncertainty remains among businesses regarding AML enforcement processes in

18 *Agreement on Trade in Services to the Mainland and Hong Kong Closer Economic Partnership Arrangement*, MOFCOM, 27th November 2015, viewed 28th June 2021, <https://www.devb.gov.hk/filemanager/en/content_164/Agreement_on_Trade_in_Services_EN_19Oct2017.pdf>

19 *Agreement on Trade in Services to the Mainland and Macao Closer Economic Partnership Arrangement*, MOFCOM, 2nd July 2007, viewed 28th June 2021, <https://www.dsedt.gov.mo/public/docs/CEPA_ACBLC/index/en/main_text.pdf>

20 *Official Reply of the Ministry of Justice on Approving the Work Plan for the Pilot Programme of Exploring the Manner of and Mechanisms for Closer Business Cooperation between Chinese and Foreign Law Firms in China (Shanghai) Pilot Free Trade Zone*, MOJ, 27th January 2014, viewed 28th June 2021, <<http://www.china-shftz.gov.cn/PublicInformation.aspx?GID=e86e7a98-b9c0-4901-b874-d3e4ee11b6d2&CID=953a259a-1544-4d72-be6a-264677089690&MenuType=>>>

21 *Notice on SAMR's Public Consultation on the Draft Amendments to AML (Draft for Comments)*, SAMR, 2nd January 2020, viewed 25th May 2020, <http://www.samr.gov.cn/hd/zjdc/202001/t20200102_310120.html>



certain areas. This uncertainty stems from the lack of clarity with regard, but not limited, to:

1) The standards, fairness and proportionality of proceedings. For example, in relation to penalties, the current AML lists "confiscation of illegal gains" as mandatory. However, in certain cases, some companies had their illegal gains confiscated while others did not. The *Draft* also introduces a new prohibition on organising or facilitating business operators to enter into anti-competitive agreements. This expands the scope of persons potentially caught by the AML, and the precise scope of organisation or facilitation is also unclear, leaving room for discretionary and inconsistent application of the law. The *Draft* suggests that anti-competitive conduct could be subject to criminal liability without specificity. In the area of merger control, clear and transparent standards (such as definition of 'control'), fairness and proportionality are more important than ever before, especially given the proposed increase of fines to up to 10 per cent of a business' turnover, including for failure to file or closing before clearance.

2) The *Draft* introduces a 'stop-the-clock' mechanism designed largely to address the high percentage of refiled transactions, where the SAMR is unable to complete its review within the statutory review period under the AML. The Legal and Competition Working Group recognises that this mechanism could reduce the number of refiled transactions significantly. However, businesses remain concerned that this proposal may not fully address the underlying concerns over the relative unpredictability of merger reviews, especially under the standard case procedure. The working group acknowledges the progress that resulted from the creation of the 'simple case' procedure, which normally allows cases to proceed fairly quickly to acceptance, as the stakeholder process is done through publication of a notice on the SAMR's website. This has also 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, including non-simple cases. In particular, the working group encourages the SAMR to also publish notices of filings 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.

3) The *Draft* does not address the issue of connecting administrative enforcement and AML enforcement through the courts. In particular, it still leaves the divergence between administrative enforcement and judicial rulings on the treatment of resale price maintenance unsolved, which creates uncertainty for businesses over which is the appropriate legal test to apply for.

4) While the Legal and Competition Working Group commends the SAMR for including the fair competition review mechanism as a core pillar of AML enforcement, it remains concerned that, in practice, certain Chinese policies create the potential for discrimination between domestic and foreign companies (for example, granting subsidies, or bank guarantees or loans, on preferential terms to support overseas acquisitions or public procurement projects). In the area of merger control, the working group has observed that none of the interventions to date relate to domestic transactions; all have concerned transactions between foreign companies, or where at least one of the parties is a foreign company.

5) The time allowed to notify relevant parties, and the number and type of additional implementing regulations or guidance that can be expected from the SAMR. The lack of a centralised publication channel for all decisions, laws and regulations related to the AML exacerbates the situation. As local AMRs become more active in enforcing the AML, a centralised repository and timely publication of local measures or decisions are critical to ensure full compliance.

As a result, lawful business operators in China continue to face challenges and more companies are stepping up demands for clarity and transparency. The absence of such clarification may reduce or even eliminate the positive economic benefits that an effective competition law affords companies and consumers, as set out in Article 1 of the AML.

Recommendations

- Ensure that the AML is implemented and enforced equally among all companies, domestic and foreign, including in the area of merger control enforcement and conduct issues.
- Ensure that all notified transactions are reviewed on a timely basis, particularly high-profile transactions notified under the standard case procedure.





- Ensure that application and enforcement of the AML is consistent with the policy objectives of the fair competition review mechanism.
- Adopt centralised publication channels, such as websites, for all information relevant to AML enforcement, including new measures and decisions both from the SAMR and local AMRs.
- Clarify further and refine the conditions in AML enforcement and judicial practice.

Abbreviations

AI	Artificial Intelligence
AML	Anti-monopoly Law
CPC	Communist Party of China
ECL	Export Control Law
EU	European Union
FIE	Foreign-invested Enterprises
FIL	Foreign Investment Law
IP	Intellectual Property
IPR	Intellectual Property Rights
JV	Joint Venture
M&A	Mergers and Acquisitions
MNC	Multinational Corporation
MOFCOM	Ministry of Commerce
MOJ	Ministry of Justice
NDRC	National Development and Reform Commission
NPC	National People's Congress
NPCSC	Standing Committee of National People's Congress
PRC	People's Republic of China
SAMR	State Administration for Market Regulation
SPC	Supreme People's Court
WTO	World Trade Organization



Research and Development Working Group

Key Recommendations

1. Encourage Foreign-invested Enterprises (FIEs) to Contribute to China's Research and Development (R&D) Operations by Optimising the Financial Incentives Framework as well as Improving International R&D Cooperation 🇪🇺 3

- Establish a transparent, efficient and fair mechanism to facilitate Chinese-European R&D cooperation with participation by foreign companies based in China.
- Publish English-language versions of notices about R&D funds and grants application and communicate them in a timely manner, with an appropriate response period allowed.
- Remove restrictions that hinder multinational corporations from applying for HNTE status.
- Promote best practices from local governments with comprehensive regulations that encourage further development of foreign-funded R&D centres.

2. Facilitate the Mobility of International Talent between China and Foreign Countries 🇪🇺 3

- Provide a single window for consultation on foreign talent topics, and communicate policy advances actively via various channels such as industrial associations and organisations in a timely manner.
- Increase FIEs' autonomy in issuing invitations to international talent and establish a preferential visa policy targeting R&D personnel for important projects.
- Clarify existing policies' requirements on foreign intern recruitment.
- Encourage special visa facilitation for young researchers in general.

3. Facilitate Multinational Enterprises' Digital Innovation in China 🇪🇺 2

- Publish a list of open databases that FIEs can access, and clarify whether they can establish and manage their own public database independently.
- Promote the harmonisation of Chinese and international information technology (IT) standards to incentivise international companies to increase investment in R&D in China.
- Integrate investment in IT infrastructure in state-level economic and technological development zones into the development plans for local digital economies.

4. Invest in Green and Sustainable Technology Development to Facilitate Relevant R&D Activities 🇪🇺 3

- Provide enterprises with additional incentives that focus on the long-term development of new breakthroughs on green technologies.
- Facilitate the creation of pilot and demonstration areas for low-carbon and green technologies and their commercialisation.
- Enhance European Union-China collaboration in R&D of green technology.

5. Strengthen Protection of R&D, Including Intellectual Property (IP)-related Aspects, in Order to Foster a Business Environment that Enables World-class Innovation in China 🇪🇺 3

- Consult universities, foreign research institutions, and foreign and local companies' R&D departments when drafting new policies related to innovation and IP rights (IPR) protection.





- Increase technical expertise and avoid local protectionism in local courts, and establish a more centralised jurisdiction for IPR-related cases involving innovation and R&D aspects.
- Enhance the enforcement of IPR legislation to avoid forced technology transfer or technology transfer difficulties.
- Allow the existence of co-ownership of IPs between the parent company and local affiliates (or ownership of the parent company) in R&D projects funded by the Chinese Government.

Introduction to Working Group

The European Chamber's Research and Development Working Group provides a platform for exchanging information, experiences and best practices among member companies and to promote dialogue and transparency in R&D policy in China. 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 50 European multinational corporations (MNCs) that have R&D centres and large-scale R&D operations in China, the majority of which are located in and around Beijing and Shanghai. Various industries are represented in the working group, including automotive, chemicals and petrochemicals, information and communications technology (ICT), aerospace, energy and pharmaceuticals. The activities of the working group are aimed at helping China strengthen its global science and technology (S&T) cooperation and engage the international R&D community, in order for China to reach its goal of becoming a world S&T power by 2049,¹ leaping from 'made in China' to 'created in China'.

Recent Developments

With the rapid development of S&T, China has progressed further on its journey to become an innovation-based country. In the most recent National People's Congress (NPC) and Chinese People's Political Consultation Conference plenary sessions in March 2021, innovation was mentioned as central to

the overall development of China's modernisation.² The 2020 Global Innovation Index, published by the World Intellectual Property Organization (WIPO), ranks China 14th out of all 131 countries and first out of 37 upper-middle-income economies.³ In 2019, China invested a total of Chinese yuan (CNY) 2.2 trillion yuan in R&D, an increase of 12.5 per cent on the previous year. The intensity of R&D-based funding (ratio to gross domestic product) rose to 2.23 per cent, up by 0.09 per cent year-on-year.⁴ In recent years, the Chinese Government at all levels has rolled out policy plans to stimulate domestic R&D development, in which the importance of international stakeholders' participation is often highlighted.

MNCs play an essential role in China's R&D development. As part of the national innovation system, MNCs' R&D centres in China employ Chinese nationals, generate Chinese patents, and develop their innovations into Chinese products while collaborating with Chinese universities and academic laboratories. MNCs are equipped with decades of experience and leadership in S&T that can contribute to the improvement of China's R&D ecosystem and domestic innovation capacity. While 40 per cent of respondents in the *European Business in China Business Confidence Survey 2021* (BCS 2021) report that China is increasingly becoming an attractive environment for R&D and innovation compared to the worldwide average,⁵ more can be done to improve the transparency of the process for granting

1 *Building a World Power in Science and Technology*, Xinhua, 30th May 2018, viewed 10th March 2021, <http://www.xinhuanet.com/politics/xxjxs/2018-05/30/c_1122908666.htm>

2 *Proposal of the Central Committee of the Communist Party of China on the Formulation of the 14th Five-year Plan for National Economic and Social Development and the Visionary Goals for 2035*, Xinhua, 3rd November 2020, viewed 2nd June, <http://www.gov.cn/zhengce/2020-11/03/content_5556991.htm>

3 *Global Innovation Index 2021*, WIPO, 2021, viewed 10th March 2021, <https://www.wipo.int/global_innovation_index/en/2020/>

4 *China's science and technology funding to achieve a new breakthrough*, Ministry of Science and Technology (MOST), 16th September 2020, viewed 10th March 2021, <http://www.most.gov.cn/kjzc/zdkjzcjd/202009/120200916_158771.html>

5 *European Business in China Business Confidence Survey 2021*, European Chamber of Commerce in China, 8th June 2021, <<https://www.eurochamber.com.cn/en/publications-business-confidence-survey>>





incentives for innovation, to provide flexible access to global talent and to deliver greater legislative support.

On 13th May 2020, the Ministry of Science and Technology (MOST) and the Ministry of Education issued the *Implementation Opinions on Further Promoting the Construction and Development of Specialised Technology Transfer Institutions in Higher Education*, which clarifies that universities give technology transfer institutions⁶ the right to manage and transform (transfer, license and invest for value) scientific and technological achievements, including intellectual property rights (IPR). Technology transfer institutions in universities are also encouraged to establish cooperation mechanisms with national independent innovation demonstration zones and high-technology zones.⁷

On 31st December 2020, leaders of China and the European Union (EU) jointly announced the completion of the negotiations on the EU-China Comprehensive Agreement on Investment (CAI) as scheduled. China committed to limited additional market openings in manufacturing, automotive industry, financial services, bio-resources R&D, telecom/cloud services, computer services and other areas.⁸ The European Chamber regrets that the subsequent diplomatic friction between the EU and China has resulted in an indefinite freezing of the CAI's ratification process. The European business community in China hopes that each side will now consider how they might proceed with their end of the deal.⁹

One key development in EU-China innovation cooperation is the ongoing discussion on the creation of a joint roadmap for future initiatives on science, technology

and innovation cooperation. European enterprises' R&D activities in China act as an organic and indispensable part of China's future independent innovation system, and the working group hopes they will be given the same treatment as domestic enterprises in terms of personnel, capital, equipment and intellectual property (IP).

Key Recommendations

1. Encourage Foreign-Invested Enterprises (FIEs) to Contribute to China's R&D Operations by Optimising the Financial Incentives Framework as well as Improving International R&D Cooperation 3

Concern

Compared with local Chinese enterprises, FIEs still face market access difficulties such as acquiring the status of high and new technology enterprise (HNTE), and obtaining access to public funding and grants for R&D.

Assessment

China has a solid set of incentives in place to stimulate innovation, including 'strategic support' (long-term structural incentives like HNTE status and a super-deduction scheme for reducing costs) and 'tactical support' (focussed grants for projects with a definite scope and target). The criteria for HNTE status recognition were revised in 2016 by the MOST, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT).¹⁰ Although certain requirements were somewhat relaxed, such as the minimum R&D expense ratio and academic qualifications of technical personnel, those relating to IP ownership were actually tightened. Currently, the applicant needs to own the core IP of their product or service. While FIEs run some of China's largest R&D operations, in many cases, their core technologies were originally developed outside of China, thus they lack IP ownership in China.

Frameworks allowing international R&D cooperation between China and other countries exist in abundance, the EU's Horizon 2020 is an example. Through this project, academic and industry members from Europe and China have jointly developed innovative technologies of common interest. However, the working

⁶ Specialised technology transfer institutions in universities (hereinafter referred to as technology transfer institutions) are professional institutions that provide a complete chain of comprehensive services for the transfer and transformation of scientific and technological achievements in universities. These universities can; set up technology transfer offices, technology transfer centres and other internal institutions; independent institutions engaged in technology development, technology transfer and pilot maturation set up jointly with localities and enterprises; or technology transfer companies and IP management companies wholly owned by universities to establish technology transfer institutions.

⁷ *Notice on the Implementation Opinions on Further Promoting the Establishment and Development of Specialised Technology Transfer Bodies of Universities*, MOST, 13th May 2020, viewed 10th March 2021, <http://www.gov.cn/zhengce/zhengceku/2020-05/20/content_5513172.htm>

⁸ *Core Elements of the EU-China CAI*, Sohu, 2nd January 2021, viewed 10th March 2021, <https://www.sohu.com/a/441991731_120220684>

⁹ *European Chamber stance on the European Parliament freezing of the CAI ratification process*, European Union Chamber of Commerce in China, 28th May 2021, viewed 2nd June 2021, <https://www.europeanchamber.com.cn/en/press-releases/3342/european_chamber_stance_on_the_european_parliament_freezing_of_the_cai_ratification_process>

¹⁰ *Regulation on the Determination and Administration of High and New-Technology Enterprise (2016 Revision)*, MOST, MOF & SAT, 2016, viewed 23rd March 2021, <http://www.most.gov.cn/kjzc/gjkjzc/qyjsjb/201706/t20170629_133827.html>





group noted a lack of coordination between the Chinese Government and the EU in terms of funding, project timelines and approval processes. The working group expects the Chinese and European governments to hold open discussions on establishing a common, transparent, efficient and equal mechanism to facilitate the implementation of this important international R&D cooperation.

Regarding Chinese domestic R&D grant applications, there are indications that MNCs are in a disadvantaged position due to the preference of some local authorities for 'domestic champions'. For example, taking the amount and complexity of the required materials into account, application and announcement periods are often extremely short, meaning there is very little time for FIEs to translate documents and send them to headquarters in Europe for input. At the same time, FIEs tend to have more limited access to grants due to the language barrier and the resulting delays in communication.

According to the BCS 2021, legal and professional services firms consider the innovation environment in China as more favourable than in recent years. Over 44 per cent of firms in Southwest China, Nanjing and South China see a more favourable innovation environment in China. The country's improving status as an R&D centre is fuelled by attractive government incentives, in particular for FIEs. However, these improvements are hampered by a perceived lack of IP protection and continuing internet restrictions.

The working group welcomes the Chinese Government's commitment to allow international businesses to participate in national S&T projects and to receive access to the same policies offered to their Chinese counterparts, as stated in the *Notice of the State Council on Several Measures for Promoting Growth of Foreign Investment*.¹¹ For innovation, while funds are indeed "catalysts" to development, talent and an innovative culture or atmosphere matter as well.

The working group is pleased to note that provincial policies to encourage foreign-funded R&D centres have recently been passed. In September 2020, the State Council issued the *Overall Plan for the China (Beijing)*

Pilot Free Trade Zone (FTZ), laying the groundwork to establish a FTZ in China's capital.¹² This follows another announcement, made only a few weeks earlier by the State Council, of a work plan to deepen pilot reforms in the service sector in Beijing (initiated in 2015), and to build a National Integrated Demonstration Zone for the Opening-up of the Service Sector.¹³ Shanghai also published a set of comprehensive regulations in November 2020 on foreign-funded R&D centres, which cover extensive topics from tax and funding support, customs clearance and cross-border finance facilitation to talent acquisition and development.¹⁴ The working group finds it very encouraging to see specific support mechanisms from local governments for FIEs, and hopes this development is taken up throughout China to become a long-term policy.

Recommendations

- Establish a transparent, efficient and fair mechanism to facilitate Chinese-European R&D cooperation with participation by foreign companies based in China.
- Publish English-language versions of notices about R&D funds and grants application and communicate them in a timely manner, with an appropriate response period allowed.
- Remove restrictions that hinder MNCs from applying for HNTE status.
- Promote best practices from local governments with comprehensive regulations that encourage further development of foreign-funded R&D centres.

2. Facilitate the Mobility of International Talent between China and Foreign Countries 3

Concern

International enterprises engaged in R&D in China struggle to access and recruit international talent, especially young researchers.

Assessment

Some previous concerns of the Research and Development Working Group were addressed by

¹¹ *Notice of the State Council on Several Measures for Promoting Growth of Foreign Investment*, Ministry of Commerce, 16th August 2017, viewed 23rd March 2021, <<http://www.mofcom.gov.cn/article/ae/ai/201708/20170802627851.shtml>>

¹² Alessio Petino, *Overview of policies for foreign investors in the Beijing Free Trade Zone*, EU SME Centre, 2nd December 2020, viewed 6th April 2021, <<https://www.eusmecentre.org.cn/article/overview-policies-foreign-investors-beijing-free-trade-zone>>

¹³ Ibid.

¹⁴ *Regulations of Shanghai Municipality on Encouraging the Establishment and Development of Foreign-funded Research and Development Centres*, Shanghai Municipal Commission of Commerce, 1st December 2020, viewed 6th April 2021, <https://en.www.sh.gov.cn/2020-12/01/c_424414.htm>





policy advances, such as visas for foreign interns and permanent residence for senior talent or long-term employees. The working group has also taken note of China's efforts to alleviate administrative burdens and facilitate global talent mobility; a series of changes to the rules governing Chinese work permits and permanent residency status for foreigners were introduced in 2017 and 2018, and policies related to talent acquisition piloted in FTZs rolled out nationwide in 2019.

However, in 2021, pandemic-related business travel restrictions are among the top concerns for working group members. For example, members based in Nanjing in particular report that the whole system of applying for PU letters for employees and family members remains difficult.

On 15th May 2020, during the Exclusive Dialogue with the Shanghai Science and Technology Committee on R&D Related Policies, the existing *25 Articles of Science Reform and Regulations on Construction of a Science and Innovation Centre in Shanghai*, and how they would impact R&D staffing and employees, were explained to company representatives in attendance. However, companies sometimes are not fully informed of the latest policy changes in a timely manner given the complexity of policies and the fact that multiple government agencies, such as the Human Resources and Social Security Bureau, the Science and Technology Commission Talent Service Office and the Foreign Expert Office, release information through their own channels.

Currently, the Chinese visa policy favours senior foreign talents who have made certain achievements in their career over fresh graduates and interns from non-top universities. Employees from certain areas of the globe also encounter difficulties in obtaining a visa. Special visa facilitation for researchers in an early stage of their career, in general, should be encouraged. According to a 2019 EURAXESS survey, over 95 per cent of European researchers working in China (some currently in higher positions) moved here early in their career, and stayed for approximately 7–10 years.¹⁵ This indicates that early exposure to the Chinese market and innovation ecosystem encourages long-term

commitment. The working group therefore encourages adapting a more friendly visa policy to welcome younger talent.

Meanwhile, joint R&D projects are a good way for junior staff to be trained on equipment utilisation and rules in labs across the world. To realise this, existing policies need to be further clarified. Also, a definition for a “well-known domestic enterprise” that is allowed to hire foreign interns needs to be clarified, while rules such as “only Fortune 500 companies can hire qualified foreign interns”¹⁶ should be changed to permit all companies to hire the interns they identify as potential future talent. Offering a favourable and stimulating environment for R&D talent is essential for generating innovative ideas that can become commercial successes.

Recommendations

- Provide a single window for consultation on foreign talent topics, and communicate policy advances actively via various channels such as industrial associations and organisations in a timely manner.
- Increase FIEs' autonomy in issuing invitations to international talent and establish a preferential visa policy targeting R&D personnel for important projects.
- Clarify existing policies' requirements on foreign intern recruitment.
- Encourage special visa facilitation for young researchers in general.

3. Facilitate Multinational Enterprises' Digital Innovation in China

Concern

The lack of access to open data resources, the requirements for international companies to establish databases in China, and the lack of harmonisation of Chinese and international IT standards demotivate international companies from carrying out IT R&D in China.

Assessment

In order to encourage domestic innovation, China has unveiled several important policies over the past decade,

¹⁵ Results of a survey on the internationalisation of Chinese universities, EURAXESS, 16th April 2021, viewed 25th June 2021, <<https://euraxess.ec.europa.eu/worldwide/china/results-survey-internationalisation-chinese-universities>>

¹⁶ The National Immigration Administration Promotes the Replication of 12 Policies on Immigration and Immigration Facilitation in the FTZs Nationwide, Ministry of Public Security, 17th July 2019, viewed 23rd March 2021, <<https://www.mps.gov.cn/n6557558/c6613913/content.html>>





such as *Made in China 2025*,¹⁷ the *Platform for Action to Promote Big Data Development*,¹⁸ and the *Development Plan of New Generation AI*.¹⁹ Implementation of these policies significantly accelerated the development of AI and big data in China; as a result, new applications appear every year while others mature and are adopted widely. For instance, the Health QR code application has been a great success in combatting the spread of COVID-19 in China. However, the participation of FIEs in developing the national or regional health apps was minimal.

Innovation depends on access to open data resources and the freedom to create and manage databases; in China, FIEs face many hurdles to access such resources. In 2020, the NPC released the *Guidance on the Development of Industrial Big Data (Guidance)*, which includes new measures to accelerate data pooling, promote data sharing and deepen data application.²⁰ The working group welcomes the inclusion in the *Guidance* of the following recommendations:

- "Facilitate international collaboration...;
- Boost exchange and collaboration on big industrial data in policies, technologies, standards, talent and enterprises at bigger, wider and deeper levels."

However, there is still a lack of clear guidelines on how FIEs can access and use such data resources.

In addition, China's "autonomous and controllable"²¹ policies are also having an impact on European business's R&D operations. Companies in the ICT sector have expressed concern that they may in the future be forced to either move or increase R&D activities in China to comply with these policies and

not lose market share.²² Data management rules in China are also a major factor in companies' plans. While China's sheer size makes it an attractive data pool too big to ignore, this information loses value when companies encounter barriers to dynamic and effective cross-border data transfer processes.

The Research and Development Working Group and the Standards and Conformity Assessment Working Group hopes that China will further harmonise domestic and international IT standards, and involve FIEs in the process.²³ Even though the *Regulation for Implementing the Foreign Investment Law* stipulates that FIEs shall be consulted equally in the formulation and revision of national, industrial, local and group standards,²⁴ most Chinese standard-setting bodies currently only allow very limited participation by international businesses.²⁵ Aligning rules with the international community would help to raise the international profile of China's innovative sectors, bring global recognition for China's R&D capacity and improve the reputation of Chinese products in international markets.

Article 15 of the *Notice to Promote Innovation in State-level Economic and Technological Development Zones to Create a New Plateau for Reform and Opening-up (Notice)* encourages all kinds of capital to invest in IT infrastructure in state-level economic and technological development zones to promote the development of a digital economy.²⁶ The Research and Development Working Group and the Standards and Conformity Assessment Working Group welcome the *Notice* and hope that these policies will be rolled out nationwide.²⁷

Recommendations

- Publish a list of open databases that foreign enterprises can access, and clarify whether FIEs can establish and manage their own public database independently.

17 *Notice of Made in China 2025*, NPC, 2nd June 2020, viewed 22nd March 2021, <http://www.gov.cn/zhengce/content/2015-05/19/content_9784.htm>

18 *Platform for Action to Promote Big Data Development*, People.cn, 5th September 2015, viewed 22nd March 2021, <<http://politics.people.com.cn/n/2015/0905/c1001-27545655.html>>

19 *Development Plan of New Generation Artificial Intelligence*, NPC, 20th July 2017, viewed 22nd March 2021, <http://www.gov.cn/zhengce/content/2017-07/20/content_5211996.htm>

20 *Guidance on the Development of Industrial Big Data*, NPC, 8th April 2020, viewed 22nd March 2021, <http://www.gov.cn/zhengce/zhengceku/2020-05/15/content_5511867.htm>

21 "Autonomous and controllable" (also referred to as "secure and controllable") is a concept put forward by the Chinese leadership in several recent laws and regulations whereby the government would have broad discretion on deciding how it protects information networks, devices and data deemed critical to national and economic security. This concept is closely linked to the development and use of Chinese indigenous products and technologies instead of foreign ones.

22 *Decoupling: Severed Ties and Patchwork Globalisation*, European Union Chamber of Commerce in China & Mercator Institute for China Studies (MERICS), January 2021, <<http://european-chamber.com/en/publications-decoupling>>

23 For more information, please see the *Standards and Conformity Assessment Working Group Position Paper 2021/2022*, p. 129.

24 *Regulation for Implementing the Foreign Investment Law*, State Council, 26th December 2019, viewed 22nd March 2021, <http://www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm>

25 For more information, please see the *Standards and Conformity Assessment Working Group Position Paper 2021/2022*, p. 129.

26 *Notice to Promote Innovation in State-level Economic and Technological Development Zones to Create a New Plateau for Reform and Opening-up*, State Council, 28th May 2019, viewed 22nd March 2021, <http://www.gov.cn/zhengce/content/2019-05/28/content_5395406.htm>

27 For more information, please see the *Standards and Conformity Assessment Working Group Position Paper 2021/2022*, p. 129.



- Promote the harmonisation of Chinese and international IT standards to incentivise international companies to increase investment in R&D in China.
- Integrate investment in IT infrastructure in state-level economic and technological development zones into the development plans for local digital economies.

4. Invest in Green and Sustainable Technology Development to Facilitate Relevant R&D Activities 3

Concern

The government does not sufficiently support R&D activities related to green and sustainable technology or the conversion of subsequent results into marketable products, potentially slowing down China's overall green development.

Assessment

Green development is a national strategy of China.²⁸ On 22nd September 2020, President Xi Jinping stated in his speech at the 75th General Debate of the United Nations General Assembly that China will increase its nationally determined contributions, adopt more powerful policies and measures, and “strive to reach its peak carbon dioxide emissions by 2030, and strive to achieve carbon neutrality by 2060.”²⁹ In addition, 2021 marks the start of the 14th Five-year Plan (14FYP), which emphasises the development of action plans to achieve peak carbon emissions by 2030. The implementation and enforcement of regulations that impose stricter environmental standards is a major instrument used by the Chinese Government to address environmental issues. Previous examples include the revision of the Environmental Protection Law in 2015, and a green data centre evaluation system set up by the Ministry of Industry and Information Technology (MIIT) in 2019.

Achieving China's peak carbon and carbon neutrality goals will require a comprehensive green and low-carbon transition, which in turn will need a well-designed systematic transition path and a supporting legal and regulatory system that takes into consideration the

characteristics of different regions and industries.³⁰ The working group believes that measures will also need to mobilise market forces and motivate enterprises to participate in the R&D of low-carbon technologies from the production side.³¹ As the amount of investment required in these areas is very high, additional incentives for new low-carbon and clean technologies in both research and application, accelerating the transition from the lab to market and increasing success rates of new products, are necessary. Such incentive policies need not exclusively be in the form of monetary support (subsidies and tax reductions), but could also include creating open R&D cooperation platforms, and establishing pilot and demonstration areas.

Furthermore, the European Commission and China are preparing an EU-China Joint Roadmap for Future Science, Technology and Innovation Cooperation, and both sides foresee that the Joint Roadmap will be updated on a regular basis to take account the latest developments in their collaboration. Given the EU's relatively well-established system of laws and regulations, its determination and ambition to develop green technologies and to halve emissions by 2030, as well as the related advanced technology of European companies, the Research and Development Working Group expects to see more EU-China collaboration in this area.

Recommendations

- Provide enterprises with additional incentives that focus on the long-term development of new breakthroughs on green technologies.
- Facilitate the creation of pilot and demonstration areas for low-carbon and green technologies and their commercialisation.
- Enhance EU-China collaboration in R&D of green technology.

5. Strengthen Protection of R&D, Including IP-related Aspects, in Order to Foster a Business Environment that Enables World-class Innovation in China 3

Concern

Despite continuous improvements to China's IP

28 China's National Plan on Implementation of the 2030 Agenda for Sustainable Development, Ministry of Foreign Affairs, September 2016, viewed 23rd March 2021, <https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/W020161014332600482185.pdf>

29 Matt McGrath, *Climate Change: China aims for 'carbon neutrality by 2060'*, BBC, News, 22nd September 2020, viewed 10th May 2021, <<https://www.bbc.com/news/science-environment-54256826>>

30 *Climate Change 2020 Green Paper Launch and Green Low Carbon Development Summit Forum Held in Beijing*, NetEase, 30th November 2020, viewed 23rd March 2021, <<https://www.163.com/dy/article/FSMNQ11S05446XON.html>>

31 *ibid.*





protection system, international businesses still encounter difficulties in protecting their IPR related to the innovation process, inventions and research, which negatively influences the level of assurance they need to commit to investing in top-level technological innovation in China.

Assessment

Enhancing IP protection and enforcement in China is in the interest of building an innovative country,³² developing innovation-driven enterprises, and promoting high-quality economic growth in which international businesses developing new technologies make significant contributions to China's economic transformation. Since the beginning of opening-up and reform, China has formulated and implemented numerous laws and policies on IP protection, with the most recent being the Civil Code, which went into effect on 1st January 2021. In the BCS 2021, for the first time, half of respondents reported finding IPR enforcement in China to be excellent or adequate.³³

In order to create a better technological innovation environment in China, the function, value and impact of the patent system needs to be adjusted and implemented so as to balance existing right holders and new entrants to the market. In order to foster R&D in new technologies such as biotechnology and/or AI, the related IP legal framework and patent system needs to swiftly and strategically respond to the challenges that arise. The working group recommends consulting the academic, scientific and private sectors in order to pinpoint the most suitable solutions to protect and foster innovation. China's new Patent Law went into force on 1st June 2021, and the working group believes that this will lead to a better R&D environment going forward.

In order to promote innovation, fast and fair IPR-related judgments are fundamental. Disputes need courts with a high level of technical expertise, which is not yet available at all local courts. China has established several specialised IP Courts, while general courts in Tier-1 cities have more experience in hearing IPR-related cases and can count on better prepared judges and experts. The range of IPR cases that can be heard by such courts should be expanded, while a more

centralised system of adjudication may reduce local protectionism.

Technology transfer, both from FIEs to 'indigenous' Chinese companies and the other way round, is challenging. On 2nd March 2019, the State Council repealed three controversial articles within the *Technology Import and Export Administrative Regulation (TIER)*,³⁴ a positive development in controlling forced technology transfer from a legal perspective. Yet the repeal of these articles does not automatically mean that forced technology transfer is forbidden under all conditions and circumstances. It remains of significant concern to the European Chamber that European companies are still being compelled to transfer technology in order to maintain market access, even after the Foreign Investment Law—which expressly prohibits unfair technology transfers—took effect on 1st January 2020. While the Foreign Investment Law has banned administrative tools to compel technology transfers, this does not address the core problem. Modern transfers are compelled not through administrative means, but by market access requirements.³⁵ In the BCS 2021, 16 per cent of respondents report being compelled to transfer technology. The working group believes that the enforcement of IPR legislation should still be further enhanced and that integrating international companies' feedback can help improve China's IPR system³⁶ and eventually contribute to China's innovation competency.

The process for transferring IP from Chinese firms to foreign parties has become progressively tighter, with transfers being strictly reviewed if they affect 'national security' or core technology in key fields.³⁷ According to the Science and Technology Progress Law³⁸ and industry specific/local regulations, European companies face restrictions on ownership of IP produced from research and commercialisation projects receiving Chinese Government funding. New IP produced by

32 *Opinions of the Supreme People's Court on Comprehensively Strengthening the Judicial Protection of Intellectual Property Rights*, Invest in China, 15th April 2020, viewed 22nd March 2021, < <http://www.court.gov.cn/zixun-xiangqing-226491.html> >

33 *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, June 2021, p. 37, <[https://european-chamber.com/wp-content/uploads/documents/documents/BCS_EN_final\[917\].pdf#>](https://european-chamber.com/wp-content/uploads/documents/documents/BCS_EN_final[917].pdf#>)

34 *Administrative Decree No. 709*, State Council, 2nd March 2019, viewed 22nd March 2021, <http://www.gov.cn/jzhengce/content/2019-03/18/content_5374723.htm>

35 *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, June 2021, p. 33, <[https://european-chamber.com/wp-content/uploads/documents/documents/BCS_EN_final\[917\].pdf#>](https://european-chamber.com/wp-content/uploads/documents/documents/BCS_EN_final[917].pdf#>)

36 For more information, please see the *Intellectual Property Rights Working Group Position Paper 2021/2022*, p. 76.

37 *External Transfer of Intellectual Property Rights Measures (Trial Implementation)*, State Council, 18th March 2018, viewed 22nd March 2021, <http://www.gov.cn/jzhengce/content/2018-03/29/content_5278276.htm>

38 *Science and Technology Progress Law*, Standing Committee of the NPC, 29th December 2007, viewed 22nd March 2021, <http://www.gov.cn/ziliao/tfjg/2007-12/29/content_847331.htm >





projects that receive Chinese state funding requires: 1) approval from the relevant government authorities if IP is to be transferred or exclusively licensed to non-Chinese entities, including international project partners that contribute background IP; and 2) the first licence of the newly-produced IP must be in China. The working group believes that a certain degree of relaxation in such restrictions can incentivise FIEs to participate in China's innovation projects, considering that IP owned by FIEs could be critical as essential background IP in some projects, for example, without self-owned IPR, the enterprise is not eligible for China's HNTE benefits.

Recommendations

- Consult universities, foreign research institutions, and foreign and local companies' R&D departments while drafting new policies related to innovation and IPR protection.
- Increase technical expertise and avoid local protectionism in local courts, and establish a more centralised jurisdiction for IPR-related cases involving innovation and R&D aspects.
- Enhance the enforcement of IPR legislation to avoid forced technology transfer or technology transfer difficulties.
- Allow the existence of co-ownership of IPs between the parent company and local affiliates (or ownership of the parent company) in R&D projects funded by the Chinese Government.

Abbreviations

14FYP	14 th Five-year Plan
AI	Artificial Intelligence
BCS	Business Confidence Survey
CNY	Chinese Yuan
EU	European Union
FIE	Foreign-invested Enterprise
HNTE	High and New Technology Enterprise
IoT	Internet of Things
IP	Intellectual Property
IPR	Intellectual Property Rights
IT	Information Technology
MNC	Multinational Corporation
MOF	Ministry of Finance
MOST	Ministry of Science and Technology
NPC	National People's Congress
R&D	Research and Development
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

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 🌐 14

- Ensure proper notification of all mandatory standards that may impact market access, and enlarge the scope to cover all mandatory market access requirements.
- Continue to limit the scope of technical regulations and mandatory standards to issues related to the protection of the environment, health and safety, in accordance with the WTO/TBT Agreement.
- Annul mandatory industry standards or convert them to recommended ones or mandatory national standards as soon as possible.
- Provide English versions of the notified documents.

2. Review Mandatory Market Access Requirements, Including the Simplification of Testing and Certification Procedures 🌐 14

- 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 supervised by one standardisation committee to avoid breaching China's WTO obligations.
- Simplify the designation processes for China Compulsory Certificate (CCC) testing laboratories and certification bodies to allow international laboratories or certification bodies to join the system.

3. Ensure that all Relevant Stakeholders Enjoy Equal Access and Participation Rights in Standardisation Work 🌐 14

- Grant fair access to all technical committees (TCs) for interested stakeholders.
- Grant equal rights to all organisations/companies participating in TCs.
- Encourage open and extensive industry involvement in all types of standardisation work, including the development of standardisation strategies and participation in international standardisation activities.
- Ensure transparency with regards to membership requirements, participation or sponsorship fees, and disclosure of financial information in standardisation projects.

4. Continue the Current Reform of the Chinese Standardisation System and Increase Harmonisation Efforts 🌐 6

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 in more industries.
- Avoid referring to recommended standards in mandatory standards.

Social organisation standards

- Stick to the policy of independent development and free use of social organisation standards and strictly avoid the inclusion of social organisation standards in administrative measures.
- Establish proper procedures to facilitate the transformation of social organisation standards into national and industrial standards.
- Ensure there is transparency in processes related to social organisation standards, and that equal access is granted to all relevant players.
- Formulate in a timely manner an intellectual property (IP) management system to disclose necessary patent-related information.
- Obtain the authorisation of copyright owners in cases where their standards are referenced, and clearly mention the referencing of such standards in the published document

Enterprise standards

- Clarify the definition of 'enterprise standards'.
- Clarify the disclosure or format requirements for enterprises, and limit the scope of the self-declaration mechanism to mandatory national standards adopted by enterprises.
- Improve the enterprise standards online service platform.
- Allow enterprises to make self-declarations of enterprise standards on their own websites.
- Ensure the enterprise standards 'top runner' system is fair, open, transparent and follows a reliable scientific process.
- Protect the intellectual property rights (IPR) of enterprise standards.

Industry standards

- Enhance coordination between industry standards and other standards to avoid overlaps.

International standards

- Continue participating in international standards-setting activities and increase the adoption rate of identical international standards.

5. Ensure Fair and Transparent Market Surveillance 14

- Align market surveillance and market access requirements.
- Limit market surveillance to compliance with laws, regulations, mandatory standards and certification schemes.
- Make non-mandatory requirements in market surveillance subject to civil liability rather than to administrative penalties.
- Allow commercial organisations that meet accreditation requirements to join market surveillance.

Quality and Safety Services Sub-working Group

1. Ensure Equal and Fair Treatment in Government Procurement Activities

- Regulate government procurement by establishing a fair, transparent, impartial and efficient government procurement management system.
- Set fair and reasonable conditions for government service bidding projects to provide a fair platform for non-public institutions.





2. Allow Foreign-invested TIC Agencies to Provide Container Inspection Services

- Allow foreign-invested TIC agencies to provide container inspection services.

3. Accelerate Market-orientated Reforms of Government-affiliated TIC Agencies and Accelerate the Establishment of a Fair, Open TIC Market System

- Accelerate market-orientated reform of government-affiliated TIC agencies.
- Reduce excessive and unclear market access barriers and adopt international norms for assessment.
- Provide 'national treatment' to international TIC agencies so that they enjoy equal market status to their domestic peers.

4. Speed up the Marketisation Process of Special Equipment Inspection Services

- Establish a market competition mechanism and allow enterprises to freely choose inspection agencies for statutory inspections.
- Enhance the diversity of inspection entities to make up for the inadequacy of a single source of supply from the government and to provide space for non-government-affiliated inspection agencies to grow.

5. Establish the System of Customs Accepting Inspection Results for Imported Bulk Commodities from Third-party Agencies

- Accept third-party inspection results concerning the weight and quality of imported bulk, resource-based commodities.
- Open up the market and accept evaluations by all inspection agencies, including foreign-invested, private and state-owned agencies, and grant equal treatment to foreign-invested inspection agencies.

Introduction to the Working Group

The Standards and Conformity Assessment (SCA) Working Group was founded in 2008. Its members come from various industry sectors such as automotive, automotive components, construction, cosmetics, healthcare equipment, electrical equipment, information and communication technology and machinery. It contains the Quality and Safety Services Sub-Working Group. The Standards and Conformity Assessment Working Group aims to support the development of China's SCA systems in order to facilitate China's integration into the world economy. As China opens its door wider to the world, SCA will be essential to facilitating cooperation between the European Union (EU) and China in investment, trade, environment, healthcare and production activities.

Recent Developments

The Reform of China's Standardisation System

On 11th March 2015, the State Council issued the *Deepening Reform Plan for Standardisation Work (Guofa [2015] No.13)*, which is aimed at reforming the overall standards systems and mechanisms for standardisation management. This process included the revision of the China Standardisation Law, as well as the development of other major related regulations.¹ The last stage of this process concluded in 2020,² and the working group expects a new set of standardisation

1 *Standardisation Law of the People's Republic of China*, Standardisation Administration of China (SAC), 4th November 2017, viewed 15th April 2020, <http://www.sac.gov.cn/ztl/bzhf/bzhfdt/201711/t20171106_317995.htm>

2 *Notice of the General Office of the State Administration of Market Supervision on Issuing the Division of the Key Tasks for the Implementation of the Plan for Deepening the Reform of Standardisation Work (2019–2020)*, State Council, 17th April 2019, viewed 12th April 2021, <http://gkml.samr.gov.cn/nsjg/bzjss/201904/t20190419_293018.html>





roadmaps to be presented in 2021.

Reforms have so far led to a number of developments in the following areas:

- **Building an effective standardisation coordination mechanism and streamlining standards**

During the 2018 plenary sessions of the National People's Congress and the Chinese People's Political Consultative Conference, the State Administration for Market Regulation (SAMR) was established, absorbing the State Administration of Industry and Commerce, the General Administration of Quality, Supervision, Inspection and Quarantine (AQSIQ), and the China Food and Drug Administration. The Certification and Accreditation Administration of China (CNCA) and the Standardisation Administration of China (SAC) were assigned to the SAMR, with their brands retained.

The work of streamlining and consolidating mandatory standards has been ongoing since 2017. On 17th January 2020, the SAMR published its *Administrative Measures for Mandatory National Standards*,³ and on 19th December 2020, it launched a public consultation on the *Administrative Measures for National Standards*.⁴ The Standards and Conformity Assessment Working Group hopes the feedback it submitted to the authorities will be taken into account in the development of the final document.

Finally, in 2020, the SAC released four batch plans on recommended national standards, with a total of 1,409 formulated standards and 577 revised standards.⁵ According to April 2021 data from the SAC, the number

of mandatory national standards had been reduced to 2,048, while there were 37,813 recommended national standards.⁶

- **Cultivating and developing social organisation standards**

Following the mandate from *Guofa [2015] No. 13* encouraging associations, federations, unions, industrial technology alliances and other social organisations to develop standards,⁷ social organisation standards—also known as association standards—were granted legal status in the revised China Standardisation Law. On 9th January 2019, the Ministry of Civil Affairs and the SAC issued the *Provisions on the Administration of Social Organisation Standards*, which stipulates, among other things, that technical requirements should not be lower than those for mandatory standards, and that this category of standards should fill any gaps left by other standards and meet market needs for innovation.⁸ A search through the national social organisation standard information platform in April 2021 showed that the number of registered groups was 4,592,⁹ and that the number of standards had risen to 23,918 (a 60 per cent increase over 2020).¹⁰

- **Easing restrictions to, and allowing more room for, enterprise standards**

In 2018, an enterprise standard 'top runner' system was established to encourage enterprises to proactively set and implement advanced standards.¹¹ This system materialised with the joint issuing of the *Opinions on Implementing the Enterprise Standards 'Top Runner' System (Opinions)* by eight regulatory agencies. According to the *Opinions*, third party institutions will assess the quality of different enterprise standards and

3 *Administrative Measures for Mandatory National Standards*, SAMR, 13th January 2020, viewed 12th April 2021, <http://gkml.samr.gov.cn/nsjg/fgs/202001/t20200113_310467.html>

4 *Announcement of the SAMR on the Public Consultation for the 'Administrative Measures for National Standards (Draft for Comment)'*, SAMR, 19th December 2021, viewed 12th April 2021, <http://www.samr.gov.cn/hd/zjdc/202012/t20201215_324374.html>

5 *Notice of the National Standardisation Administration on the Issuance of the First Batch Plan on Recommended National Standards*, SAC, 31st March 2020, viewed 7th April 2021, <<http://www.standardcnjc.com/index/news/detail/id/164.html>>; *Notice of the National Standardisation Administration on the Issuance of the Second Batch Plan on Recommended National Standards*, SAC, 7th August 2020, viewed 7th April 2021, <<http://www.samr.gov.cn/bzjss/tzgg/202008/P020200812533255477845.pdf>>; *Notice of the National Standardisation Administration on the Issuance of the Third Batch Plan on Recommended National Standards*, SAC, 19th November 2020, viewed 7th April 2021, <<http://www.samr.gov.cn/bzjss/tzgg/202011/P020201123590061105333.pdf>>; *Notice of the National Standardisation Administration on the Issuance of the Fourth Batch Plan on Recommended National Standards*, SAC, 24th December 2020, viewed 7th April 2021, <<http://www.samr.gov.cn/bzjss/tzgg/202012/P020201228591104234979.pdf>>

6 *Updates of China's Standards*, National Standards Open System, 20th April 2020, viewed 21st April 2020, <<http://openstd.samr.gov.cn/bzgk/gb/>>

7 *Notice of the State Council on Printing and Distributing the Report Plan for Deepening Standardisation Work*, State Council, 11th March 2015, viewed 10th July 2020, <http://www.gov.cn/zhengce/content/2015-03/26/content_9557.htm>

8 *Provisions on the Administration of Social Organisation Standards (For Trial Implementation)*, National Social Organisation Standards Information Platform, 26th December 2017, viewed 15th April 2021, <<http://www.ttbz.org.cn/Home/>>

9 *Associations List*, National Social Organisation Standards Information Online Platform, viewed 7th April 2021, <<http://www.ttbz.org.cn/Home/ActGroupList?serType=1&serKey=&sheng=&page=122>>

10 *Standards List*, National Social Organisation Standards Information Online Platform, viewed 7th April 2021, <<http://www.ttbz.org.cn/Home/Standard?page=456>>

11 *SAC Holds Enterprises Standards Management Reform Team Meeting*, SAC, 1st August 2017, viewed 12th April 2021, <http://www.sac.gov.cn/xw/bzhxw/201708/t20170802_251882.htm>





rank them.¹² 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)*,¹³ and 'top runner' lists were released in 2018, 2019 and 2020.^{14,15&16}

- **Internationalising Chinese standards, strengthening Chinese participation in international standardisation, increasing the adoption rate of international standards and opening up the Chinese standardisation system**

Enhancing the international influence of Chinese standards is an important goal for the Chinese Government. This encompasses actions like promoting Chinese standards internationally and through schemes like the Belt and Road Initiative,¹⁷ increasing participation in international standardisation organisations and boosting the adoption of international standards.

As of April 2021, China has 64 secretariats in the International Standardization Organization (ISO) and 11 in the International Electrotechnical Commission (IEC).¹⁸ Between 2011 and 2018, China's share of secretariats in the ISO grew from 5.0 per cent to 8.21 per cent. Over the same period, its share in working group secretariats rose from 2.0 per cent to 6.58 per cent.¹⁹ In 2020, China led the development of 121 ISO standards (7.4 per cent of the total ISO standards published that year, an increase of two per cent over 2019).²⁰

Despite multiple government policies and regulations consistently encouraging the adoption of international standards, according to SAC data, as of April 2021, 35 per cent of all current national standards had been adopted from international standards.²¹ By comparison, according to the latest European Committee for Standardization and European Committee for Electrotechnical Standardization (CEN-CENELEC) *Global Outreach Report*, as of December 2020, 78 per cent of the CENELEC catalogue was identical to or based on IEC deliverables (for CEN, it was 33.9 per cent).²²

In addition, a number of China's laws and regulations,^{23,24&25} stipulate that foreign-invested enterprises (FIEs) will enjoy the same treatment as domestic enterprises while doing standardisation work in China. This commitment from China to ensure equal participation by foreign and domestic companies in standardisation was also enshrined bilaterally in the EU-China Comprehensive Agreement on Investment (CAI), although this agreement is yet to be ratified and, as of June 2021, discussions at the political level within the EU had been put on hold while China's sanction on certain EU institutions and individuals remain.

China's Standardisation Strategy

In January 2018, the SAC and the former AQSIQ announced that, along with the Chinese Academy of Engineering, they would develop a national standardisation strategy, titled *China Standards 2035*.²⁶ The project is aimed at tackling the following: 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. The concluding meeting

12 *Opinions on Implementing the Enterprise Standards 'Top Runner' System*, SAMR, 20th July 2018, viewed 12th April 2021, <http://www.sac.gov.cn/xwlbzbxw/201807/t20180703_342614.htm>

13 *Notice on the Opinions on Implementing the Enterprise Standards 'Top Runner' (Trial)*, CNIS, 22nd February 2019, viewed 15th April 2021, <http://www.cnis.gov.cn/wzgg/201902/t20190222_24758.shtml>

14 *Enterprise Standards Top Runner List Announced*, Standards Information Platform, 7th November 2018, viewed 15th April 2021, <<http://www.zjsis.com/contents/4/464630.html>>

15 *2019 Enterprise Standards Top Runner List Announced*, SAMR, 28th May 2019, viewed 12th April 2021, <<http://www.sac.gov.cn/sbgs/sytz/201906/P020190604503571128473.pdf>>

16 *The First Enterprise Standard 'Top Runner' List of 2020 has been Released*, National Quality News Network, 21st December 2020, viewed 12th April 2021, <http://www.cqn.com.cn/zgzb/content/2020-12/21/content_8653922.htm>

17 *Action Plan for Harmonisation of Standards for Jointly Building the Belt and Road (2018–2020)*, SAC, 19th January 2018, viewed 12th April 2021, <http://www.sac.gov.cn/ztydy/bzhyw/201801/t20180119_341413.htm>

18 *SAC China*, ISO, viewed 7th April 2021 <<https://www.iso.org/member/1635.html>>; *China IEC full member*, IEC, viewed 7th April 2021, <https://www.iec.ch/dyn/www/?p=103:34:4934401698192:::FSP_ORG_ID,FSP_LANG_ID:1003,25>

19 Rühlig, Tim, *Technical standardisation, China and the future international order – A European perspective*, Heinrich Böll Stiftung, February 2020, viewed 7th April 2021, <<https://www.ui.se/globalassets/ui.se-eng/publications/other-publications/technical-standardisation-china-and-the-future-international-order.pdf>>

20 *Notice on the Disclosure of Information on the National-led Development and Revision of International Standards issued by ISO in 2020*, SAMR, 8th February 2021, viewed 14th April 2021 <http://www.samr.gov.cn/bzcx/tzgg/202102/t20210208_326006.html>

21 National public service platform for standards information, SAC, viewed 14th April 2021, <<http://std.samr.gov.cn/gb/search/gbAdvancedSearch?type=std>>

22 *CEN-CENELEC Global Outreach Report*, CEN-CENELEC, December 2020, viewed 14th April 2021, <https://ftp.cenelec.eu/EN/IntCooperation/GlobalOutreach_2020.pdf>

23 *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 2021, <http://www.gov.cn/zhengce/content/2017-01/17/content_5160624.htm>

24 *Guiding Opinions on Foreign-funded Enterprises Participating in the Standardisation Work of China*, SAC, 6th November 2017, viewed 15th April 2021, <<http://www.sac.gov.cn/szhywb/sytz/201711/P020171130363181265870.pdf>>

25 *Foreign Investment Law of the People's Republic of China (bilingual)*, China Daily, 22nd March 2019, viewed 15th April 2021, <<http://language.chinadaily.com.cn/a/201903/22/WS5c94798ca3104842260b205f.html>>

26 *China Standards 2035 Project is being formulated*, Xinhua, 10th January 2018, viewed 15th April 2020, <http://www.xinhuanet.com/fortune/2018-01/10/c_129787658.htm>



on the strategy took place in January 2020, with standardisation roadmaps expected to be rolled out by in the second half of 2021.

Update on the China Compulsory Certificate (CCC)

On 15th March 2018, the CNCA published the *Notice on the China Compulsory Certificate Product Marks Reform*.²⁷ The notice cancelled the review and fee for printing/moulding CCC marks. It also required certification bodies to start issuing standard-sized CCC marks, and that the categories of CCC marks be simplified. On 16th October 2019, the SAMR released its *Regulations on Adjusting and Perfecting the Compulsory Product Certification Catalogue and the Implementation Requirements*. Among other provisions, it adjusted the implementation requirements through measures like eliminating the issuing of compulsory product certificates for products that follow self-declaration evaluation procedures. The transition period concluded on 1st November 2020, after which the designated certification body cancelled all compulsory product certification certificates for such products.

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 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, to enable amendments and comments to be taken into account.

While the working group recognises the positive progress made by China in this regard, there are still many cases where either no notification has been given or was incomplete. Incomplete notification of CCC standards has long been subject to criticism, as they generally incorporate many recommended standards that are usually not included in China's notification list. A considerable proportion of these recommended standards are domestic ones that may differ significantly from their international counterparts, which may result in significant obstacles to trade.

Aside from CCC, many other mandatory market access schemes in China have never been notified to the WTO despite affecting market access for the products they cover. Examples of these schemes include the *Certification of Critical Network Equipment and Security-Specific Products*, the *Licence for Sale of Computer Information System Security-Specific Products*, the *Network Access Evaluation for Broadcasting and Television Equipment*, and the *Technical Review on the Compliance of On-Vehicle Terminals and Platforms of Satellite Positioning Systems*. The working group recommends that the government take meaningful steps to address this issue. The working group also suggests that English versions of the notified standards be published for reference.

b) Limiting the scope of technical regulations and mandatory standards to issues related to the protection of the environment, health and safety (EHS), according to the WTO/TBT Agreement

The WTO/TBT Agreement allows countries to take necessary measures to fulfil legitimate objectives, such as national security requirements, the prevention of deceptive practices, and the protection of EHS. The working group is pleased to note that China intends to limit the scope of mandatory standards to the above-mentioned objectives. The working group recommends that China continue its efforts and fulfils its commitments in this regard, while implementing ongoing standardisation reforms by either annulling mandatory industry standards, or converting them to either recommended ones or mandatory national standards,

²⁷ *Notice on the China Compulsory Certificate Product Marks Reform*, CNCA, 13th March 2018, viewed 15th April 2021, <http://www.cnca.gov.cn/zw/gg/gg2018/202007/t20200714_59635.shtml>





in order to facilitate notification. Similar efforts should be made to ensure that technical regulations can fulfil the legitimate objectives defined in the WTO/TBT Agreement.

Recommendations

- Ensure proper notification of all mandatory standards that may impact market access, and enlarge the scope to cover all mandatory market access requirements.
- Continue to limit the scope of technical regulations and mandatory standards in accordance with the WTO/TBT Agreement.
- Annul mandatory industry standards, or convert them to recommended ones or mandatory national standards as soon as possible.
- Provide English versions of the notified documents.

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 fulfil multiple requirements published by different authorities that are not coordinated with one another, while certain testing and certification procedures place unnecessary burdens on manufacturers by increasing costs, and hinder the import of technology and services without increasing product safety.

Assessment

a) The concurrent existence of mandatory standards, compulsory certification and administrative licensing schemes

According to the Standardisation Law, many products must comply with mandatory standards. In addition, other regulations require certain products to comply with specific mandatory certification schemes and individual administrative licensing schemes. Although the Standardisation Law and subsequent regulations provide for the streamlining of standards, some areas like environmental protection, engineering and medical devices are exempted.²⁸ Furthermore, the lack of coordination between these regulations results in overlapping testing requirements, which leads to

additional costs for manufacturers and can even delay product launches.

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. Improved coordination, or even supervision by a single authority, can help to eliminate any overlap/conflict between the various mandatory standards, compulsory certification schemes and administrative licensing systems. It would also allow for reductions in waiting times for companies to access the latest technologies and increase manufacturing efficiency, which would in turn help to revitalise the Chinese economy. With the standardisation reform process coming to an end, the working group therefore expects to see further efforts to improve coordination going forward.

b) Recognition of test reports at the national level and enhancement of the efficiency of testing and certification processes

The working group is concerned that European companies still encounter test reports issued by CCC-designated testing laboratories not being accepted by other testing laboratories for identical tests of the same product. In such cases, manufacturers have to re-test their products, which wastes company resources and ultimately results in delayed product launches, increased costs and reduced efficiency.

The working group therefore recommends ensuring nationwide recognition of test reports for the same technical qualifications to avoid product test repetition. This will require certain testing requirements to be clearly 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 CNCA, which would facilitate the use of test reports documenting manufacturers' in-house testing or third-party type testing for medical device product registration, among other requirements.²⁹ The working group also recommends that the designation process for certification bodies is simplified in order to allow globally-recognised entities to access the system.

²⁸ For further information on medical device mandatory standards, please refer to Key Recommendation (KR) 3 of the *Healthcare Equipment Working Group Position Paper 2021/2022*, p. 244.

²⁹ For more information on industry concerns regarding to other aspects of testing, please see KRs 2 and 3 of the *Healthcare Equipment Working Group Position Paper 2021/2022*, p. 244.



Since September 2020, according to the *Opinions of the General Office of the State Council on Supporting the Transfer of Export Products to Domestic Sales*, in order to support development of the domestic market for export products and help ease the administrative burden of foreign trade enterprises, companies are allowed to sell products developed before the end of 2020 once they provide a self-declaration that the products conform to mandatory national standards.³⁰ Relevant enterprises can make this declaration through the enterprise standard information public service platform, or in the form of product instructions, factory certificates and product packaging, among others. The working group believes that these measures will enhance the efficiency of product certification, shorten the cycle of product listing, reduce testing and certification costs, improve the level of mutual recognition of standards and effectively promote the development of the domestic market for export products, while also meeting the needs of domestic supply-side reform.

c) Recommended standards used as market access requirements

Recommended standards need to remain voluntary. Unfortunately, some have either become *de facto* mandatory after being chosen as the basis for mandatory certification and administrative licensing schemes or include some mandatory terms. As mentioned in Key Recommendation (KR) 1, the practice of using recommended standards in mandatory certification schemes is still widespread in China. The lack of transparency in these instances causes problems for enterprises that must comply with multiple mandatory market access 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 supervised by one standardisation committee to avoid breaching China's WTO obligations.

- Simplify the designation processes for CCC testing laboratories and certification bodies to allow 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 numerous pieces of Chinese legislation stipulate that all relevant stakeholders shall be granted equal access and participation rights in standardisation work, there is still a 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 multiple pieces of legislation like the Foreign Investment Law, there is still room for improvement when it comes to implementation. At the macro level, major strategies for the development of standardisation work, such as China Standards 2035, have remained at best opaque to international players, and opportunities for them to provide constructive input have been extremely limited. The working group firmly believes that its members could provide valuable contributions to the development of this strategy if they were granted a degree of involvement in the process.

Access to technical committees (TCs) is one area where some encouraging progress has been observed by the working group throughout the past few years.³¹ However, the principle of granting equal access to TCs to all stakeholders has not been fully implemented. In fact, data from the European Chamber-Mercator Institute of Chinese Studies (MERICS) joint report *Decoupling: Severed Ties and Patchwork Globalisation* shows that while direct barriers like expressly being denied participation in TCs seem to have been reduced to a limited number of sectors (such as cryptography and rail), only 24 per cent of European

³⁰ *Opinions of the General Office of the State Council on Supporting the Transfer of Export Products to Domestic Sales*, State Council, 22nd June 2020, viewed 15th June 2021, <http://www.gov.cn/zhengce/content/2020-06/22/content_5521078.htm>

³¹ *European Business in China Business Confidence Survey 2020*, European Union Chamber of Commerce in China, p. 64, 10th June 2020, <http://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>





Chamber member companies surveyed for the report say they enjoy full access to standardisation activities in China. The top three reasons for lack of access stated by companies were unclear access procedures, unavailability of information and the inability to obtain full voting rights.³² Members have also reported issues with participation fees for certain standardisation projects. In some instances, FIEs have been required to pay additional participant or sponsorship fees to obtain the right to participate in certain standardisation projects, even though neither such an obligation, nor the required amount of fees, are included in the documents regulating these projects. This raises concerns over unfair competition – that participants are not enjoying equal access to standardisation work. Meanwhile, the financial status of standardisation projects is seldom reported, which illustrates a further lack of transparency.³³

The working group hopes that the Chinese Government will step up its efforts to encourage FIEs' equal participation in domestic standardisation activities, such as holding the secretariat of a TC, leading the drafting of Chinese standards, participating in or leading in China's international standardisation activities in certain technical fields, and enjoying incentive policies from governments at all levels. The working group also recommends supervising the standardisation behaviour of social groups—such as associations, industry alliances and federations—to ensure the fair and equal access, and participation rights, of all stakeholders.

Recommendations

- Grant fair access to all TCs for interested stakeholders.
- Grant equal rights to all organisations/companies participating in TCs.
- Encourage open and extensive industry involvement in all types of standardisation work, including the development of standardisation strategies and participation in international standardisation activities.
- Ensure transparency with regard to membership requirements, participation or sponsorship fees, and the disclosure of financial information in standardisation projects.

³² *Decoupling, Severed Ties and Patchwork Globalisation*, European Union Chamber of Commerce in China, 14th January 2021, <<https://www.europeanchamber.com.cn/en/publications-decoupling>>

³³ For sector-specific recommendations on transparency and equal access to standardisation work, please see KR 2 of the *Information and Communication Technology Working Group Position Paper 2021/2022*, p. 327.

4. Continue the Current Reform of the Chinese Standardisation System and Increase Harmonisation Efforts

Concern

Although China has entered the final stage of standardisation reform, and the revised Standardisation Law has been in force since 2018, neither the law nor relevant reforms have been completely implemented in all technical fields, and the transparency and fairness of existing standard-setting procedures still need to be improved.

Assessment

a) Mandatory national standards

The working group has observed progress in China's streamlining and consolidating mandatory national standards over the past few years, as well as in establishing processes for the management of such standards. The working group expects the following outcomes from the implementation of these regulations:

- Notification of all mandatory national standards in accordance with the procedures prescribed by the WTO.
- Alignment with international standards.
- Avoidance of conflicting mandatory requirements and standards.
- Reduction of mandatory standards to a minimum.
- Guarantees that, before listing and drafting any mandatory national standard, the industry authority shall work with the SAC to arrange calls for comments from key industry stakeholders, including both Chinese and foreign industry associations, trade associations and all relevant enterprises. The time allocated for the commenting round should not be less than two months.
- Establishment of clear work processes, roles and responsibilities of both industry authorities and the SAC in organising the drafting of mandatory national standards.
- An effective guarantee that Chinese and foreign enterprises and organisations shall enjoy equal rights to participate in the drafting of mandatory national standards.
- Development of reasonable transition periods between issuance and implementation dates for mandatory national standards.
- Explicit prohibition of the referral of recommended

standards in any mandatory national standards.

b) Social organisation standards

Social organisation standards, along with enterprise standards, are meant to satisfy the needs of the market and innovation, and stimulate market vitality. China's social organisation standards system has been developing at a break-neck speed throughout the past few years.

One of the key points of the *Provisions on the Administration of Social Organisation Standards* is that, if standards formulated by associations meet the stipulated requirements, the association can apply to have them converted into national, industry or local standards.³⁴ Government bodies are also encouraged to apply social organisation standards in industrial policy formulation, administrative management, government procurement, and testing and certification, as well as bidding. The working group recommends that authorities stick to the policy of independent development and free use of social organisation standards, and strictly avoid their inclusion in administrative measures. In addition, when social organisation standards do get transformed into national or industry standards, all stakeholders should have equal opportunities to provide feedback. In particular, when a social organisation standard has been transformed into a mandatory national standard, the relevant standard-setting and WTO/TBT procedures should be followed. Currently, some associations favour their own interests through the formulation of social organisation standards by means of requiring membership fees, charging for the formulation of standards or simply refusing access to FIEs. The working group believes that FIEs and domestic companies should have equal access to all Chinese social organisations.

Finally, the working group recommends that the relevant authorities formulate an intellectual property (IP) management system to disclose necessary patent-related information in a timely manner, particularly for standard-essential patents. The working group also urges the Chinese authorities to ensure that copyright owners' authorisation is obtained in cases where their standards are referenced within other standards, and to

ensure that the referencing of such standards is clearly mentioned in the published document.

c) Enterprise standards

The Standardisation Law defines enterprise standards as individual companies' proprietary product or service specifications, which detail product features and/or how a company puts together its products and services. These details—in particular the testing methods—often contain confidential information protected through IP rights (IPR). However, Article 27 of the Standardisation Law states that the function and performance indicators of products need to be disclosed. While the principle of making limited standards disclosures for the sake of adherence to customer protection requirements or for limited marketing purposes is acceptable, companies should not be required to disclose confidential information that could potentially put their IP at risk. Furthermore, for complex products, there is no efficient and cost-saving way to develop a comprehensive list of standards implemented in the final product, which can effectively discourage companies from participating in the enterprise standards system.

The current written guidelines and definitions under the system are not sufficient to direct enterprises from a compliance point of view. However, during market surveillance by the Chinese authorities, some European companies have reported being strongly encouraged to follow the format for national standards and include all information (including type test and factory inspection) in the disclosed standards, even if the company already meets quality compliance requirements. This is concerning, as it points towards more stringent and extensive disclosure requirements. Therefore, the working group suggests limiting the scope of the self-declaration mechanism to mandatory national standards, and that the disclosure and format of requirements of enterprise standards be clarified, with any potential requirements that could lead to involuntary disclosure of IP to the public avoided by all means. Given the need for clear and well-defined guidelines for the development and management of enterprise standards, the working group welcomes SAMR's inclusion of the *Administrative Measures for Enterprise Standards* on its legislative workplan for 2021, and looks forward to providing feedback on the draft.³⁵

³⁴ *Provisions on the Administration of Social Organisation Standards (For Trial Implementation)*, National Social Organisation Standards Information Platform, 26th December 2017, viewed 15th April 2021, <<http://www.ttbz.org.cn/Home/>>

³⁵ 2021 Legislative Work Plan, SAMR, 1st April 2021, viewed 12th April 2021, <http://gkml.samr.gov.cn/nsjg/fgs/202104/t20210401_327476.html>



With regard to the enterprise standards management system, an online service platform has been set up, and manufacturers are encouraged to make disclosures online and sign the self-declaration of conformity. However, in order to be more user-friendly, the platform still needs improvement in certain areas, such as the categories of products listed. Although it is impossible to list all categories on the platform, this remains a mandatory selection item, raising compliance risks post-market surveillance if the correct category is not available. For instance, in the platform there is an option for 'medical masks' but no specifications for different types (such as single-use disposable masks). Another example is that when a company has several subsidiaries, different identification numbers are required for registering an account for each subsidiary, as each is a different legal entity. The working group therefore recommends that enterprises be allowed to declare enterprise standards on their own website. This would provide a platform that is better suited to self-disclosure and help prevent IP leaks, while also being beneficial for company branding.

Schemes such as the 'top runner' system have also 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 spirit of standardisation reform—should be based on market competition and encourage market-led processes. Members of the working group are also concerned about the possibility of some companies developing advanced standards for the 'top runner' system purely as a marketing tool, but that these standards do not necessarily reflect the actual quality of the products in the market. The working group therefore recommends that the government take steps to ensure the system is fair, open and transparent, and follows a reliable scientific process that includes measures to check the real situation in the market.

d) Industry standards

The Standardisation Law has clarified that industry standards are voluntary standards; yet, some industry standards remain mandatory, such as the YY series standards for medical devices. Furthermore, while the number of mandatory national standards has been reduced, the number of industry, market-driven social

organisation and enterprise standards are sky-rocketing. This situation has created numerous overlaps among different standards. One of the stated goals of the SAC's *Guiding Opinions on the Further Strengthening Management of Industry Standards* is to optimise the industry standard supply structure and improve coordination with other standards.³⁶ The working group hopes that the upcoming *Administrative Measures for Industry Standards* can provide further guidance for the effective implementation of this goal, and recommends that harmonisation efforts be expanded to the whole standards system.

e) Continue participation in international standardisation and improve the adoption rate of international standards

Key policy documents like the revised Standardisation Law, China Standards 2035 and, more recently, the 14th Five-year Plan have consistently pointed towards the Chinese Government's willingness to increase its participation in international standardisation activities and to continue to adopt international standards.³⁷ The working group has also observed the increase in China's participation in international standardisation bodies such as the ISO, the IEC and the International Telecommunications Union, and welcomes China's integration into the international standardisation system. While the industry has observed that the overall percentage of new international standards issued by China has slightly increased since 2017 (see chart on p. 132), it also notes a general downward trend in the past decade, and that a number of these standards are not identical to their international counterparts. The industry recommends that the authorities increase the issuance and the adoption rate of identical international standards, as this will not only support the domestic economic development, but also international initiatives.

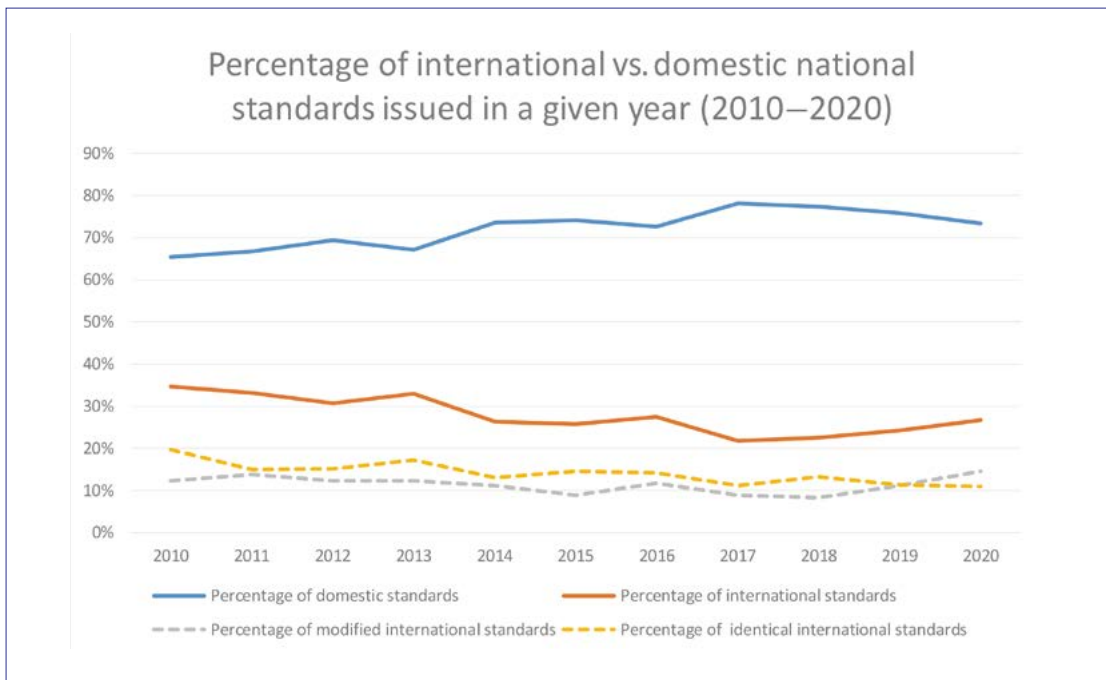
Recommendations

Mandatory national standards

- Expand standardisation reform to include exempted areas.
- Introduce reasonable transition periods for mandatory standards and implement the European concept of

³⁶ *Guiding Opinions on Further Strengthening Management of Industry Standards*, SAC, 10th April 2020, viewed 25th April 2021, <<http://www.sac.gov.cn/sbgs/syzt/202004/P020200415371585800963.pdf>>

³⁷ *The 14th Five-year Plan for the National Economic and Social Development of the People's Republic of China*, State Council, 13th March 2021, viewed 12th April 2021, <http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm>



Sources: SAC, European Chamber³⁸

transition periods in more industries.

- Avoid referring to recommended standards in mandatory standards.

Social organisation standards

- Stick to the policy of independent development and free use of social organisation standards and strictly avoid the inclusion of social organisation standards in administrative measures.
- Establish proper procedures to facilitate the transformation of social organisation standards into national and industrial standards.
- Ensure transparency in processes related to social organisation standards, and that equal access is granted to all relevant players.
- Formulate in a timely manner an intellectual property (IP) management system to disclose necessary patent-related information.
- Obtain the authorisation of copyright owners in cases where their standards are referenced, and clearly mention the referencing of such standards in the published document.

Enterprise standards

- Clarify the definition of 'enterprise standards'.
- Clarify the disclosure or format requirements for

enterprises, and limit the scope of the self-declaration mechanism to mandatory national standards adopted by enterprises.

- Improve the enterprise standards online service platform.
- Allow enterprises to make self-declarations of enterprise standards on their own websites.
- Ensure the enterprise standards 'top runner' system is fair, open, transparent and follows a reliable scientific process.
- Protect the IPR of enterprise standards.

Industry standards

- Enhance coordination between industry standards and other standards to avoid overlaps.

International standards

- Continue participating in international standards-setting activities and increase the adoption rate of identical international standards

5. Ensure Fair and Transparent Market Surveillance

Concern

The current market surveillance process for many products has been extended in practice to voluntary requirements, which are not related to mandatory market access requirements, while not enough products—particularly on e-commerce platforms—are being

³⁸ This graph was developed by collecting the data on national standards published at the SAC's National Public Service Platform for Standards Information. National Public Service Platform for Standards Information, SAC, viewed 17th June 2021 <<http://std.samr.gov.cn/gb/search/gbAdvancedSearch?type=std>>





checked for mandatory requirements.

Assessment

While the working group recognises that product quality surveillance and inspection in China is becoming more standardised and systematic, it would like to highlight that some technical market surveillance requirements are not in line with mandatory market access requirements.

Market surveillance has been extended in practice to recommended and voluntary standards, which has resulted in the punishment of manufacturers whose products do not meet the requirements. Such a situation—which tends to happen more frequently at the provincial or city level—increases workloads for both manufacturers and authorities, and prevents the latter from focussing on important tasks such as improving EHS and preventing deceptive practices. Additionally, as described in KR4, in market surveillance processes, European businesses have been strongly encouraged to make extensive disclosures for enterprise standards. The working group therefore recommends aligning market surveillance and market entry requirements, and limiting market surveillance to compliance with national laws, regulations and mandatory standards. In addition, on 2nd January 2019, the SAMR released its *Interim Provisions on Administrative Punishment Procedures for Market Supervision and Administration*, which regulate the penalties for non-compliance with market surveillance requirements.³⁹ The working group recommends that non-mandatory requirements be subject to civil liability rather than administrative penalties.

Another issue encountered by European companies in certain sectors is that market surveillance of mandatory requirements in products is not sufficient. For example, out of thousands of different types of lighting products, the SAMR generally only checks three, and do so once a year. However, many lighting products being sold on e-commerce platforms are not compliant with CCC. The working group therefore recommends that the relevant authorities increase their market surveillance efforts—particularly of products sold on e-commerce platforms—in order to improve market compliance. The working

group also recommends that Chinese authorities at both national and local levels strengthen transparency and accessibility in their processes, for instance, through diversifying the channels used to obtain feedback from consumers (such as using dedicated applications or WeChat accounts). Finally, the working group believes that, in order to avoid instances of the performance/safety features of products sold in the market differing from the samples sent for testing, the authorities should intensify their follow-up market checks and develop processes and penalties that serve as effective deterrents.

Recommendations

- Align market surveillance and market access requirements.
- Limit market surveillance to compliance with laws, regulations, mandatory standards and certification schemes.
- Make non-mandatory requirements in market surveillance subject to civil liability rather than to administrative penalties.
- Allow commercial organisations that meet accreditation requirements to join market surveillance.

Abbreviations

AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
CCC	China Compulsory Certification
CNCA	Certification and Accreditation Administration of China
CNIS	China National Institute of Standardisation
EHS	Environment, Health and Safety
EU	European Union
FIE	Foreign-invested Enterprise
IEC	International Electrotechnical Commission
IP	Intellectual Property
IPR	Intellectual Property Rights
ISO	International Standardization Organization
KR	Key Recommendation
MERICs	Mercator Institute of Chinese Studies
SAC	Standardisation Administration of China
SAMR	State Administration for Market Regulation
SCA	Standards and Conformity Assessment

³⁹ *Interim Provisions on Administrative Punishment Procedures for Market Supervision and Administration*, SAMR, 2nd January 2019, 12th April 2021, <http://gkml.samr.gov.cn/nsjg/bgt/201901/t20190102_279555.html>



European Chamber
中国欧盟商会

SESEC	Seconded European Standardization Expert in China
TC	Technical Committee
WTO/TBT	Technical Barriers to Trade of the World Trade Organisation





Quality and Safety Services Sub-working Group

Introduction to the Sub-working Group

Established in 2012, the Quality and Safety Services (QSS) Sub-working Group is a sub-working group of the Standards and Conformity Assessment (SCA) Working Group. The QSS sector is made up of companies that are 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 members on the sub-working group are primarily European QSS industry leaders that have operated in China for over two decades, providing tailor-made, high-end services for Chinese manufacturers.

These member companies have contributed significantly to both China's market-orientated reforms and to development plans like the Belt and Road Initiative (BRI) by sharing their expertise and advanced management experience with the State Administration for Market Regulation (SAMR) and the Certification and Accreditation Administration of China (CNCA). The sub-working group identifies industry concerns and makes constructive recommendations in order to create a more transparent and better-coordinated QSS system that improves market access for all players. The sub-working group is advocating for China to further open its TIC market and provide opportunities for cooperation between China and Europe in the area of quality and safety management.

Recent Developments

Compared to other major economies, China imposes heavy regulation on third-party TIC, which comes under the primary purview of the SAMR. These authorities have a tremendous amount of influence on quality and safety—as well as standards development and enforcement—by exerting extensive control over mandatory TIC processes. This situation enables state-owned enterprises (SOEs) and government-affiliated enterprises to monopolise a huge market share of China's QSS sector, with international TIC agencies accounting for only a small portion. Occasional

scandals related to quality and safety have exposed the shortcomings of such a semi-closed market. The lack of transparency in regulatory processes and inadequate communication and coordination between different regulatory bodies have also contributed to overall low-quality production and poor safety performance in China.

Government-affiliated and state-owned TIC agencies also occupy a favourable position in terms of defining national and industry standards, receiving important science and research projects, and being appointed or recommended as designated laboratories. This leaves international QSS firms at a competitive disadvantage in the areas that are of crucial importance to the Chinese Government. However, the sub-working group is encouraged that in the *Catalogue of Encouraged Industries for Foreign Investment (2019) (Catalogue)*,¹ released jointly by the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) on 30th June 2019, the TIC industry was included for the very first time.

Market Developments in the TIC Industry

The TIC industry continued to grow quickly throughout 2020. According to the SAMR, by the end of the year, 724 TIC agencies had been approved in total; over 2.7 million valid certificates issued to 800,000 organisations; and there were 48,000 testing and inspection market entities with 590 million testing reports issued in total.²

Developments in the Regulatory Environment

On 3rd November 2020, the SAMR issued the revised *Measures for the Administration of Certification Agencies (Measures)*.³ The *Measures* removed a requirement for foreign-invested enterprises (FIEs) to meet additional conditions under the *Regulations on Certification and Accreditation (Regulations)* in

1 *Catalogue of Encouraged Industries for Foreign Investment (2019)*, NDRC & MOFCOM, 30th June 2019, viewed 11th May 2021, <<http://www.mofcom.gov.cn/article/b/f/201906/20190602877005.shtml>>

2 *Report on the National Certification, Accreditation, Testing & Inspection Conference*, CNCA, 28th January 2021, viewed 6th April 2021, <http://www.cnca.gov.cn/rdzt/qgh2021/202101/t20210128_65023.shtml>

3 *Measures for the Administration of Certification Agencies*, SAMR, 3rd November 2020, viewed 6th April 2021, <http://gkml.samr.gov.cn/nsjg/fgs/202011/t20201103_322872.html>





order to qualify as a certification agency.⁴ Shortly afterwards, on 11th December 2020, the State Council issued its *Decision on Amending and Repealing Some Administrative Regulations*,⁵ which removed Article 11 from the *Regulations*. This adjustment removed the extra requirements FIEs had to meet to become a qualified certification agency,⁶ meaning that access to the certification market is now the same for both domestic enterprises and FIEs. The sub-working group welcomes these reform measures.

Key Recommendations

1. Ensure Equal and Fair Treatment in Government Procurement Activities 2

Concern

Certain discriminatory and unreasonable conditions set in government procurement activities exclude foreign-invested TIC agencies from obtaining equal and fair treatment in the process.

Assessment

The Chinese Government is committed to and has achieved notable results in establishing a government procurement system that provides equal and fair treatment for domestic enterprises and FIEs.⁷ Public procurement processes have undergone reform and the scope of procurement activities has been expanded. As a result, more third-party inspection agencies can now participate in government quality sampling and inspection activities. However, since the reform involves multiple parties, overlapping responsibilities between different authorities has become a prominent issue. The imposition of unfair and unreasonable bidding requirements so as to exclude or restrict market competition is also still a major hurdle encountered by FIEs.

Furthermore, in the process of promoting a market-orientated approach to public resource allocation, many current practices are found to conflict with current legislation. These practices are also not in line with China's efforts to join the World Trade Organisation's Agreement on Government Procurement.

Public bidding and competitive negotiation are the two statutory methods of public procurement most commonly adopted by the Chinese authorities. Comparatively speaking, the process of competitive negotiation receives fewer complaints, as this approach relies solely on prices to determine winners and the tender price will eventually be publicly announced. The public bidding process involves a comprehensive scoring method where price accounts for only a portion of the score. Other factors, such as product quality, sales and after-sales services, are also taken into consideration, which can leave the system at risk of manipulation. Specifically, bidding requirements could be established to impede bidders that are otherwise qualified but unable to meet unreasonable procurement rules set in the bidding document.

The Ministry of Finance (MOF) issued a notice on eliminating any practices and regulations that hinder fair competition in the field of government procurement in the interests of:

- furthering the implementation of the *Plan for Deepening the Reform of the Government Procurement Mechanism* and the *Notice by the General Office of the State Council on Focussing on Enterprises' Concerns and Further Promoting the Implementation of Policies to Optimise the Business Environment (Notice)*;^{8,9}
- creating a unified, open, competitive and orderly government procurement market system; promoting fair competition in government procurement; and
- optimising the business environment.¹⁰

The notice calls for the strict implementation of a fair competition review system. After review, regulations

⁴ The requirement: "To obtain the qualification as a certification agency in the People's Republic of China, FIEs shall also meet the conditions under the *Regulations on Certification and Accreditation (Regulations)*", listed in Chapter 2, Article 8 of the 2017 version of the *Measures for the Administration of Certification Agencies (Measures)*, was removed from the 2020 version of the *Measures*. The "other conditions" under the *Regulations* refer to the requirements listed in Article 11 of the *Regulations* (2016 version), as follows: "(1) FIEs shall be recognised by the accreditation body in the targeted country or area; (2) FIEs shall have a minimum of three years of experience in the certification activities. FIEs shall also observe rules in line with the Foreign Investment Law and other relevant administrative and state regulations in order to be qualified for the application, approval and registration as a certification agency."

⁵ *Decision of the State Council on Amending and Repealing Some Administrative Regulations*, State Council, 11th December 2020, viewed 6th April 2021, <http://www.gov.cn/zhengce/content/2020-12/11/content_5568885.htm>

⁶ Ibid.

⁷ *Policy Briefing of the State Council on 29th October 2019*, State Council Information Office, 29th October 2019, viewed 11th May 2021, <<http://www.gov.cn/xinwen/2019zccfh/69/index.htm>>

⁸ *Plan for Deepening the Reform of the Government Procurement Mechanism*, Central Comprehensively Deepening Reforms Commission, 14th November 2018, viewed 11th May 2021, <<http://www.cgpnews.cn/articles/46544>>

⁹ *Notice by the General Office of the State Council on Focussing on Enterprises' Concerns and Further Promoting the Implementation of Policies to Optimise the Business Environment*, General Office of the State Council, 8th November 2018, viewed 11th May 2021, <http://www.gov.cn/zhengce/content/2018-11/08/content_5338451.htm>

¹⁰ *Notice on Promoting Fair Competition in Public Procurement and Optimising the Business Environment*, MOFCOM, 4th December 2019, viewed 11th May 2021, <<http://www.mofcom.gov.cn/article/b/fwzl/201912/20191202919267.shtml>>



considered to not exclude or restrict competition can be published and implemented, while those considered unfair should not be published or must be revised. Those that have not gone through a fair competition review process cannot be published at all.

However, in practice, some local governments still adopt terms or conditions that could be considered to exclude or restrict competition in their bidding documents. For instance, winning factors in the bid scoring include: 1) enterprises' experiences in sampling and inspection services carried out by Administrations for Market Regulation at the national and provincial level; 2) recommendations or awards the agencies have received; and 3) year-end performance reviews. However, sampling and inspection services were opened nationwide to private players only recently.¹¹ Previously, such services had been led solely by government agencies or assumed by public institutions. Therefore, foreign-invested TIC agencies clearly lack the necessary national or regional experience in this field. Additionally, awards, commendations and performance reviews are mostly exclusive to public institutions, which constitutes another invisible barrier for non-public institutions.

The above-mentioned factors have resulted in foreign-invested TIC agencies receiving low scores in bidding activities, leaving them severely disadvantaged in and practically excluded from market competition. This explains the low proportion of foreign-invested TIC agencies engaged in public bids for sampling and inspection services in recent years.

Recommendations

- Regulate government procurement by establishing a fair, transparent, impartial and efficient government procurement management system.
- Set fair and reasonable conditions for government service bidding projects to provide a fair platform for non-public institutions.

¹¹ While some districts began opening up the market since 2013, it was not until in the *Administrative Measures on Food Safety Sampling Inspection*, approved by the SAMR on 30th July 2019 and effective on 1st October 2019, Chapter 3, that Article 11 states that market supervision and administration authorities can conduct sampling either of their own accord or by delegating the task to third-party inspection agencies. This marks the beginning of the sampling and inspection services being officially open to private inspection agencies.

2. Allow Foreign-invested TIC Agencies to Provide Container Inspection Services



Concern

According to the *Regulations Governing Survey of Ships and Offshore Installations (Regulations)*, and several other regulatory documents issued by the Ministry of Transport (MOT) and its governing administration, foreign-invested TIC agencies are restricted from providing container inspection services.¹²

Assessment

Currently, in China, containers are still subject to statutory surveys managed by the MOT and the China Maritime Safety Administration (MSA). The latter delegates the qualification of statutory surveys of containers solely to the China Classification Society (CCS)—a secondary public interest institution—which then subcontracts the work to its subsidiary company, namely the China Classification Society Certification Company (CCSC), authorising it to carry out surveys of containers owned by both domestic and foreign enterprises. Foreign-invested ship inspection agencies are restricted to inspecting only containers owned by foreign businesses, i.e., foreign export containers, through the *Regulations*, the *Notice on Improving the Supervision and Management of Inspections Carried Out by Foreign Ship Survey Agencies in China*, and the *Vessel Inspection Administration Regulation*.^{13&14}

The sub-working group recommends that China open up the container inspection market to ship inspection agencies from all member states signatory to the *International Convention for Safe Containers (Convention)*,¹⁵ and that it authorises foreign-invested TIC agencies to provide survey services for containers owned by Chinese businesses for the following reasons:

¹² *Regulations Governing Survey of Ships and Offshore Installations*, State Council, 2nd March 2019, viewed 11th May 2021, <http://www.gov.cn/gongbao/content/2019/content_5468917.htm>

¹³ *Notice on Improving the Supervision and Management of Inspections Carried Out by Foreign Ship Survey Agencies in China*, pkulaw.cn, 2nd March 2009, viewed 11th May 2021, <http://pkulaw.cn/fulltext_form.aspx?Db=chl&Gid=8492e9f098114d90bdfb>

¹⁴ *Vessel Inspection Administration Regulation*, MOT, 4th February 2016, viewed 11th May 2021, <http://xxgk.mot.gov.cn/jigou/fgs/201602/t20160204_2973409.html>

¹⁵ *International Convention for Safe Containers*, IMO, 6th September 1977, viewed 11th May 2021, <[https://www.imo.org/en/About/Conventions/Pages/International-Convention-for-Safe-Containers-\(CSC\).aspx](https://www.imo.org/en/About/Conventions/Pages/International-Convention-for-Safe-Containers-(CSC).aspx)>





1) To meet the principle of reciprocity

The relevant authorities of European Union (EU) Member States neither restrict Chinese inspection agencies or their inspection companies established in EU countries to inspecting containers owned by non-EU governments, nor do they prohibit them from inspecting containers owned by businesses from EU countries. Therefore, it is recommended that the relevant industry authorities in China follow the principle of reciprocity. The sub-working group also suggests that China should no longer restrict the licensed business scope of inspection agencies in China, which are invested in and established by European classification societies, based on the nationality of container owners.

2) To meet the principle of mutual recognition of the Convention

According to the *Convention*, once an inspection agency obtains the necessary qualification to survey containers from one contracting state, then all contracting states must mutually accept the qualification of the agency in question as well as the inspection process and results it provides. However, such mutual recognition is not observed in the Chinese market, with European enterprises restricted to inspecting only containers owned by foreign businesses. In so doing, China does not recognise the qualifications granted by the governments of the counterpart contracting states and, as such, violates the principle of mutual recognition of the *Convention*. Hence, it is recommended that China, as a contracting state, recognise container inspection services provided by FIEs to Chinese enterprises.

3) To conform to the 'pre-establishment national treatment plus negative list' administrative system

Article 4 of the Foreign Investment Law (FIL) stipulates that the state will apply the 'pre-establishment national treatment plus negative list' administrative system to foreign investments. 'Pre-establishment national treatment' is defined as the obligation to treat foreign investors and their investments no less favourably than domestic investors and their investments at the initial stage of market access; 'negative list' refers to the special administrative measures imposed by the state on foreign investment in specific fields. Meanwhile, foreign investments that are not included in the negative list are entitled to national treatment.¹⁶ According to Article 6 of the *Regulation on the Implementation of*

the Foreign Investment Law, domestic and FIEs shall be treated equally by the authorities according to law with respect to government funding arrangements, land supply, tax reductions, certification, standard-setting, project applications and human resource policies.¹⁷

The inspection of Chinese-owned containers does not appear in the negative list. However, in practice, only Chinese public institutions or their domestic affiliates are permitted to inspect domestic and export containers, regardless of their ownership being domestic or foreign-invested in nature. Ship inspection agencies registered in China and with investors from EU Member States are only allowed to inspect ships owned by foreign businesses, even if the agencies have obtained the qualifications granted by several contracting states to the *Convention*. Any inspection of Chinese containers by such agencies is considered a breach of Chinese regulations and will be penalised. This practice is not in line with the FIL.

4) To avoid monopolistic behaviour, in line with international practices

The statutory inspection of containers is a charged service provided by third parties. The service fees are adjusted in accordance with market prices, and supply and demand, as international practices dictate. In the majority of jurisdictions worldwide, enterprises are at liberty to choose from international classification societies with the qualifications required by the Convention for statutory inspection services for their containers. When administrative measures specify only a single organisation can provide such services, a monopoly can easily result, as this results in a lack of competition and a price adjustment mechanism for inspection fees.

5) To promote the development of the industry and alleviate the burden on enterprises

The implementation of the *Vessel Inspection Administration Regulation* has been impeded by the administrative policy that foreign ship inspection companies cannot carry out surveys of containers owned by Chinese enterprises. For instance, if foreign-invested agencies wish to conduct inspection services on the Chinese tank containers of hazardous cargo used for international shipping, when applying for a

¹⁶ *Foreign Investment Law*, NPC, 15th March 2019, viewed 11th May 2021, <http://www.npc.gov.cn/npc/xinwen/2019-03/15/content_2083532.htm>

¹⁷ *Regulation on the Implementation of Foreign Investment Law*, State Council, 26th December 2019, viewed 11th May 2021, <http://www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm>





testing certificate with the China Classification Society (CCS), they also need to apply separately for an additional certificate. The additional certificate has to be issued by a ship inspection company domiciled in an EU Member State and registered in China, after the same tank containers are tested in accordance with the *European Agreement Concerning the International Carriage of Dangerous Goods by Road*. This enables tank containers to comply with Chinese regulations as well as those of EU Member States.¹⁸ A certificate from a ship inspection company domiciled in an EU country is required for these tank containers because China has yet to become a member of the *European Agreement*; consequently, without the authorisation of EU countries, the CCS cannot issue the corresponding certificate. Therefore, the policy prohibiting EU-domiciled ship inspection agencies in China from inspecting Chinese-owned containers prevents Chinese businesses from receiving the desired services. It also adversely affects China's international shipping business and impedes the advancement of the Belt and Road Initiative (BRI). Moreover, the cost burden is increased, as two inspection agencies are involved in completing a procedure that could otherwise have been completed by one single agency, hence the inspection fees are doubled.

The sub-working group therefore recommends that the relevant Chinese authorities open the container inspection market without delay and abolish the current administrative restriction on foreign-invested ship inspection agencies. Introducing market-orientated operations helps establish a fair, competitive landscape, further optimising China's business environment, and facilitating the overall development of a healthy and orderly container industry.

Recommendation

- Allow foreign-invested TIC agencies to provide container inspection services.

3. Accelerate Market-orientated Reforms of Government-affiliated TIC Agencies and Accelerate the Establishment of a Fair, Open TIC Market System

Concern

The progress of market-orientated reforms of government-

affiliated TIC agencies needs to be accelerated to remove industry barriers.

Assessment

TIC services play a vital role in promoting the sustainable development of entire industries, safeguarding the rights and interests of consumers, and facilitating trade, service market regulation and social governance. Having more world-leading foreign-invested players in the China market is beneficial to end users and consumers as the quality, safety and performance of products will be better guaranteed through the provision of high-quality TIC services. In addition, a market filled with more competent players helps accelerate industry upgrading, since a more precise and comprehensive set of quality evaluation standards can be formed. As a consequence, lower-quality service providers will be effectively supplanted by those with higher standards. According to the CNCA's *Research Report on the Share of the Contribution of the Certification and Accreditation Industry to National Economic and Social Development*, the TIC services industry alone contributed over one per cent of China's gross domestic product (GDP) in 2015 and 2016 respectively. This demonstrates the importance of the industry to the overall development of China's economic growth.

In order to further motivate the TIC industry to facilitate economic and social progress, a more mature system must be developed that is market-orientated, fair and open, and where healthy competition is present among TIC agencies of different natures (i.e., state-owned, private and foreign-invested).

The 13th *Five-year Plan for China's Testing, Inspection-certification and Accreditation Development*, issued in November 2016, proposed the development target of accelerating TIC reforms.¹⁹ It called for the establishment of a fair and open TIC market system, including classifying and reforming state-owned TIC agencies; separating business and commercial, public institutions from the government administrative system, so that the former can operate as companies; simplifying administration, delegating power and breaking down the administrative monopoly and industry barriers, to create a nationally unified, competitive TIC market; and methodically opening the market and exploring ways to

¹⁸ *Vessel Inspection Administration Regulation*, MOT, 4th February 2016, viewed 11th May 2021, <http://xxgk.mot.gov.cn/jigou/fgs/201602/t20160204_2973409.html>

¹⁹ *The 13th Five-year Plan for China's Testing, Inspection-certification and Accreditation Development*, CNCA, 3rd November 2016, viewed 11th May 2021, <http://www.cnca.gov.cn/rdzt/2015/sswzt/zcdt/201612/t20161213_53010.shtml>



implement a 'pre-establishment national treatment plus negative list' administrative system. The sub-working group believes that these measures have stimulated market vitality and accelerated the healthy development of the TIC industry, to help further serve economic and social development in China.

The sub-working group also believes that market-orientated reforms of government-affiliated TIC agencies is still required. Statistics released by the SAMR for the TIC industry in 2019 show that while most domestic TIC agencies are private companies, just over 25 per cent are public institutions.²⁰ In addition, varying degrees of industry monopolies and barriers remain in specific domains, for example, unreasonable and non-transparent market access conditions. If such monopolies and barriers are not removed, or if advanced TIC technologies and experiences are not promptly introduced, it will stifle innovation and competitiveness in China's TIC industry and ultimately impede its development.

Recommendations

- Accelerate market-orientated reform of government-affiliated TIC agencies.
- Reduce excessive and unclear market access barriers and adopt international norms for assessment.
- Provide 'national treatment' to international TIC agencies so that they enjoy equal market status to their domestic peers.

4. Speed up the Marketisation Process of Special Equipment Inspection Services

Concern

The rapid development of China's economy and society has exposed many issues in its TIC industry, including a lack of clarity in terms of accountability, insufficient supply, low productivity and corruption.

Assessment

'Special equipment' is defined as equipment that poses a significant threat to health and safety, such as boilers, pressure vessels (including gas cylinders), pressure pipes, elevators, lifting machinery, passenger ropeways, large-scale amusement facilities and special-purpose motor vehicles. 'Special equipment' is a term unique to

China, as there is no universal standard definition of the concept. Instead, in other countries, special laws and regulations are enacted for a certain group of devices that pose a significant risk to human safety, stipulating articles regarding safety supervision. The list of the items for special supervision is similar to that of China. Testing and inspection for special equipment includes supervision and inspections, periodic inspections, type tests, as well as specific non-destructive testing services.

As of the end of 2020, special equipment across China amounted to 16,484,100 units, including: 355,900 boilers; 4,396,300 pressure vessels; 7,865,500 elevators (ranking first); 2,538,400 units of heavy-lifting machinery; 1,103 passenger ropeways; 24,800 large-scale entertainment facilities; 1,302,100 special-purpose motor vehicles; 179,000,000 gas cylinders; and 1,012,600 kilometres of pressure pipes. China has set up 4,085 supervisory agencies to test and inspect special equipment—one at the national level, 33 provincial, 477 municipal, 2,631 county and 943 district—supported by over 105,000 supervisory personnel. The majority of testing and inspection agencies are government-affiliated institutions tasked with quality supervision, with non-public agencies making up a small proportion of the total.²¹

The public TIC institutions are categorised as either state-funded, partially state-funded or self-funded, the latter two being the dominant forces in the market. By that logic, testing and inspection fees are of a public administrative nature and are charged to organisations that manufacture, install and use special equipment at prices fixed by the price supervision authorities. The revenue from testing and inspection services for special equipment is a significant source of income for government inspection agencies, whose qualifications are granted by the SAMR.

The current model for the testing and inspection of special equipment in China market is problematic in the following ways:

1) Unclear liabilities for different parties

According to Chinese law, special equipment must undergo testing and inspection before being put into use. Manufacturers and users assume the primary

²⁰ 2019 Annual Statistical Results on the Inspection and Testing Services Industry, CNCA, 28th June 2020, viewed on 28th June 2021, <http://www.cnca.gov.cn/xwjj/jgdt/202007/20200714_59399.shtml>

²¹ Notice on the Status of Special Equipment in 2020, SAMR, 15th March 2021, viewed 11th May 2021, <http://gkml.samr.gov.cn/nsjg/tzsbj/202103/t20210315_326902.html>





liability, with government departments assuming supervisory liability and inspection agencies inspection liability. Currently, testing and inspection services for special equipment are mainly carried out by affiliated agencies of administrative supervisory departments, which charge fees and issue inspection reports just like ordinary businesses. This means that government inspection agencies assume a dual identity as both 'referee' and 'player', blurring the line between responsibilities of the government administration and enterprise operations.

2) Prone to corruption

Enterprises are not allowed to choose their inspection agencies due to the 'regional coverage' of the testing and inspection services for special equipment. This means that government agencies have absolute dominance in the industry, which results in insufficient performance improvement and a high degree of exclusiveness. Inadequate supervision can even lead to agencies engaging in the practice of leveraging power for unfair market competition, thus leaving a large margin for corruption in China's TIC industry.

3) Inadequate supply of services

In recent years, the surge in the volume of special equipment in China has led to rapidly-growing demand for testing and inspection services. In response, the authorities have integrated inspection agencies to combine their resources. Although some progress has been made, the primary role of the market in allocating resources is not being fully utilised, given that the authorities still decide which companies will be responsible for inspections. Restricted by the nature of China's public institution system, local government inspection agencies are not staffed to cope with the burgeoning demand for special equipment. This leads to sub-par inspections and quality, which results in high accident rates.

The factors causing the above-mentioned problems are as follows:

1) Lack of competition

Fair competition is the most powerful driving force in upgrading service standards and quality. However, in China, inspection regions for special equipment are designated by market regulators and hence operate individually. Given the monopolistic position held by public institutions and government-affiliated agencies

in these areas, the absence of external pressure from competitive players in the field means that there is little impetus to improving efficiency and service quality.

2) Lack of flexibility in the systems of public institutions

Government-affiliated agencies are highly restricted by the management systems of public institutions with regard to personnel management, pricing, technical research and design (R&D) and equipment investment. As such, these agencies lack the discretion and liberty of deciding their own development path, making it difficult for them to grow as scientific and technical organisations. In addition, they face a contradiction – on one side, they are labelled non-profit, public institutions, while on the other, revenue is one of the indicators for performance appraisal by the local supervision bodies. This dilemma can only be addressed in tandem with the state's reform of public institutions, advancing the TIC industry in a market-orientated direction.

The importance of market-orientated reforms are as follows:

- 1) They help balance the shortfall in the supply of testing and inspection services for special equipment and the general public's ever-growing safety needs. A market-orientated transformation of testing and inspection services can effectively improve their volume, quality and efficiency, thereby addressing safety issues.
- 2) They accelerate changes in government functions and reforms of public institutions. Market-orientated testing and inspection services for special equipment would force public institutions to shift from a self-serving role to a consumer-orientated one. It would also require a large number of public inspection institutions for special equipment in China to be restructured.
- 3) They help stimulate social vitality and promote societal development. Progressing towards market-orientated testing and inspection services for special equipment allows the authorities to 'return' power to the market and society.

Recommendations

- Establish a market competition mechanism and allow enterprises to freely choose inspection agencies for statutory inspections.
- Enhance the diversity of inspection entities to make up for the inadequacy of a single source of supply



from the government and to provide space for non-government-affiliated inspection agencies to grow.

5. Establish the System of Customs Accepting Inspection Results for Imported Bulk Commodities from Third-party Agencies

Concern

While there is an increased demand for inspections, customs inspection talent is in short supply and imbalanced in geographical distribution, which slows down the importation of commodities.

Assessment

As China's economy develops, higher standards of customs supervision and services are required. Customs services have been constantly optimised in recent years, yet Chinese authorities still need to improve the efficiency of customs clearance. Reforms are needed urgently to optimise clearance management, reduce clearance costs and time for import and export enterprises, and enhance supervision efficiency to meet the needs of social development.

On 1st October 2020, the customs authorities implemented the 'release before declaration modification', a significant shift in its inspection and supervision of imported crude oil, which allows cargo to be unloaded while samples are sent for inspection.²² This new model will further optimise the business environment at ports and significantly reduce the clearance time and costs for imported crude oil, thereby facilitating trade. Under the new policy, crude oil is subject to customs inspection and can only be sold or used by enterprises after being issued with a certificate of quality.

While their traditional functions remain unchanged, customs authorities have also been tasked with new functions, posing severe challenges to their limited managerial resources. Although the new policy reduces clearance time, inspection work is still necessary, and a backlog may build up if the volume of bulk imports continues to increase. Accordingly, that would lead to import and export enterprises having to queue up for their inspection results. Thus, allowing third-party inspection agencies access to the market and accepting their inspection results presents an effective solution.

In line with rapid growth of foreign trade and the transformation of government functions, China is stepping up reforms to simplify administration and delegate power, combine decentralisation and management, and optimise public services. In this context, third-party inspection agencies are flourishing, and starting to play an increasingly important role in the quality and safety supervision of imported and exported commodities. According to the *Opinions of the State Council on Improving the Quality Safety Risk Early Warning and Quick Response Regulation System for Imports and Exports and Effectively Protecting Consumer Rights and Interests (State Council Document No. 43 or Guofa [2017] No. 43)*, customs need to accelerate improvements to the management system for accepting inspection results from qualified third-party agencies, to encourage their participation in supervision work. The sub-working group believes that the third-party inspection results will become the primary means to supervise the quality of imported and exported commodities. This practice will also apply to imported bulk resource-based commodities.

The advantages of accepting third-party inspection results are as follows:

1. It provides relief in areas where law enforcement lacks staff and funding

Third-party agencies can be introduced to make up for the lack of enforcement power of the supervisory authorities due to shortages in human resources and funding.

2. It brings the inspection process forward

Reliable third-party agencies can be utilised to ensure that imported commodities maintain the quality and safety standards as in their country of origin by extending inspection services overseas. This can deflect complex problems in overseas law enforcement, for example, relating to the legality of jurisdiction and protection of domestic industries.

3. It enhances the adaptability of law enforcement and supervision

The supervisory authorities tend to lag in adjusting their standards and procedures for law enforcement to meet the evolving needs of commodity quality and safety supervision. Third-party agencies are able to update their inspection criteria and methods to help mitigate authorities' enforcement limitations. As such, they are

²² 'Release before Declaration Modification' Regulation to Speed up the Imported Crude Oil Inspection, GAC, 12th October 2020, viewed 28th June 2021, <<http://www.customs.gov.cn/customs/xwfb34/302425/3313452/index.html>>





better able to respond to emerging crises regarding the quality and safety of commodities.

In the report given by President Xi Jinping at the 19th National Congress of the Communist Party of China (CPC) in 2017, he called for the nation to “transform government functions, innovate regulatory approaches, and further implement reforms to simplify administration and delegate power, and enhance the government's credibility and power of execution”.²³ The Fourth Plenary Session of the 19th Central Committee of the CPC in 2019 further noted the need to “clarify the relationship between the government and the market, and that between the government and society, further implement reforms to simplify administration and delegate powers, combine decentralisation and management, optimise the business environment, and stimulate the vitality of all market entities”.²⁴ In line with this, China's customs authorities should conduct their work from a macro perspective, changing their role from ‘players’ who inspect and supervise to ‘referees’. Meanwhile, the strengths of the market and society should be fully mobilised for TIC. A new model for quality and safety supervision for imported and exported commodities, based on third-party inspection results, should be established step-by-step.

Recommendations

- Accept third-party inspection results concerning the weight and quality of imported bulk, resource-based commodities.
- Open up the market and accept evaluations by all inspection agencies, including foreign-invested, private and state-owned agencies, and grant equal treatment to foreign-invested inspection agencies.

Abbreviations

BRI	Belt and Road Initiative
CCDRC	Central Comprehensively Deepening Reforms Commission
CCS	China Classification Society
CM2025	China Manufacturing 2025
CNCA	Certification and Accreditation Administration of China
CPC	Communist Party of China
EU	European Union
FIE	Foreign-invested Enterprise
FIL	Foreign Investment Law
GAC	General Administration of Customs
IMO	International Maritime Organization
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOT	Ministry of Transport
NDRC	National Development and Reform Commission
NPC	National People's Congress
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

²³ *Xi Jinping's Report at the 19th National Congress of the CPC*, Xinhua, 27th October 2017, viewed 22nd May 2021, <http://www.gov.cn/zhuanti/2017-10/27/content_5234876.htm>

²⁴ *Communique of the Fourth Plenary Session of the 19th Central Committee of the CPC*, Xinhua, 31st October 2019, viewed 22nd May 2021, <http://www.xinhuanet.com/politics/2019-10/31/c_1125178024.htm>





European Chamber
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3

Section Three

Goods

Goods

The Goods section of the *Position Paper* encompasses 11 European Chamber working groups and four sub-working groups:

- Agriculture, Food and Beverage
 - Dairy Industry
 - Food for Special Medical Purpose, and Paediatric Nutrition (two sub-working groups)
- Automotive
- Auto Components
- Cosmetics
- Energy
 - Carbon Market
- Fashion and Leather
- Healthcare Equipment
- Maritime Manufacturing and Industrial Services
- Petrochemicals, Chemicals and Refining
- Pharmaceutical
- Rail

European companies producing goods in, and importing goods into, China ultimately fared much better in 2020 than had originally been expected at the beginning of the year. At that time, European companies in general were extremely pessimistic, with the majority forecasting revenue decreases for the coming year.¹ In fact, although year-on-year revenue was down for European Chamber members overall, 42 per cent of respondents to the *European Business in China Business Confidence Survey 2021* (BCS 2021) reported revenue increases,² which were most pronounced in retail, pharmaceuticals, automotive and machinery.

However, this does not paint a complete picture. Despite the relatively positive financial results, many companies producing goods in, and importing goods into, China continue to face long-standing regulatory issues and market access barriers that prevent them from reaching their potential and contributing fully to the Chinese economy.

European producers of high-end apparel, for example, benefitted from resurgent demand in 2020. With consumers unable to spend on travel due to COVID-19-related restrictions, many indulged in 'revenge spending' on luxury goods instead.³ However, luxury brands report that their rights continue to be infringed by counterfeiters, particularly for those selling online and even more so for those that sell via social media platforms.⁴ The Fashion and Leather Working Group is advocating for the strengthening of intellectual property rights enforcement, and for authorities to ensure that social media platforms fulfil their social and legal responsibilities in this respect.

European companies operating in China's medical devices industry experienced a difficult year. Despite

¹ COVID-19: The Impact on European Business in China, European Union Chamber of Commerce in China, 27th February 2020, viewed 16th June 2021, <<https://www.europeanchamber.com.cn/en/publications-archive/766>>

² *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, <https://www.europeanchamber.com.cn/en/publications-archive/917/Business_Confidence_Survey_2021>

³ Frank, Robert, 'Revenge spending' by the rich could drive luxury recovery, CNBC, 13th May 2020, viewed 17th June 2021, <<https://www.cnbc.com/2020/05/13/revenge-spending-by-the-rich-could-drive-luxury-recovery.html>>

⁴ China's counterfeit sellers flee to social media to hawk their fake goods, Bloomberg News, 16th January 2019, viewed 17th June 2021, <<https://www.digitalcommerce360.com/2019/01/16/chinas-luxury-counterfeit-sellers-flee-to-social-media-to-hawk-their-fake-goods/>>



the extra demand for their products, they were plagued by supply chain disruptions and the global shortage of shipping containers. These companies also continue to miss out on opportunities due to local procurement policies that encourage hospitals to favour domestically-branded products,⁵ and are frequently disadvantaged by procurement practices in China, in which tenders at the local level are often successful based on price alone. The Healthcare Equipment Working Group is concerned that this comes at the expense of product quality and, more worryingly, clinical requirements.

Pharmaceutical companies also continue to face indirect barriers that are costing them business opportunities. Some of this is a result of China's recently-introduced volume-based procurement (VBP) system under which, in order to secure market share, pharmaceutical companies are having to adopt aggressive price-cutting strategies that are eroding their bottom lines. China's drug review and approval processes are also slower for foreign pharmaceutical companies, leading many to miss opportunities as it takes longer for them to bring their products to the Chinese market. While the Pharmaceutical Working Group understands the need to ensure healthcare is as affordable as possible, it is concerned that favouring price over quality will negatively impact clinical outcomes.

The scale of challenges faced by companies often varies across different industries, depending on the level of utility they provide in helping China reach its policy goals as set out in the 14th Five-year Plan,⁶ with the 'dual circulation' strategy as its core.⁷

For example, petrochemicals companies have found themselves increasingly welcome to play a stronger role, as China needs their technological know-how to facilitate the upgrading of its manufacturing industry overall. While they were previously pushed towards forming joint ventures with Chinese partners, several foreign chemical manufacturers have received approval to invest as wholly foreign-owned enterprises. Despite this positive development, some chemical facilities continue to face difficulties related to forced relocation or even closure as a result of environmental protection measures, even though they are fully compliant with environmental regulations. The Petrochemicals, Chemicals and Refining Working Group is continuing to advocate for a more customised approach based on individual entities' actual environmental performance, to reduce costs and eliminate unnecessary disruptions to production.

European automotive companies find themselves in the position of being relatively welcome in China, despite not being in a 'priority' industry. The logic is that while China's consumers maintain strong demand for European automobiles they might as well be manufactured here, so that China can benefit from the resulting employment and tax revenues (including that derived from onshored automotive component suppliers), while increasing competition for domestic manufacturers. As China strives to meet its 2030/2060 carbon neutrality goals,⁸ new energy vehicles (NEVs) represent the future of the automotive industry. The Automotive Working Group is therefore advocating for a fairer and more transparent implementation of related policies to ensure that the NEV industry can develop sustainably.

China's carbon neutrality pledges are also of great relevance to European energy companies, whose

5 Letter of the Department of Finance of Guangdong Province on the Reply to the Proposal No. 20200567, Department of Finance of Guangdong Province, 20th July 2020, viewed 14th April 2021, <http://czt.gd.gov.cn/yjzj/zxwylafwgk/content/post_3049428.html>

6 Two of the cornerstone policies that feature in the 14th Five-year Plan are industrial upgrading, and achieving carbon neutrality by 2060.

7 This dynamic was detailed in the European Chamber's report jointly published with the Mercator Institute for China Studies (MERICS), *Decoupling: Severed Ties and Patchwork Globalisation*. *Decoupling: Severed Ties and Patchwork Globalisation*, European Union Chamber of Commerce in China & MERICS, 14th January 2021, <https://www.europeanchamber.com.cn/en/publications-archive/869/Decoupling_Severed_Ties_and_Patchwork_Globalisation>

8 China is aiming to peak carbon emissions by 2030 and become carbon neutral by 2060. McGrath, Matt, *Climate Change: China aims for 'carbon neutrality by 2060'*, BBC, 22nd September 2020, viewed 16th June 2021, <<https://www.bbc.com/news/science-environment-54256826>>

expertise will be crucial if the 2030/2060 goals are to be met. China cannot achieve its aims by abruptly switching from the use of fossil fuels to renewables, as there are currently neither enough renewable energy sources, nor the capacity to integrate them into China's energy mix at a scale that would make this possible. That is why the Energy Working Group is emphasising the importance of a smooth energy transition. China must slowly wean itself off cheap, highly-polluting coal onto cleaner fuels such as natural gas, before taking the final steps towards fully renewable energy once the necessary capacity and infrastructure has been built.

China's push for carbon neutrality also depends on the refinement of its national emissions trading system (ETS), in order to ensure that it functions fairly and effectively. This is another area where European companies have a great deal of experience they can bring to bear. The Carbon Market Sub-working Group believes a number of improvements are needed in order for the ETS to fulfil its aim. These include ensuring greenhouse gas (GHG) data collected from companies are more reliable and the methods for collecting it more transparent; promoting consistent requirements for GHG data disclosure nationwide; and establishing a regulation on the oversight and compulsory disclosure of information by enterprises, followed by a corresponding incentive and penalty mechanism.

Another important element for China to fulfil its 2060 carbon neutrality pledge will be the decarbonisation of its maritime sector. To illustrate the scale of this challenge, in order for the industry to meet the International Maritime Organization's target of cutting GHG emissions from shipping in half by 2050, economically competitive, zero-emission vessels must be operating on a global scale by 2030. The Maritime Manufacturing and Industrial Services Working Group is therefore advocating for further market opening in the sector in China, to accelerate the decarbonisation process overall, and to introduce competition that can push Chinese companies to further develop and improve their own low-carbon technologies.



Agriculture, Food and Beverage Working Group

Key Recommendations

1. Adopt a Reasonable Monitoring and Regulatory Framework that Contains Clear Targets for Overseas Manufacturers and Importers of Food 🌐 2

- Accept protocols established for the food safety system for all categories of food, and avoid laborious individual exporting country protocol assessments for multiple newly-introduced categories.
- Apply transition periods of two years for the implementation of new requirements and ensure timely processing of registrations.
- Recognise existing food safety management systems established in other countries, increase trust in industry associations and certificates issued by certified bodies, and recognise existing globally established voluntary certification systems.
- Clarify the specific requirements about what importers need to inspect and how inspections need to be carried out.

2. Optimise and Coordinate COVID-19 Testing and Disinfection Measures on Imported Food

- Plan and implement COVID-19 disinfection measures on imported goods based on scientific principles that are aligned among the General Administration of Customs China (GACC) at the central and local levels, as well as with other related authorities like National Health Commission (NHC) and the State Administration for Market Regulation (SAMR), so that food safety and quality is retained in the process.

3. Distribute Responsibilities Proportionately Across the Supply Chain while Implementing the 'Punishment Exemption' Principle where Appropriate, Reasonably Design the Major Punishment System and Establish a Unified National Traceability System 🌐 8

3.1 Distinguish the Responsibilities of Food Producers and Food Business Operators, and Establish a Punishment System that is Reasonable and Based on Specific Principles

- Distinguish and enforce the responsibilities of food producers and food business operators separately.
- Take full account of the subjectivity of senior management of enterprises while penalising individuals responsible for breaches of laws or regulations.
- Abide strictly by the principle of 'matching misbehaviour and penalties' and improve the fairness and consistency of law enforcement in all regions.

3.2 Establish a Unified National Traceability Platform, Legal Framework and Basic Standards to Promote Effective Tracing

- Unify the national platform, regulations and standards for food safety traceability.
- Ensure that tracing entities, products and information are bonded, technologies used are compatible and information is reliable.





3.3 Implement the 'Punishment Exemption' Principle on Agricultural Products and Imported Foods, from Production to Circulation

- Guide local enforcement departments in all regions to actively apply the 'punishment exemption'.
- Include the 'punishment exemption' principle in the upcoming Agricultural Products Quality and Safety Law.
- Clarify that food business operators and food importers can be exempted from punishment if they have taken proper measures to fulfil their compliance responsibilities.

4. Further Relax Foreign Investment Negative List Restrictions in the Seed Industry and Level the Playing Field

- Remove the restrictions on genetically modified (GM) technology and GM seed production.
- Relax further the restrictions on foreign investment in the selection, breeding and production of new crop varieties of wheat and maize.
- Allow foreign investment in rice and soybean breeding and production.

5. Ensure a Transparent, Scientific and Efficient Procedure for Biotechnology Product Evaluation and Approval, and Strengthen the Protection of New Plant Varieties 2

5.1 Accelerate the Approval Procedure for Gene Modified Microorganism (GMM) Feed Additives and GM Agricultural Products

- Establish different approval procedures based on the product safety risk level.
- Simplify the approval requirements and speed up the approval process for feed additive products from GM microorganisms but without living GMMs and recombinant DNA.
- Refer to the EU practice of recognising third-party test reports or delegating independent culture collection organisations for further evaluation instead of depositing GMM strains for feed enzyme production directly to the Ministry of Agriculture and Rural Affairs and then to the institution.
- Establish a clear pathway for the importation of agricultural microbial products.

5.2 Create a Favourable Environment for Innovation in the Seed Sector and Safeguard the Rights and Interests of Seed Breeders by Strengthening Intellectual Property Rights (IPR) Protection for New Plant Varieties

- Create a favourable environment for innovation in the seed sector and safeguard the rights and interests of seed breeders.
- Strengthen the protection of new plant varieties by providing more IPR tools.

6. 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 Pesticides 2

- Strengthen communication with the OECD and its members to support the advancement of China's accession to the OECD framework agreement on pesticides.

7. Optimise the Implementation of the National Nutrition Plan 2017–2030 based on Strong Scientific Evidence and Under the Guidance of the Healthy China 2030 Plan Outline To Better Guide Consumers' Choices 2

- Implement the National Nutrition Plan 2017–2030 based on scientific data and the current



- conditions, especially taking into account the differences among regions.
- Promote education programmes on the role of a healthy diet, appropriate portions and frequency of consumption.
- Coordinate different stakeholders in adopting a more unified framework of front of package labelling (FOP) systems.

8. Optimise the Food Contact Materials (FCMs) and Articles Regulatory Framework



8.1 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 commonly-used additives for FCMs on the positive list in an efficient manner.
- Speed up the registration and approval process of new food-related products.

8.2 Establish Risk Assessment Framework for rPET (recycled Polyethylene terephthalate) in FCMs, and Legalise its Use

- Establish a risk assessment framework and legalise the use of rPET in FCMs in China.

8.3 Update the Technical Requirements for FCMs to Stipulate Limitations of Used Ingredients and Additives in Food-related Products

- Update the technical requirements for FCMs, stipulating limitations for used ingredients and additives in food-related products.

Dairy Industry Sub-working Group

1. Improve Dairy-related National Food Safety Standards

- Better align the development and revision of dairy-related standards with international standards and practices, as well as the reality of domestic and international dairy markets and supply chains.
- Implement the Dairy Products Quality and Safety Improvement Action Plan and related industry policies by encouraging the introduction of group/industry standards instead of national standards.
- Optimise the development and revision of the national food safety standards to provide a more transparent and open channel to all industry players.

2. Optimise the Regulation of Cultures Applied in Dairy Production

- Revise the labelling requirement in the relevant national food safety standards so that only the general name of the 'food culture' needs to be listed on the label instead of all individual cultures, in order to align with international regulations.
- Exempt cultures that have a history of safe use in dairy production from China's current food culture positive list, or expand the list to include certain cultures based on the historical safe use of their application in dairy products, and classify them as permitted ingredients in dairy production as soon as possible.

Food for Special Medical Purpose Sub-working Group and Paediatric Nutrition Sub-working Group

1. Optimise the Registration System for Special Food

- Improve regulations related to the change in registration of Food for Special Medical Purpose





(FSMP) and infant formula recipes, and provide relevant detailed guidelines as early as possible.

- Clarify review and approval requirements for product registration in an open and transparent manner.

2. Continue to Fine-tune National Food Safety Standards Related to Special Food and Ensure the Smooth Transition of Product Registration under New Standards

- Improve national food safety standards for special food to align with the latest scientific research and international standards.
- Introduce additional product categories to the national food safety standards for FSMP and develop comprehensive, technical indicators for relevant products.
- Verify differences among existing testing methods, clarify the scope for each method, develop national testing methods, and clarify detection and quantification limits for liquid and solid FSMP.
- Establish industry standards and improve existing national standards for raw and auxiliary materials used in both infant formula and FSMP products.
- Ensure product re-registrations are carried out in an orderly fashion under the newly revised national food safety standards related to infant formula and FSMP.

3. Encourage the Expansion of FSMP Market Access Channels, Standardise Post-market Supervision and Improve Public FSMP Education 🌐 2

- Simplify general registration for nutritionally complete FSMP.
- Publish educational materials for consumers and encourage local-level governments to educate the public on basic nutrition, to help people understand and recognise FSMP and its correct usage.

4. Explore Alternative Plans for Overseas On-site Inspection to Relieve the Dilemma Faced by Overseas Manufacturers in Infant Formula and FSMP Registration

- Clarify both the “actual needs” to conduct on-site inspections (i.e., specify the criteria to implement an on-site inspection) and the timeline for overseas inspections.
- Explore alternatives to overseas on-site inspections, such as cooperating with overseas authorities, entrusting qualified third-party organisations or considering remote audit to conduct inspections that have been stalled due to the COVID-19 pandemic.
- Ensure overseas onsite inspection are carried out in an orderly fashion under the newly revised national food safety standards related to infant formula.

5. Enhance the Transparency and Consistency of Law Enforcement in the Administration of Special Food, and Facilitate Communication with the Industry 🌐 2

- Provide a pre-review channel for clinical study design, that allows enterprises to discuss study design with registration-review organisations before clinical trials are conducted.
- Improve the openness and transparency of food safety supervision processes, spot-checking and risk monitoring, and discuss these matters sufficiently with the industry.



- Strengthen risk research and assessment based on spot-checking results and monitoring, then classify the findings to avoid unnecessary panic among consumers.

6. 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 companies do not interfere with the promotion of 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.

7. Optimise the Requirements for Clinical Trials of FSMP

7.1 Rationalise the Requirements Imposed 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 those with rare diseases, to ensure the proper use of clinical trial resources and satisfy the needs of special groups.
- Accept the normal diet as a control group, and either the 'before and after' comparison of one patient or the comparison with standard normal growth, instead of mandating parallel controlled clinical trials.
- Specify clearly the FSMP that apply to single group studies.

7.2 Adopt Hierarchical Management to Verify FSMP Clinical Effectiveness

- Waive clinical trials or conduct post-marketing clinical data collection for hypoallergenic formulas for toddlers over one year old.
- Compare the non-inferiority indicators for renal-specific formulas by using before and after comparisons (i.e., single-arm) or the renal-specific formula of an approved overseas product rather than the clinical trials of FSMP.
- Consider the fact that FSMP are only clinical nutritional support products, and design reasonable clinical observation indicators.

Introduction to the Working Group

The Agriculture, Food and Beverage (AFB) Working Group helps connect member companies with the Chinese authorities, in order for the government to better understand what needs to be done to promote food safety, improve market access for European food and beverage companies and promote a healthy diet in China. The working group has over 150 member companies that include importers and exporters, manufacturers, distributors, retailers, catering service providers, specialised testing laboratories and consultancies.

The Agriculture, Food and Beverage Working Group includes three sub-working groups – the Dairy Industry Desk, the Food for Special Medical Purpose (FSMP) Advisory Committee and the Paediatric Nutrition (PN) Desk. The Dairy Industry Desk was originally established in 2014 as the Cheese Industry Desk to promote better market access for European cheese and cheese products. With the regulatory improvement in the cheese sector, members of this group decided to widen the scope and look for further improvement in the entire dairy sector. It now has ten prominent European dairy producers and industry associations as its members. The Food for Special Medical Purpose





Advisory Committee was established in 2016 and has four leading international manufacturers that focus on special nutrition. The Paediatric Nutrition Desk was established in 2009 and currently has 11 international companies as members and four domestic manufacturers as local partners. All three desks represent members' interests and promote dialogue and communication among relevant stakeholders.

Recent Developments

A number of major legislative changes have drawn the attention of the working group and raised questions for the industry in the past year. In April 2021, the General Administration of Customs China (GACC) published the newly updated *Regulations on the Administration of Registration of Overseas Food Manufacturing Enterprises* and the *Measures for the Administration of the Safety of Import and Export Food*.^{1&2} While these regulations may result in quicker import and export processes, working group members have also flagged the potential additional financial burdens and administrative requirements for all companies importing food into China.

In recent years, the State Administration for Market Regulation (SAMR) has been working on the draft *Measures for the Supervision and Administration of Food Labelling*, which overlaps with the revised draft *GB 7718-2011 General Standard for the Labelling of Pre-packaged Foods* from the National Health Commission (NHC). The working group is concerned about the undefined legal hierarchy between these two documents and the contradictory requirements they contain. In the interest of providing clarity to the industry, further alignment between these two documents is needed.

In 2020, discussions on the revision of the Food Safety Law began, in which the working group participated. In 2021, the SAMR is expected to publish six new laws and revise 61 regulations,³ among which several will have a significant impact on the AFB sector. The working group hopes that clear rules will accompany

these regulatory changes, but also that those rules will not impose extra burdens on enterprises.

The European Union (EU)-China bilateral agreement—the first bilateral trade agreement between the two sides—to protect 100 European Geographical Indications (GIs) in China and 100 Chinese GIs in the EU against imitations entered into force in March 2021. Further EU-China exchanges at the technical level in the AFB sector are anticipated under this agreement.

Key Recommendations

1. Adopt a Reasonable Monitoring and Regulatory Framework that Contains Clear Targets for Overseas Manufacturers and Importers of Food

Concern

The *Regulations on the Administration of Registration of Overseas Food Manufacturing Enterprises (Regulations)* leave uncertainties about China's future risk assessment management system and corresponding additional requirements for overseas food manufacturers and government bodies.

Assessment

The list of categories under Article 7 of the *Regulations*, which is normally understood by the industry as high-risk products, has been extended from meat, dairy and aquatic products to a number of additional categories with significant trade volume, including bee products, egg and egg products, edible oil and fat plants, some food grains, nuts and seeds, unroasted coffee beans, industrial products of grain flour, seasonings, special dietary foods and health foods, among others. The risk assessment that led to the establishment of these categories is not clear to the industry, and manufacturers of the products covered may face bureaucratic barriers in meeting the new requirements.

According to the *Regulations*, documents required for categories under Article 7 may need to be issued by the exporting countries' authorities, yet authorities from certain countries do not possess the necessary legal framework to provide certificates for production facilities and to confirm compliance with Chinese standards. At the same time, many countries and industries have long-established food safety certification systems based on voluntary certification by certified bodies,

1 *Regulations on the Administration of Registration of Overseas Food Manufacturing Enterprises*, GACC, 12th April 2021, viewed 27th April 2021, <<http://www.customs.gov.cn/customs/302249/302266/302267/3625372/index.html>>

2 *Measures for the Administration of the Safety of Import and Export Food*, GACC, 12th April 2021, viewed 27th April 2021, <<http://www.customs.gov.cn/customs/302249/2480148/3619657/index.html>>

3 *2021 Legislative Plan*, SAMR, 29th March 2021, viewed 27th April 2021, <http://gkml.samr.gov.cn/nsjg/fgs/202104/t20210401_327476.html>





like the Global Food Safety Initiative, whose technical equivalence with the Hazard Analysis Critical Control Point (HACCP) system has been applied by the Chinese authorities.

Businesses appreciate the introduction of paper and video audits, and hope the potential cost and time benefits are not undermined by limited accessibility. Due to the new high-risk categories under Article 7, and further requirements in the *Regulations* such as registration under Article 9 for non-high-risk categories, the increased workload of authorities may result in registration delays.

Furthermore, the *Measures for the Administration of the Safety of Import and Export Food* requires importers to set up a system to inspect overseas exporters and manufacturers,⁴ but the scope of the required inspection is currently unclear.

Recommendations

- Accept protocols established for the food safety system for all categories of food, and avoid laborious, individual exporting-country protocol assessments for the multiple newly introduced categories.
- Apply a transition period of two years for the implementation of new requirements and ensure timely processing of registrations.
- Recognise existing food safety management systems established in other countries, increase trust in industry associations and certificates issued by certified bodies, and recognise existing globally established voluntary certification systems.
- Clarify the specific requirements relating to what importers need to inspect and how inspections need to be carried out.

2. Optimise and Coordinate COVID-19 Testing and Disinfection Measures on Imported Food

Concern

Some of the local policies related to coronavirus disease 2019 (COVID-19) testing, disinfection and certification of imported food contain measures that duplicate or conflict with those at the central level, which

places a heavy burden on the operations of many food importers in China.

Assessment

Due to the impact of COVID-19, numerous extra requirements were imposed on imported goods. While the necessity to prevent COVID-19 being introduced by imported goods is recognised by all parties in the supply chain, some of the measures taken have led to significant financial losses and the waste of valuable food products that could have been avoided.

The GACC randomly selects batches of imported food, with a focus on chilled and frozen food, for mandatory disinfection by GACC-appointed third parties. However, in several reported cases, these batches were handled unprofessionally and the cold chain storage was interrupted for long periods, which rendered the food unsafe for consumption and necessitated its disposal. Temperature-controlled containers set to 20°C were treated like chilled containers, although they are at the same risk level as ambient transport.⁵ Food transported in temperature-controlled containers that was packed in non-hermetically sealed packaging was required to be treated with chemicals not fit for food contact, which also led to the spoiling of these batches. The impact of disinfection requirements and activities were not tolerated by other relevant authorities like the SAMR and the NHC/ the Centre for Disease Control and Prevention.

In addition, imported food policies related to COVID-19 certificates vary among different regions in China. Many of them either contain duplicated requirements or are inconsistent with the central government policies and guidance.

Recommendation

- Plan and implement COVID-19 disinfection measures on imported goods based on scientific principles that are aligned among the GACC at central and local levels, as well as with other related authorities like the NHC and the SAMR, so that food safety and quality is retained in the process.

⁴ *Measures for the Administration of the Safety of Import and Export Food*, GACC, 12th April 2021, viewed 27th April 2021, <<http://www.customs.gov.cn/customs/302249/2480148/3619657/index.html>>

⁵ Han J, Zhang X, He S, Jia P., *Can the coronavirus disease be transmitted from food? A review of evidence, risks, policies and knowledge gaps*, Environmental Chemistry Letters, October 2020, viewed 5th July 2021, <<https://pubmed.ncbi.nlm.nih.gov/33024427/>>





3. Distribute Responsibilities Proportionately Across the Supply Chain while Implementing the ‘Punishment Exemption’ Principle where Appropriate, Reasonably Design the Major Punishment System and Establish a Unified National Traceability System

3.1 Distinguish the Responsibilities of Food Producers and Food Business Operators, and Establish a Punishment System that is Reasonable and Based on Specific Principles

Concern

Relevant laws and regulations do not clearly define the distinct responsibilities of food producers and food business operators, while implementation of policies and standards is inconsistent across different regions.

Assessment

Food producers (including farming, manufacturing and processing) and food business operators bear different responsibilities in the value chain. However, in many cases, the Food Safety Law and its supporting regulations often regulate the responsibilities and obligations by combining food producers with food operators, resulting in operators often having penalties imposed on them that should be borne by producers. With the implementation of policies and punishment standards also varying among different regions, these challenges become even more severe.

In addition, the senior management of chain retailers are normally not involved in the daily operations of each store. The existing systems of punishment, broad principles and inconsistent policies and enforcement among regions increase the potential compliance, reputational and financial risks for chain retailers and their senior management.

Recommendations

- Distinguish and enforce the responsibilities of food producers and food business operators separately.
- Take full account of the subjectivity of senior management of enterprises while penalising individuals responsible for breaches of laws or regulations.
- Abide strictly by the principle of ‘matching misbehaviour and penalties’ and improve the fairness and consistency of law enforcement in all regions.

3.2 Establish a Unified National Traceability Platform, Legal Framework and Basic Standards to Promote Effective Tracing

Concern

Different government agencies at all levels have set up various food traceability platforms with incompatible technologies and inconsistent standards.

Assessment

Article 42 of the Food Safety Law stipulates that the state shall establish a whole-value-chain food safety traceability system, and food producers and food business operators shall establish relevant policies and implementation practices.⁶ Yet government departments at all levels in different regions have established their own traceability platforms, which are independent of each other. The tracing categories and technologies used are incompatible, which seriously hinders cross-departmental and cross-regional food safety traceability. Effective food safety traceability must integrate all links in the food value chain and requires a uniform platform, regulations and standards. Given the long and complex food safety value chain, it is necessary to ensure that the tracing entities, products and information are bonded, and that platforms are compatible with each other, in order to provide true and reliable information.

Recommendations

- Unify the national platform, regulations and standards for food safety traceability.
- Ensure that tracing entities, products and information are bonded, technologies used are compatible and information gathered is reliable.

3.3 Implement the ‘Punishment Exemption’ Principle on Agricultural Products and Imported Foods, from Production to Circulation

Concern

Although there has been some progress in the application of the ‘punishment exemption’, it is not always enforced in regard to retailers and food importers, nor is it consistently applied across the whole agricultural product value chain.

Assessment

Article 136 of the Food Safety Law lays out the ‘punishment

⁶ Food Safety Law, SAMR, 11th October 2019, viewed 20th April 2021, <http://www.gov.cn/zhengce/2015-04/25/content_2853643.htm>





exemption' principle, under which a food business operator that has implemented its compliance responsibilities could be exempted from punishment.⁷ The working group hopes to see the SAMR, the Ministry of Agriculture and Rural Affairs (MARA), and the GACC refine the guidelines to ensure local authorities correctly implement the 'punishment exemption'. The safety of edible agricultural products falls under the responsibilities of the MARA and the SAMR. The MARA is revising the Agricultural Products Quality and Safety Law, which needs to align with the Food Safety Law in retaining the principle of 'punishment exemption' in order to avoid operators being punished for producers' issues, such as an excess of pesticide residue. The *Regulation on the Administration of Import and Export Food Safety* published by the GACC regulates the responsibilities, obligations and punishment of food producers, importers and business operators, and should be aligned with Article 136 of the Food Safety Law.

Recommendations

- Guide local enforcement departments in all regions to actively apply the 'punishment exemption'.
- Include the 'punishment exemption' principle during revision of Agricultural Products Quality and Safety Law.
- Clarify that food business operators and food importers can be exempted from punishment if they have taken proper measures to fulfil their compliance responsibilities.

4. Further Relax Foreign Investment Negative List Restrictions in the Seed Industry and Level the Playing Field

Concern

The 2020 update of the *Special Administrative Measures for Foreign Investment (Negative List 2020)* still prohibits or restricts foreign investment in seed selection, breeding and production.

Assessment

Although the 2018 *Free Trade Zone Special Administrative Measures on Access to Foreign Investment (FTZ Negative List 2018)* increased foreign equity caps on wheat and maize breeding and seed production from 49 per cent to 66 per cent, neither the *Negative List*

2020 nor the *FTZ Negative List 2020* lifted restrictions with respect to crop breeding and seed production. The *Negative List 2020* and the *FTZ Negative List* still prohibit foreign investment in "genetically modified (GM) varieties breeding and GM seed production." Prohibiting foreign investment in these areas not only limits competition and efficiency but is detrimental to China's goals for innovation and modernisation of the agricultural sector.

Recommendations

- Remove the restrictions on foreign investment in GM technology and GM seed production.
- Relax further the restrictions on foreign investment in the selection, breeding and production of new crop varieties of wheat and maize.
- Allow foreign investment in rice and soybean breeding and production.

5. Ensure a Transparent, Scientific and Efficient Procedure for Biotechnology Product Evaluation and Approval, and Strengthen the Protection of New Plant Varieties

5.1 Accelerate the Approval Procedure for Gene Modified Microorganism (GMM) Feed Additives and GM Agricultural Products

Concern

The approval procedure for GMM feed additives and GM agricultural products is currently inefficient, and there is no pathway for the importation of agricultural microbial products.

Assessment

According to the *Guidance for the Safety Assessment of GMM for Animal Use*,⁸ products derived from the expression products of GMM (such as phytase and antimicrobial peptides) or metabolites, and from inactivated GMM, should pass an intermediate test and environmental release evaluation to qualify for a safety certificate. Feed products produced with a GMM but without living GMMs and recombinant DNA are excluded from the scope of GM food and feed regulation in the EU, but are currently still included in this category in China. They thus need to go through the aforementioned procedure, which is unnecessarily

⁷ Ibid.

⁸ *Guidance for the Safety Assessment of GMM for Animal Use*, Ministry of Agriculture, 3rd Feb 2012, viewed 20th April 2021, <http://www.moa.gov.cn/ztlz/jyqwgz/sbzn/201202/t20120203_2474484.htm>





complex and time-consuming. In addition, a long approval procedure and accompanying uncertainties further impede innovation in the development of new GMM feed additives. The working group recommends differentiating non-GMM-containing products from GMM-containing products, and requiring only the intermediate test for the issuance of safety certificates for the former, in order to shorten the time needed to import these products into the Chinese market.

According to the *Administrative Measures for Safety Assessment of Agricultural Genetically Modified Organisms*, when applying for safety certificates, agricultural GM biological samples and control samples, as well as testing materials and testing methods, must be submitted to the MARA for safety assessment.⁹ The GMM strains need to be deposited with the MARA, and then with a delegated testing institution for verification. This procedure chain may lead to inefficiencies in the evaluation process, slowing down industrial development and innovation. The working group suggests adopting the current EU practice, whereby recognising third-party test reports or delegating an independent culture collection organisation for further evaluation, instead of having GMM strains deposited directly with the MARA. Simplification of the procedure could also improve efficiency throughout the safety assessment process.

Agricultural micro-organisms can help to protect the soil and roots of plants, and restore the vitality of land, thus increasing the production yield. With China striving to achieve carbon neutrality by 2060, agricultural micro-organisms could be a greener solution compared with chemicals in crops cultivation and soil restoration. However, in the importation of agricultural micro-organisms, there is still no clear pathway from the GACC to indicate which category such products should belong to. As a result, many advantageous and innovative products, such as microbial fertilisers and seed inoculants, are unavailable to the Chinese market.

Recommendations

- Establish different approval procedures based on the product safety risk level.
- Simplify the approval requirements and speed up the approval process for feed additive products

from GM microorganisms without living GMMs and recombinant DNA.

- Refer to the EU practice of recognising third-party test reports or delegating independent culture collection organisations for further evaluation instead of depositing GMM strains for feed enzyme production directly with the MARA and then to the institution.
- Establish a clear pathway for the importation of agricultural microbial products.

5.2 Create a Favourable Environment for Innovation in the Seed Sector and Safeguard the Rights and Interests of Seed Breeders by Strengthening Intellectual Property Rights (IPR) Protection for New Plant Varieties

Concern

Problems such as the lack of legislation, the difficulty of enforcing existing laws, the complexity and high cost of litigation, and the vague definitions for infringement and damage compensation are impeding IPR protection of new plant varieties in China.

Assessment

China became the 39th member of the International Union for the Protection of New Varieties of Plants in 1999,¹⁰ yet the text adopted by China does not contain the concept of substantially derived varieties, which means the rights of original breeders cannot be effectively protected.

The absence of this concept intensifies the homogeneity of varieties, which is not conducive to innovation. Introducing additional intellectual property (IP) tools to provide comprehensive innovation protection, and an IP credit system for seed companies, would help better manage IPR related to seed development and enhance plant variety protection enforcement.

The working group also suggests incorporating essentially derived varieties (EDV) into the final version of the *Regulations on the Protection of New Varieties of Plants*,¹¹ establishing technical specifications for the

⁹ *Regulations on the Safety Management of Agricultural Genetically Modified Organisms*, MARA, 22nd December 2017, viewed 20th April 2021, <http://www.moa.gov.cn/ztl/zjqwqg/zcfg/201007/t20100717_1601306.htm>

¹⁰ *China Accedes to UPOV*, Grain, 7th April 1999, viewed 20th April 2021, <<https://www.grain.org/en/article/1900-china-accedes-to-upov>>

¹¹ *Announcement on Further Soliciting Public Opinions on the Revised Draft Regulation of the People's Republic of China on the Protection of New Plant Varieties*, National Forestry and Grassland Administration, 15th May 2019, viewed 21st April 2021, <<https://www.forestry.gov.cn/xpzh/bh/4704/20190515/172838025835329.html>>





determination of EDV as soon as possible, especially for corns; ensuring trade secret protections are applied to germplasm products to protect breeding innovation rights; granting proper patent rights to innovative biotech products that are not individual plant varieties; and introducing molecular detection methods to protect crops from pests and disease.

Recommendations

- Create a favourable environment for innovation in the seed sector and safeguard the rights and interests of seed breeders.
- Strengthen the protection of new plant varieties by providing more IPR tools.

6. 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 🌐 2

Concern

As of 1st November 2017, the MARA stopped accepting OECD Good Laboratory Practice (GLP) reports issued by overseas laboratories for the pesticide registration procedure, which has increased costs for foreign enterprises.

Assessment

On 1st June 2017, China's newly revised *Pesticide Management Regulations* went into effect,¹² with the *Pesticide Registration Administration Measures* released shortly afterwards. 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* are difficult to implement in practice because 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). China is in discussions but has yet to join the Mutual Acceptance of Data (MAD) system of the OECD in the pesticide field.¹³ Consequently, foreign enterprises must now conduct registration tests with a China-based entity, at a cost of Chinese yuan (CNY) 20–30 million

per registration, and face an additional procedure that can stretch out for three to four years. China is now one of the only countries in the world that will not accept data for pesticide registration under the MAD system and which requires all registration tests to be conducted within its territory.

Therefore, before Article 16 of the *Measures for Pesticide Registration Administration* is reinterpreted and the provisions of “signing a mutual recognition agreement with relevant departments of the Chinese Government” implemented, transitional measures need to be taken from the MARA side.

Recommendation

- Strengthen communication with the OECD and its members to support the advancement of China's accession to the OECD framework agreement on pesticide.

7. Optimise the Implementation of the National Nutrition Plan 2017–2030 based on Strong Scientific Evidence and Under the Guidance of the Healthy China 2030 Plan Outline to Better Guide Consumers' Choices 🌐 2

Concern

Current health and wellness policies lack incentives and guidance to encourage enterprises to upgrade their product portfolios to make them healthier, to invest in public education or to engage in responsible marketing.

Assessment

Food and beverage industry players in China are expecting clearer guidance from authorities on the implementation of the *National Nutrition Plan 2017–2030* (*Guoban Fa [2017] No. 60 2017*).¹⁴ The plan advocates for accelerating “transformation of nutrition in food processing, and introduce timely measures to control oil, salt and sugar in processed food”. In April 2018, the National Institute for Nutrition and Health and the Chinese Nutrition Society (CNS) jointly released the *Guidelines for Salt Reduction in Chinese Food Industry*,¹⁵ echoing the requirements contained

12 *Pesticide Management Regulation*, State Council, April 1st 2017, viewed May 22nd 2021, <http://www.gov.cn/zhengce/content/2017-04/01/content_5182681.htm>

13 *Mutual Acceptance of Data (MAD)*, OECD, 2020, viewed 21st April 2021, <<https://www.oecd.org/env/ehs/mutualacceptanceofdatamad.htm>>

14 *Notice from the General Office of the State Council on Issuing the National Nutrition Plan 2017–2030*, State Council, 2017, viewed 21st April 2021, <http://www.gov.cn/zhengce/content/2017-07/13/content_5210134.htm>

15 *China Proposes the First Salt Reduction Strategy for Food Industry*, Xinhua, 19th April 2018, viewed 21st April 2021, <http://www.xinhuanet.com/food/2018-04/19/c_1122705738.htm>





in the National Nutrition Plan 2017–2030. However, the authorities should further consider whether it is necessary to publish similar guidelines for sugar and oil reduction in the food industry so as to tailor-make the policies. Demonising substances such as salt, sugar and oil does not generally lead to a reduction of consumption among the public. Instead, promoting a dietary pattern characterised by the consumption of foods rich in protective compounds is likely to be of more benefit. Limiting portion sizes to cut down overall energy intake would also reduce the risk of unhealthy weight gain. Realising a healthy national diet requires more sophisticated education targeting different groups of people.

The China National Food Industry Association and the CNS both have their own system of group logos indicating certain ingredients and their recommended portion to consumers, though both lean towards reducing salt, oil and sugar use in food. This overlap could lead to confusion for consumers while also causing difficulties for supervision departments. Many countries have their own front-of-package (FOP) labelling systems; however, if China's future FOP system contradicts to a large extent those of most other countries, it might lead to trade barriers.

Recommendations

- Implement the National Nutrition Plan 2017–2030 based on scientific data and the current conditions, especially taking into account the differences among regions.
- Promote education programmes on the role of a healthy diet, appropriate portions and frequency of consumption.
- Coordinate different stakeholders in adopting a more unified framework of FOP systems.

8. Optimise the Food Contact Materials (FCMs) and Articles Regulatory Framework

8.1 Speed up the Approval Process for Registering New Food-related Products and Include all Commonly-used Additives for FCMs on 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)*,

depriving Chinese consumers of new food-related products.

Assessment

The standard GB 9685-2016 entered into effect on 19th October 2017, setting out a clear management model for raw and auxiliary materials through positive lists (FCM White List). For each category of FCM—including plastic, coating, rubber and silica gel—a permitted additives list is provided, with the use of unlisted additives illegal. The NHC has since approved new additives and FCM to satisfy the demands of the industry.¹⁶ However, in 2019, the NHC received 48 applications for new food-related products. At time of writing, none have been approved. The registration of new food-related products usually takes considerable time, which may lead to a significant reduction in inbound trade in terms of both volume and value. Even though GB 9685-2016 took reference from standards and laws of the EU (EU 10/2011),¹⁷ the United States (US) (*Code of Federal Regulations Title 21*)¹⁸ and Germany (*BfR Recommendations on Food Contact Materials*),¹⁹ many essential substances proven safe in FCM used by European industries are not compliant with Chinese regulations.

Recommendations

- Include commonly-used additives for FCMs on the positive list in an efficient manner.
- Speed up the registration and approval process of new food-related products.

8.2 Establish a Risk Assessment Framework for rPET (recycled Polyethylene terephthalate) in FCM, and Legalise its Use

Concern

The industry remains uncertain about the use of rPET in FCM, as it is not included in the FCM White List and no official notice on the legal use of the substance has been issued.

¹⁶ *Crisis Evaluation*, NHC, viewed 20th April 2021, <http://www.nhc.gov.cn/sp/s2909/new_list.shtml>

¹⁷ *Commission Regulation (EU) No 10/2011 of 14th January 2011 on plastic materials and articles intended to come into contact with food*, European Commission, 2021, viewed 5th July 2021, <<https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:012:0001:0089:EN:PDF>>

¹⁸ *Code of Federal Regulations Title 21 database*, US Food and Drug Administration, updated 1st April 2020, viewed 28th June 2021, <<https://www.accessdata.fda.gov/scripts/cdrh/cfdocs/cfCFR/CFRSearch.cfm>>

¹⁹ *Recommendations on Food Contact Materials*, German Federal Institute for Risk Assessment, 2020, viewed 21st April 2021, <https://www.bfr.bund.de/en/bfr_recommendations_on_food_contact_materials-1711.html>





Assessment

Many European countries, as well as the US, permit the use of rPET in FCM, given the high demand for food packaging. The US considers each proposed use of recycled plastic on a case-by-case basis and issues informal advice as to whether the recycling process is expected to produce plastic suitable for FCM. As early as 2012, the European Food Safety Authority (EFSA) authorised six PET recycling processes for up to 100 per cent use in FCM.²⁰ In the working group's opinion, it is important for China to be geared towards international standards and practices in this regard. Permitting the use of rPET in FCM could help clear any confusion over policy when importing food packed in rPET materials, thereby facilitating the international food trade. In addition, rPET use also helps to develop the circular economy and promote environmental awareness in China.

Recommendation

- Establish a risk assessment framework and legalise the use of rPET in FCMs in China.

8.3 Update the Technical Requirements for FCM to Stipulate Limitations of Used Ingredients and Additives in Food-related Products

Concern

Without information on raw and auxiliary materials of FCM, especially with regard to restricted substances and their conditions of use, FCM traders cannot accurately assess their level of compliance.

Assessment

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 FCM buy products from overseas traders instead of overseas manufacturers. In general, FCM traders lack knowledge on product composition in terms of ingredients or additives, a situation that is often compounded by manufacturers actively protecting IP related to product development, manufacturing and processing.

Nevertheless, technical requirement laws and regulations for FCM 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 FCM—can the industry accurately assess the compliance and safety of the materials. However, much of this information is usually considered a trade secret, which further adds to difficulties in analysing risks and complying. Therefore, requiring traders to bear responsibility for accurately assessing FCM safety is unreasonable.

Recommendation

- Update the technical requirements for FCM, stipulating limitations for used ingredients and additives in food-related products.

Abbreviations

AFB	Agriculture, Food and Beverage
CNS	Chinese Nutrition Society
CNY	Chinese Yuan
COVID-19	Coronavirus Disease 2019
EDV	Essentially Derived Varieties
EFSA	European Food Safety Authority
EU	European Union
FCM	Food Contact Materials
FOP	Front of Package
GACC	General Administration of Customs
GB	<i>Guobiao</i> or Chinese national standard
GI	Geographical Indication
GLP	Good Laboratory Practice
GM	Genetically Modified
GMM	Genetically Modified Micro-organism
MAD	Mutual Acceptance of Data
MARA	Ministry of Agriculture and Rural Affairs
MOA	Ministry of Agriculture
NHC	National Health Commission
OECD	Organisation for Economic Cooperation and Development
R&D	Research and Development
rPET	Recycled Polyethylene Terephthalate
SAMR	State Administration for Market Regulation
US	United States

²⁰ EFSA Authorizes Six PET Recycling Processes for up to 100% Use in Food Contact Materials, Food Packaging Forum, 6th December 2012, viewed 17th April 2021, <<https://www.foodpackagingforum.org/news/efsa-authorizes-six-petrecycling-processes-for-up-to-100-use-in-food-contact-materials>>





Dairy Industry Sub-working Group

Introduction to the Sub-working Group

Dairy products are important sources of protein, iodine, calcium and several other vitamins. Dairy consumption in China continues to grow, and the industry is undergoing rapid development and modernisation. Currently, Europe is the leading dairy supplier for the Chinese market, accounting for almost half of all imports.

The European Chamber's Dairy Industry Sub-working Group, originally the Cheese Industry Desk, was established in 2014 and has nine prominent European dairy producers and industry associations that are committed to bringing the best dairy products to the Chinese market.

The sub-working group represents members' interests and promotes constructive dialogue between relevant stakeholders, including industry associations and regulators, to ensure a level playing field for all market participants.

Recent Developments

Over the past year, dairy imports have faced severe challenges as a result of the global COVID-19 outbreak and China's epidemic prevention and control policies. Due to the special characteristics of some dairy products and raw materials, the working group is concerned that COVID-19 tests and disinfection requirements increase the risk of cross-contamination and cause damage to some products, resulting in a waste of resources.

At the same time, 2020 saw China's demand for dairy products achieve its highest growth in fifteen years.¹ Part of this is a result of continuing urbanisation advances and rising income levels. However, the supply/demand ratio of domestic raw milk is chronically tight, the price of raw milk in China is very high and, as manufacturers in China often source low-priced raw materials, the price gap between domestic raw

materials and international raw materials widened further over the past year.²

Because China's demand for dairy products is growing while the production capacity of its domestic dairy industry remains limited, there is a great need for imported dairy products, particularly milk powder, cheese, butter, cream and whey powder. In 2020, China's total imports of dairy products reached 3.28 million tonnes, representing a growth rate of 10.4 per cent year-on-year, with a value of United States dollars (USD) 11.7 billion. Solid dairy products accounted for more than 67 per cent of imports, representing a year-on-year growth rate of 7.8 per cent.³

The European Union (EU)-China Agreement on the Protection and Cooperation of Geographical Indications (GI) (EU-China GI Agreement) was finally signed in September 2020—after 22 rounds of official negotiations since 2011—and came into force on 1st March 2021⁴. Included among the first 200 GI products mutually recognised by China and Europe were 14 cheese products. This was extremely welcome news to the EU dairy industry, which expects the implementation of the agreement to provide fresh impetus for cooperation and exchange with the Chinese dairy industry.

The regulations and standards for dairy products are among the strictest in China's food industry, with the Chinese authorities imposing very stringent supervision standards and a high sampling frequency. The qualified rate of sampling of dairy products has remained above 99 per cent for many years. In December 2020, the State Administration for Market Regulation (SAMR) issued the *Dairy Products Quality and Safety Improvement Action Plan*,⁵ which is aimed at further strengthening dairy product regulations and standards,

¹ *Consumer demand for dairy products grew at its fastest pace in 15 years*, *Economic Daily*, 22nd March 2021, viewed 27th April 2021, <<https://www.cfsn.cn/front/web/site.newshow?hyid=3&newsid=49029>>

² *2020 Review and 2021 Outlook of China Dairy Industry*, China Dairy Industry Association, 31st March 2021, viewed 27th April 2021, <https://mp.weixin.qq.com/s/9FYQryzsscmDHV_ZJDsGvw>

³ *China Dairy Trade Monthly Report of January 2021*, National Dairy Industry, Technology and Economy Research Office, 28th January 2021, viewed 27th April 2021, <<https://mp.weixin.qq.com/s/CJwAABLoxpDSBSIM1uoBsA>>

⁴ *EU-China Agreement on Geographical Indications to Take Effect in March*, *Xinhuanet*, 1st March 2021, viewed 20th May 2021, <http://www.gov.cn/xinwen/2021-03/01/content_5589472.htm>

⁵ *Dairy Products Quality and Safety Improvement Action Plan*, SAMR, 30th December 2020, viewed 27th April 2021, <http://gkml.samr.gov.cn/nsjg/spscs/202012/t20201230_324821.html#>





as well as dairy product sampling and risk monitoring. Imported dairy product manufacturers expect that, before this action plan is implemented, broader industry feedback will be taken into consideration and international experience and regulations used as reference.

Several national food safety standards related to dairy products are also currently under revision. Between 2015 and 2017, the former National Health and Family Planning Commission (NHFPC)—now the National Health Commission (NHC)—announced the initiation of revisions to a series of national food safety standards related to dairy products, including: *National Food Safety Standard Raw Milk (GB 19301-2010)*;⁶ *National Food Safety Standard Pasteurised Milk (GB 19645-2010)*;⁷ *National Food Safety Standard Sterilised Milk (GB 25190-2010)*;⁸ *National Food Safety Standard Fermented Milk (GB 19302-2010)*;⁹ *National Food Safety Standard Milk Powder (GB 19644-2010)*;¹⁰ *National Food Safety Standard Condensed Milk (GB 13102-2010)*;¹¹ *National Food Safety Standard Cream, Butter and Anhydrous Cream (GB 19646-2010)*;¹² *National Food Safety Standard Whey Powder and Whey Protein Powder (GB 11674-2010)*;¹³ *National Food Safety Standard Cheese (GB 5420-2010)*;¹⁴ *National Food Safety Standard Prepared Milk (GB 25191-2010)*;¹⁵ *National Food Safety Standard*

Processed Cheese (GB 25192-2010);¹⁶ *National Food Safety Standard Lactose (GB 25595-2010)*;¹⁷ and *National Food Safety Standard Good Manufacturing Practice for Dairy Products (GB 12693-2010)*.¹⁸

In March 2021, after five years of revision, the NHC published the modified standard on cheese *GB 5420*, which will take effect in November 2021. The Dairy Industry Sub-working Group actively participated in the revision of this standard by assisting in research, participating in discussions with the authorities and providing industry opinions. The newly-revised standard includes updates on its overall scope, terms and definitions, sensation requirements and microbial limitations. Of particular note, the limits on yeasts and moulds have been removed. The revision is very much welcomed by the European dairy industry. The new standard not only fully guarantees the safety of cheese products, but also enables more high-quality cheese varieties that have a long and safe consumption history in the European market to enter the Chinese market.

The other, previously-mentioned dairy standards are still in the process of revision, organised by the NHC's National Food Safety Standards Review Committee. The sub-working group has submitted comments on many of them and expects subsequent revisions to be based on existing scientific evidence. At the same time, the sub-working group hopes the barriers currently hindering the import of certain European dairy products and the development of China's domestic dairy industry can be further removed.

In September 2017, the importation of certain types of European cheeses that use particular types of cultures (such as *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 former Cheese Industry Sub-working Group and has been discussed, in detail,

6 *National Food Safety Standard Raw Milk (GB 19301-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/6DEFF20C-AEBD-49D3-8C35-C9B086A0F44B.html>>

7 *National Food Safety Standard Pasteurised Milk (GB 19645-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/BB832452-5017-4EA8-AD06-A6F1557A423D.html>>

8 *National Food Safety Standard Sterilised Milk (GB 25190-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/69F95D12-21FC-46D0-BA60-0D8802593A1A.html>>

9 *National Food Safety Standard Fermented Milk (GB 19302-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/849A1775-3D0A-4674-BCE4-3253BE5531CB.html>>

10 *National Food Safety Standard Milk Powder (GB 19644-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/EF931D82-DF12-4CF5-B123-5D1B099D887E.html>>

11 *National Food Safety Standard Condensed Milk (GB 13102-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/7904104F-3CD8-4F31-9C38-0FD3CCE3574B.html>>

12 *National Food Safety Standard Cream, Butter and Anhydrous Cream (GB 19646-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/6818B3FF-4E2C-400B-AF62-D7BE3CF7FE3A.html>>

13 *National Food Safety Standard Whey Powder and Whey Protein Powder (GB 11674-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/806A934C-35AA-44F6-8BE5-110A11B2B4D7.html>>

14 *National Food Safety Standard Cheese (GB 5420-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/02EF5257-E9E3-472C-8382-02E6372DADF8.html>>

15 *National Food Safety Standard Prepared Milk (GB 25191-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/EA77F1FA-3775-46D3-83C4-C845AD564355.html>>

16 *National Food Safety Standard Processed Cheese (GB 25192-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/530CCB86-FD78-41DD-A6B0-DFA00861BF2E.html>>

17 *National Food Safety Standard Processed Lactose (GB 25595-2010)*, NHFPC, 21st December 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/3885AFC7-00A0-40EC-98C1-38E88900BD6E.html>>

18 *National Food Safety Standard Good Manufacturing Practice for Dairy Products (GB 12693-2010)*, NHFPC, 26th March 2010, viewed 14th May 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/3A0055A3-DAFA-4D30-BC81-73DF14E8D029.html>>





in its past six position papers. After holding extensive discussions with the relevant government authorities, the *Codex Alimentarius*—a collection of internationally-recognised standards relating to food safety—was employed by China in 2017 as a frame of reference to address the regulations relating to the use of cultures in cheese production. This action was welcomed by the dairy industry.

The former NHFPC started work in 2016 on the development of the *National Food Safety Standard for Microbial Food Cultures*. In 2019, the Centre of Food Safety Risk Assessment (CFSA) launched the revision of the *List of Cultures Applied in Food*, potentially leading to more cultures being evaluated and included in the list. Also, according to the latest draft of GB 7718 *National Food Safety Standard General Labelling Rules for Pre-packaged Food*, the general name of 'fermentation strains' can be listed on the label instead of individual culture names. The dairy industry is encouraged by this trend of China further optimising its standards and aligning them with international regulations.

It is important for regulatory barriers to continue to be reduced and for the development of the dairy industry to be facilitated, in line with the Chinese Government's position on promoting trade liberalisation and economic globalisation. As dairy products are well-recognised as nutritional foods, the development of the industry would 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 2030,¹⁹ and the National Nutrition Plan 2017–2030.²⁰

The Chinese Government intends to enhance its technical competence with respect to dairy industry regulation in order to ensure the safety of dairy products in China. The Dairy Industry Sub-working Group expects that the formulation and revision of the national food safety standards for dairy products will be compatible with related international standards and manufacturing conditions, while maintaining a high level of food safety. As market demand for dairy products 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. Improve Dairy-related National Food Safety Standards

Concern

As current revisions to China's dairy-related standards sometimes do not take into account the reality of domestic and international markets and supply chains, many dairy products that have a long history of safe consumption in global markets are, and will continue to be, unable to meet the required standards, which may hinder innovation in China's dairy sector.

Assessment

According to the Food Safety Law, food safety standards aim to protect the public health, and the formulation of national food safety standards should be based on the results of risk assessments. The law states that relevant international standards and international food safety risk assessment results should be referenced, and the draft should be opened to food producers, traders, consumers and relevant departments for public consultation.²¹

The current national food safety standards related to dairy products were formulated and released in 2010. Over the past ten years, innovation in technology for dairy production has increased, and product categories have become more rich and varied. Meanwhile the Chinese dairy market has become more internationalised. The conflict between the current national food safety standards for dairy products and the development status of the international and domestic dairy markets is a problem that needs to be urgently solved through the revision of the relevant standards.

For example, the definition of 'processed cheese' and the testing methods for phosphates are the main industry concerns with regard to GB 25192-2010. In the draft for public consultation of GB 25192, released on 31st August 2020, the melting salt—which is required for production and features in the current standard—has

¹⁹ *Outline of Healthy China 2030*, State Council, 25th October 2016, viewed 16th April 2021, <http://www.gov.cn/xinwen/2016-10/25/content_5124174.htm>

²⁰ *National Nutrition Plan (2017-2030)*, State Council, 30th June 2017, viewed 16th April 2021, <http://www.gov.cn/zhengce/content/2017-07/13/content_5210134.htm>

²¹ Food Safety Law, National People's Congress, 24th April 2015, viewed 16th April 2021, <http://www.npc.gov.cn/wxzl/gongbao/2015-07/03/content_1942866.htm>





been removed from the definition of 'processed cheese', bringing the definition better in line with international standards and products. However, in the same draft, the proportion of cheese used as the main raw material was adjusted from more than 15 per cent to more than 50 per cent, and a new category of 'cheese products' (in which the proportion of cheese used is less than 50 per cent and more than 15 per cent) was added. This classification does not conform to international standards and industry practices, or reflect the wide variety of processed cheese marketed worldwide. The move may result in some popular processed cheese products not being classified as 'processed cheese' but 'cheese products' instead, thus impeding product innovation. For instance, some spreadable processed cheeses that have a high water content and other raw materials added to enrich the texture and taste may not meet the 50 per cent cheese content requirement. Moreover, there is no clear way to accurately gauge the cheese content in processed cheese products, which may lead to difficulties for both enterprises' implementation and the government's administration.

Additional problems with national food safety standards related to dairy products include the mixing of safety standards with quality standards, and the influence of industrial policies on the revision of mandatory standards.

For example, the industry learned that in the latest revision to the draft standard GB 19644, the definition of 'modified milk powder' was changed so that the main ingredient should contain no less than 70 per cent milk solids, and that 'main ingredients' must be limited to processed products produced from raw milk and/or whole milk (or skimmed or partially skimmed) derived from a single variety. The modification of this definition aims to improve the overall quality level of milk powder products, but, at the same time, it will require large-scale adjustments to existing mixed milk powder products on the market, resulting in fluctuations of the raw material market. This deviates from the fundamental objective of the revision of national food safety standards, which is to ensure food safety and public health.

Due to China's limited cultivated areas for raising dairy cattle, inadequate feeding technology, climate conditions and other reasons, the domestic supply of high-quality milk is insufficient to meet demand, so

imported dairy ingredients and products are necessary supplements. In order to meet the increasingly diversified demands of domestic consumers and to provide high-quality, reasonably-priced products for domestic consumption, the Dairy Industry Sub-working Group recommends that the development status of the domestic and international dairy industries and the objective situation of Chinese and global supply chains should be fully taken into account when formulating policies and standards.

In terms of industrial policies related to improving the quality of dairy products and encouraging the use of fresh milk to produce dairy products, the sub-working group recommends encouraging the creation of industry standards and group standards to guide enterprises to develop higher quality products, rather than mandatory national food safety standards. It further recommends taking a holistic approach to promoting the sustainable development of China's dairy industry, based on the concept of globalisation.

Recommendations

- Better align the development and revision of dairy-related standards with international standards and practices, as well as the reality of domestic and international dairy markets and supply chains.
- Implement the Dairy Products Quality and Safety Improvement Action Plan and related industry policies by encouraging the introduction of group/industry standards instead of national standards.
- Optimise the development and revision of the national food safety standards to provide a more transparent and open channel to all industry players.

2. Optimise the Regulation of Cultures Applied in Dairy Production 6

Concern

Many cultures traditionally used in European dairy production 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 only 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*.²² It included a 'positive' list that recognised only 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. This means that only 17 cultures have been added in ten years. Cultures other than the 38 listed and those used in Chinese traditional foods are not permitted for use in food production until they are approved in a safety review conducted by the NHC. However, the review process is made almost impossible for producers of cultures used in dairy products, as it requires information that is very difficult to obtain—such as the toxicological assessment of a certain culture, which is very time- and resource-consuming—thereby hindering the development of the Chinese dairy industry, especially the cheese sector. Furthermore, the review process itself is labour-intensive, which is an unnecessary cost, as these cultures have a long history of safe usage in a wide variety of European dairy products.

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. 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.²³ 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) list of notified microbial cultures is a record of all microbial cultures the DVFA has been notified of, and can be expanded if culture manufacturers provide more information. Safety documentation is not precluded in the notification process: the DVFA does not approve microbial cultures before they are used, but safe use history and safety risks are evaluated before a culture is included on the list. In European countries, cultures are considered ingredients and must satisfy legal safety requirements, with the responsibility for their safety lying with manufacturers. Related regulations state that manufacturers shall only use cultures that have a history of safe use.

The contributions certain microbes have made to cheese have been widely recognised, and pure microbial cultures are commonly used by dairy makers. In addition to lactic acid bacterial starter cultures, various species of bacteria and fungi can be added to dairy products to give them 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; and the actinomycete bacterium *Brevibacterium linens* (*B. linens*) contribute to the reddish-orange colour found in the traditional cheese Epoisses. Dairy makers have learned over centuries how to consistently cultivate specific microbial colonies by manipulating the conditions that a dairy product is subjected to during the ageing process. Recognising the historical safe use of cultures applied in cheese will help promote the industry in China and allow Chinese customers to enjoy a wider variety of dairy products.

Recommendations

- Revise the labelling requirement in the relevant national food safety standards so that only the general name of the 'food culture' needs to be listed

²² Notice of MOH Office on Issuing the List of Cultures Applied in Food, NHC, 28th April 2020, viewed 10th April 2021, <www.nhc.gov.cn/sps/s3593/201004/65839d2d57554dd29ae40a52dca92c74.shtml>

²³ Bourdichon, F., Casaregola, S., Farrokh, C., Frisvad, J. C., Gerds, M. L., Hammes, W.P., & Powell, I. B., *Food fermentations: microorganisms with technological beneficial use*, *International Journal of Food Microbiology*, vol.154, no.3, pp. 87–97, 15th March 2012, viewed 10th April 2021.





on the label instead of all individual cultures, in order to align with international regulations.

- Exempt cultures that have a history of safe use in dairy production from China's current food culture positive list, or expand the list to include certain cultures based on the historical safe use of their application in dairy products, and classify them as permitted ingredients in dairy production as soon as possible.

Abbreviations

CFSA	Centre of Food Safety Risk Assessment
DVFA	Danish Veterinary and Food Administration
EU	European Union
GI	Geographical Indications
IDF	International Dairy Federation
NHC	National Health Commission
NHFPC	National Health and Family Planning Commission
MOH	Ministry of Health
SAMR	State Administration for Market Regulation
USD	United States Dollars





Food for Special Medical Purpose Sub-working Group and Paediatric Nutrition Sub-working Group

Introduction to the Sub-working Group

People who have particular physical or physiological conditions and/or specific diseases and disorders may need foods that are specially processed or formulated to satisfy particular dietary requirements. Such foods include food for special medical purpose (FSMP) and infant and young children formula food (infant formula).

The FSMP industry tries to 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 Food for Special Medical Purpose 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 performances in the domestic FSMP market by introducing advanced products, and are committed to FSMP industry growth in China.

While breast milk provides the most ideal nutrition for babies, a small number of mothers are unable to breastfeed because of medical or other reasons. Infant formula provides nutrients for the growth and development of infants who cannot be breastfed. The European Chamber's Paediatric Nutrition Sub-working Group was established in 2009, and currently has eleven international companies as members and four domestic manufacturers as local partners. Members and partners of the sub-working group include major manufacturers of infant formula that are active in China, and their expertise is widely recognised by Chinese consumers. They are known for providing high-quality paediatric nutrition products that meet consumer needs.

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 fall under the European Chamber's Agriculture, Food and Beverage Working Group. All groups 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. The two sub-working groups strive to promote dialogue and communication among all relevant stakeholders, including with industry associations and regulators. Both are 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

By May 2021, a total of 71 FSMP products and 1,327 infant formulas had been approved for recipe registration in China (while 36 infant formula recipes having been cancelled). The rate of registration of infant formula dropped dramatically since 2018, and the rate of registration of FSMP has stagnated somewhat over the same period, as can be seen in Table 1.

Table 1

Year	FSMP registrations	Infant formula registrations
2017	3	952
2018	18	243
2019	22	80
2020	14	40
2021 (till May)	14	12

Meanwhile, intensive regulatory and standard changes have had a significant impact on the operation and management of FSMP and the recipe registration of infant formula:

- Jinan Municipal Health Commission issued the *Standards for Clinical Nutritional Diagnosis and Treatment in Jinan* and *Jinan Administrative Measures for Formula FSMP* on 14th October 2020.¹
- Jiangsu Administration for Market Regulation (AMR)

¹ Notice on Enhanced Development of Clinical Nutrition Departments in Medical Institutions and Promoting the Reasonable Use of Formula FSMP, Jinan Municipal Health Commission, 14th October 2020, viewed 1st April 2021, <http://jnmhc.jinan.gov.cn/art/2020/10/14/art_14408_4760432.html>





issued the *Jiangsu Administrative Measures for the Registration of FSMP (Trial)* on 30th December 2020.²

- The Shanghai Administration for Market Regulation issued a notice to further regulate the management of formula FSMP in medical institutions on 16th January 2021.³
- The National Health Committee (NHC) and the State Administration for Market Regulation (SAMR) issued the *National Food Safety Standard – Infant Formula* ((GB 10765-2021), *National Food Safety Standard – Older Infant Formula* (GB 10766-2021), and *National Food Safety Standards – Young Children Formula* (GB 10767-2021) on 18th March 2021.⁴
- The SAMR issued the *Announcement on Matters Concerning the Formula Registration of Infants and Young Children Formula Milk Powder Product* on 23rd March 2021.⁵

Key Recommendations

1. Optimise the Registration System for Special Food 🍽️ 5

Concern

The requirements and procedures for infant formula and FSMP registration and subsequent supervision are uncoordinated and administratively demanding.

Assessment

Product or recipe modification

Infant formula and FSMP manufacturers sometimes need to change recipes that have already been registered to adapt to the needs of targeted consumers.

However, the *Administrative Measures for the Registration of Food for Special Medical Purpose* and other relevant regulations are ambiguous and unclear with respect to registration updates. The *Items and Requirements*

on *Application Materials for FSMP Registration (Trial) (Revised Edition 2017)* specifies that, "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".⁶ This overly simple wording does not serve as practical guidance and requires further clarification.

The sub-working groups therefore recommends promulgating regulations or guidelines for implementing recipe changes of infant formula and FSMP that contain clear evaluation principles and data requirements for recipe upgrades, so that enterprises can develop new formulas accordingly.

Differences in formulas

China's current registration review on FSMP recipes requires significant differences among the respective formulas of similar products submitted by the same applicant for registration purposes. However, the criteria on such differences in formula are not published in any official guidelines and are only communicated to applicants verbally. FSMP encompasses food types processed and developed to meet the specific nutritional needs of people with dietary restrictions, digestion and absorption disorders, metabolic disorders or certain diseases. In actual clinical use, these products are already diversified based on individual patient needs and their different medical conditions. As a result, it is essential to introduce a greater variety of safe and high-quality FSMP into the Chinese market to meet the various needs of patients and clinicians. The sub-working group also believes that a greater variety of safe, high-quality FSMP would contribute to the development of China's special food industry, paving the way for the delivery of highly personalised products and services. For enterprises to better develop their products and apply for registration with less uncertainty, the criteria on difference in formulas need to be clarified and published officially.

Onsite verification of clinical trials

According to existing regulations, there are 13 kinds of diseases for which nutritionally complete FSMP

2 *Jiangsu Administrative Measures for the Registration of FSMP (Trial)*, Jiangsu AMR, 30th December 2020, viewed 1st April 2021, <http://scjgj.jiangsu.gov.cn/art/2020/12/30/art_78964_9619567.html?tdsourcetag=s_pcqq_aiomsg>

3 *Notice of the Shanghai Health Commission on Further Regulating the Management of Formula FSMP in Medical Institutions*, Shanghai AMR, 16th January 2021, viewed 1st April 2021, <<http://scjgj.sh.gov.cn/209/20210118/2c9bf2f6770081e001771442be5d0d6d.html>>

4 *Notice on the Issuance of 50 National Food Safety Standards and 4 Amendments Including National Food Safety Standard-Cheese* (GB 5420-2021), NHC, 18th March 2021, viewed 1st April 2021, <<http://www.nhc.gov.cn/sp/s7891/202103/0bdb6c4318724644b40e3f3f894aa88f.shtml>>

5 *Announcement on Matters Concerning the Formula Registration of Infants and Young Children Formula Milk Powder Product*, SAMR, March 23rd 2021, viewed April 20th 2021, <http://gkml.samr.gov.cn/nsjg/tssps/202103/t20210324_327214.html>

6 *Application Materials and Requirements for FSMP Registration (Trial)* (Revised in 2017), SAMR, 11th March 2019, viewed 20th April 2021, <http://www.samr.gov.cn/tssps/tzgg/zjwh/201903/t20190311_291856.html>





must undergo clinical trials based on actual needs, before being verified upon completion of the trials. However, it remains unclear 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 is urgently needed to provide guidance on the process and improve trial quality.

Recommendations

- Improve regulations related to the change in registration of FSMP and infant formula recipes, and provide relevant detailed guidelines as early as possible.
- Clarify review and approval requirements for product registration in an open and transparent manner.

2. Continue to Fine-tune National Food Safety Standards Related to Special Food to Ensure the Smooth Transition of Product Registration under New Standards

Concern

The current development/revision of national food safety standards for special foods is too slow and does not meet enterprises' needs in terms of product innovation, while product re-registration under the newly revised national standards related to special food, such as infant formula, brings a number of challenges to enterprises' operations.

Assessment

FSMP

The *National Food Safety Standard General Principles for Infant Formula for Special Medical Purpose (GB 25596-2010)* was released in 2010,⁷ and the *National Food Safety Standard General Principles for Food for Special Medical Purpose (GB 29922-2013)* was released in 2013,⁸ both of which are currently under revision. Disease-specific FSMP encompasses 13 product categories, and nutrient-incomplete FSMP consists of five product categories, for which standards need to be issued as soon as possible to guide product R&D and production, thus meeting market needs.

7 *National Food Safety Standard General Principles for Food for Special Medical Purposes (GB 25596-2010)*, former National Health and Family Planning Commission (NHFP), 21st December 2010, viewed 20th April 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/236F9F58-107D-4D26-8461-647C1270D99F.html>>

8 *National Food Safety Standard-General Principles for FSMP (GB 29922-2013)*, former NHFP, 26th December 2013, viewed 20th April 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/EC073419-CC4C-463E-9BA2-8372D034396C.html>>

Infant complementary foods

Chinese complementary food products for infants currently follow the *National Food Safety Standard of Cereal-based Complementary Foods for Infant and Young Children (GB 10769-2010)* and the *National Food Safety Standard of Canned Complementary Foods for Infant and Young Children (GB 10770-2010)*.^{9&10} These standards were issued in 2010, and revisions to both started in March 2018. In the revision of *GB 10769*, an upper limit is set for basic and optional nutritional indicators. In view of the characteristics of production processes of cereal-based food supplements and the instability of detection methods for nutrients, it is suggested to relax the set upper limit value and to finish the revision of the standard as soon as possible. On the other hand, there are many advanced complementary foods for infants and young children in overseas market – such as canned instant cereal-based food supplements, baby melts, fruit and vegetable crisps. They are subject to limited access to R&D and production in China market as they cannot be defined as main cereals (for cereal-based food supplements) or meet the requirements of commercial sterility (for canned complementary foods) in accordance with the existing national food safety standards. It is suggested to add product types in the revision of the related standards, cover more complementary foods for infants and young children and standardise the production and processing activities of complementary foods for infants and young children so as to facilitate the healthy development of the industry and provide abundant and safe choices of complementary foods for infants and young children in China.

Testing method standards for FSMP

Since 2015, the former National Health and Family Planning Commission (NHFP) (now the NHC) has reviewed and consolidated hundreds of testing method standards. In developing and verifying the national food safety standards on testing methods (GB 5009 series of standards), no method validation or research were conducted on FSMP (with liquid and solid substrates), resulting in the incompatibility of pre-processing steps, detection limits and quantification limits. As a result, in some cases in which a given product is tested through

9 *National Food Safety Standard of Cereal-based Complementary Foods for Infant and Young Children (GB 10769-2010)*, NHC, 26th March 2010, viewed 20th April 2021, <<http://www.nhc.gov.cn/wjw/psp/201005/47404.shtml>>

10 *National Food Safety Standard of Canned Complementary Foods for Infant and Young Children (GB 10770-2010)*, NHC, 26th March 2010, viewed 20th April 2021, <<http://www.nhc.gov.cn/wjw/psp/201005/47405.shtml>>





national-standard methods, nutrients in the test result can be quite different from the actual amount in the finished product, and such discrepancies can lead to erroneous judgements.

Raw and auxiliary materials

The current national standards for infant formula and FSMP raw and auxiliary materials are either lacking or incomplete. Except for L-phenylalanine, which is lightly regulated, the amino acids permitted in infant formula and FSMP products have no separate national standards. This has hindered Chinese amino acid production plants from obtaining food production licences, meaning that downstream infant formula and FSMP manufacturers are unable to purchase domestically produced amino acids, forcing the industry to rely on imports. Other raw materials currently lacking national standards include milk fat globule membrane protein/ α -lactalbumin, sodium chloride, choline chloride, concentrated milk protein, milk protein isolate and sodium fluoride/potassium. Moreover, the national standards established for certain raw materials are incomplete, causing industry-wide problems. Lactoferrin, for example, faces such problems. The working group thus recommends the lactoferrin standard be reviewed and re-evaluated from a broader perspective.

Transitioning to new national standards

To adhere to international standards and meet domestic regulatory needs, the NHC started revising a series of national standards for infant and young children formulas in 2016. The revised standards were released in March 2021,¹¹ with a two-year transition period for implementation.¹² The adjustments made to limits for protein, fat, vitamins and certain optional nutrients, such as docosahexaenoic acid (DHA), indicate that manufacturers will be required to adjust their formulas prior to the formal implementation of the standards. As a result, manufacturers will have to spend a considerable amount of time carrying out formula R&D, trial production, stability test research and inspection, as well as preparing formula registration materials and registering approval filing for all amended formulas.

The revision of the National Food Safety Standard Guideline for Formulas for Special Medical Purposes Intended for Infants (GB 25596-2010) poses the same challenges as the standards on infant formula with regard to the alignment between standard revision and product registration. In late 2017, the SAMR approved the first batch of infant formulas for special medical purposes that met this standard. The certificates are valid for five years, so products will be due to re-register in 2022. Although the national standards for infant formulas for special medical purposes are currently under revision, the progress is slow. The industry therefore expects the revision of this standard to be accelerated in order to guide product R&D and to bridge the gap with product re-registration.

Recommendations

- Improve national food safety standards for special food to align with the latest scientific research and international standards.
- Introduce additional product categories to the national food safety standards for FSMP and develop comprehensive, technical indicators for relevant products.
- Verify differences and scope among existing standards on testing methods, develop national testing methods, and clarify detection and quantification limits for liquid and solid FSMP.
- Establish industry standards and improve existing national standards for raw and auxiliary materials used in both infant formula and FSMP products.
- Ensure product re-registrations are carried out in an orderly fashion under the newly revised national food safety standards related to infant formula and FSMP.

3. Encourage the Expansion of FSMP Market Access Channels, Standardise Post-market Supervision and Improve Public FSMP Education 🌐 2

Concern

Despite being an emerging food category, the development of the FSMP industry in China has been slow over the past decade, which is partly a result of the strict regulations and restrictions on product standards, registration technical reviews, on-site inspections, and advertising and promotion.

¹¹ Notice on the Release of National Food Safety Standard Cheese (GB 5420-2021) and 50 Other National Food Safety Standard and Four Revision Documents, NHC and SAMR, 18th March 2021, viewed 6th May 2021, <<http://www.nhc.gov.cn/sps/s3594/202103/ba20eaa2d7624409aac15c15158336c0.shtml>>

¹² Q&A on Series National Food Safety Standard for Infant and Young Children, NHC, 18th March 2021, viewed 6th May 2021, <<http://www.nhc.gov.cn/sps/s7886t/202103/16cf6e65740e42b5a3451fe044e19c70.shtml>>





Assessment

Distribution channels and patient accessibility

FSMP products must only be used under the guidance of doctors or clinical nutritionists, which means the main FSMP product sales channels should be medical institutions and pharmacies, according to Article 38 of the *Administrative Measures for the Registration of FSMP* (CFDA Order No. 24, 2016).¹³ However, despite being professionally developed as enteral nutrition formulas, FSMP products face significant challenges in terms of circulation and application in medical institutions and clinical use. Medical professionals implementing nutritional intervention treatment and issuing medical advice are unable to prescribe FSMP under the current healthcare prescription system due to the lack of a 'medical charges' category for the products. This greatly reduces patient accessibility to FSMP products. Moreover, pharmacies are unable to sell FSMP products due to business licence restrictions and medical insurance compensation rules.

Public education and consumer awareness

The *Interim Measures for the Administration of Censorship of Advertisements on Drugs, Medical Devices, Dietary Supplements and Formula Food for Special Medical Purpose*, issued by the SAMR,¹⁴ specify that the marketing and advertising of general nutrient-complete FSMP products must be carried out based on the methods used for over-the-counter (OTC) products, and that publicity for disease-specific FSMP must be regulated in the same way as prescription drugs. These strict publicity restrictions have resulted in consumers being unable to distinguish between the FSMP products and OTC products/prescription drugs, often classifying FSMP products as medicines or even regarding them as health foods.

Recommendations

- Simplify the general registration of nutritionally-complete FSMP.
- Publish educational materials for consumers and encourage local governments to educate the public on basic nutrition, to help people understand and recognise FSMP and its correct usage.

¹³ *Administrative Measures for the Registration of FSMP*, State Council, 7th March 2016, viewed 20th April 2021, <http://www.gov.cn/gongbao/content/2016/content_5076983.htm>

¹⁴ *Interim Measures for the Administration of Advertisements on Drugs, Medical Devices, Dietary Supplements and Formula FSMP*, SAMR, 27th December 2019, viewed 20th April 2021, <http://gkml.samr.gov.cn/nsjg/fgs/201912/t20191227_309564.html>

4. Explore Alternative Plans for Overseas On-site Inspection to Relieve the Dilemma Faced by Overseas Manufacturers in Infant Formula and FSMP Registration

Concern

Manufacturers of infant formula and FSMP are facing operational challenges due to both a lack of clarity in regulations related to on-site inspections and the fact that the product registration process has been suspended indefinitely because on-site inspections have stalled as a result of the COVID-19 pandemic.

Assessment

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".¹⁵ It is also stated in Article 11 of the *Administrative Measures for the Registration of FSMP* that the evaluation institution shall conduct on-site inspections of applicants according to "actual needs".¹⁶ Yet it remains unclear what "actual needs" means in both cases. At present, the regulatory authorities have neither made nor published plans for on-site inspections of overseas factories, so manufacturers cannot plan ahead. As a result, the process of bringing a product to the market—from the submission of registration to the final launch—is unpredictable.

Manufacturers of infant formula and FSMP are facing a significant new challenge because overseas on-site inspections have stalled due to the COVID-19 pandemic, which has led to the product registration process being suspended with no possibility of restarting in the short-term. Enterprises are now at risk of failing to obtain the necessary approvals to resume regular business operations, while consumers and patients are unable to obtain the latest products in a timely manner.

Furthermore, the revised infant formula standards, including GB 10765-2021, GB 10766-2021, and GB 10767-2021, were released in March 2021, with a transition period of

¹⁵ *Management Measures on the Registration of Infant and Young Children Milk-based Powder Formula*, State Council, 15th March 2016, viewed 20th April 2021, <http://www.gov.cn/gongbao/content/2016/content_5145569.htm>

¹⁶ *Administrative Measures for the Registration of FSMP*, SAMR, 8th December 2015, viewed 20th April 2021, <http://gkml.samr.gov.cn/nsjg/tssps/201903/t20190329_292465.html>





only two years. The period between late 2021 and early 2022 will see a peak in new national standard formula registration, which means there will be an even greater volume of infant formula registrations during this time, with a commensurate increase in pressure on on-site inspections. Continued delays to overseas on-site inspections will have an immeasurable impact on European infant formula manufacturers that have been operating in China for many years, and will pose a serious obstacle to the normal trading of infant formula between China and the European Union, thus negatively impacting both parties. Consumers will also be at risk of losing the supply of their favourite and trusted products.

Recommendations

- Clarify both the "actual needs" to conduct on-site inspections (i.e., specify the criteria to implement an on-site inspection) and the timeline for overseas inspections.
- Explore alternatives to overseas on-site inspections, such as cooperating with overseas authorities, entrusting qualified third-party organisations or considering remote audit to conduct inspections that have been stalled due to the COVID-19 pandemic.
- Ensure overseas onsite inspection are carried out in an orderly fashion under the newly revised national food safety standards related to infant formula.

5. Enhance the Transparency and Consistency of Law Enforcement, and Facilitate Communication with the Industry 🗣️ 2

Concern

Frequent changes have been made in the administration of infant formula and FSMP in recent years, and the increased uncertainty in technical review and approval requirements, combined with limited communication with the industry, have brought about considerable challenges in terms of compliance and registration.

Assessment

Clinical trials for disease-specific FSMPs

The *Administrative Measures for the Registration of FSMP* specify that applications for the registration of specific nutritional formula should include clinical study reports.¹⁷ The *Administrative Measures* apply

¹⁷ *Administrative Measures for the Registration of FSMP*, China Food and Drug Administration, 10th March 2016, viewed 20th April 2021, <http://gkml.samr.gov.cn/nsjg/tssps/201903/t20190329_292465.html#>

to 13 disease-based FSMPs, yet only three relevant clinical study guidelines have been issued so far, with little practical information on the requirements or process being provided. Therefore, as registrations for disease-based FSMPs are still at a very early stage, the industry is facing much uncertainty. Enterprises are concerned that their clinical studies may not meet the registration requirements, which would result in a waste of resources and increased costs. It is therefore necessary for the relevant authorities to enhance communication with enterprises working on disease-based FSMPs, to facilitate consultation with regard to pre-review clinical study design.

Spot-checking of infant formula

As high-risk foods, infant formula and FSMP have undergone increasingly stringent spot-checking in recent years. Nevertheless, the sub-working group has observed that current spot-checking protocols are not transparent enough for enterprises, which leads to considerable compliance challenges.

First, the process is not transparent enough. While the National Sampling Inspection Plan for Food Safety Supervision previously disclosed spot-check results, its food safety monitoring plan and determination principles, but these have not been made public since 2020. However, as consumers are highly sensitive to infant formula and FSMP, if a product is reported by competent authorities as unqualified, it will be removed or recalled if the enterprise does not appeal the decision. The recall of these special foods could significantly affect public opinion, and cause consumer confidence to nosedive as a result, thus affecting the development of the industry and the interests of enterprises.

Spot-checking requirements are also inconsistent at different levels of government. At present, the types of sampling and monitoring processes from the national level down to the city level vary, and requirements and standards are also inconsistent. In some locations, some enterprises have encountered requirements that exceed current regulations and standards. This inconsistent interpretation and application of regulations and standards has led to several problems in the feasibility of standards and testing methods, which has significantly increased administrative and corporate compliance costs.





Recommendations

- Provide a pre-review channel for clinical study design for disease-based FSMP that allows enterprises to discuss study design with registration-review organisations before clinical trials are conducted.
- Improve the openness and transparency of food safety supervision processes, spot-checking and risk monitoring, and discuss these matters sufficiently with the industry.
- Strengthen risk research and assessment based on spot-checking results and monitoring, then classify the findings to avoid unnecessary panic among consumers.

6. Publish the New Administrative Measures on the Sale of Breast Milk Substitutes



Concern

The repeal of the *Administrative Measures on the Sale of Breast Milk Substitutes* by the former NHFPC has led to misleading and aggressive advertising by some brands,¹⁸ 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* were subsequently abolished in December 2017 by the former NHFPC. At present, there is no administrative regulation concerning the sale of breast milk substitutes. This has led to misleading and aggressive infant formula advertising by some brands. 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 rely on extensive scientific research and clinical evidence. Production also requires advanced technology. In practice, such products 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 recipe 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 allows medical and healthcare specialists to give science-based instructions on infants' feeding activities. 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,¹⁹ cooperation between manufacturers and medical and health institutes should be permitted in order to promote breastfeeding and increase public knowledge on nutritional issues. 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.
- Allow FSMP manufacturers to communicate with healthcare professionals regarding scientific feeding, under the prerequisite that companies do not interfere with the promotion of 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.

7. Optimise the Requirements for Clinical Trials of FSMP



7.1 Rationalise the Requirements Imposed on Trial Participants

Concern

Uniform clinical trial requirements are not suitable for diversified FSMP products, therefore clinical trial regulations must be reassessed and revised.

Assessment

Due to ethical concerns stemming from their age and

18 *Administrative Measures on the Sale of Breast Milk Substitutes*, former MOH, 13th June 1995, viewed 20th April 2021, <http://www.gov.cn/banshi/2005-08/23/content_25511.htm>

19 The most important message that the infant formula industry wants to express is that breast milk is the best food for infants and that this principle should be protected. Thus, breast milk substitutes should only be used when breast milk cannot meet the needs of an infant.





selection criteria, certain difficulties may arise when clinical trials involving paediatric patients are launched, especially large-scale trials. The *Announcement on the Technical Guiding Principles for Paediatric Populations in Drug Clinical Trials* (No. 48 of Edition 2016) clearly stipulates that, in designing clinical trials for drugs that are used in paediatric populations,²⁰ the principle of “smallest sample size, fewest specimens and least pain” shall be observed, while ensuring that the evaluation needs are met. 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.

When it comes to rare diseases, in order to obtain the necessary sample size for clinical trials, a relatively long clinical trial cycle is needed, 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.

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 subjects with rare diseases, to ensure the proper use of clinical trial resources and to satisfy the needs of special groups.
- Accept the normal diet as a control group, and either the ‘before and after’ comparison of one patient, or the comparison with standard normal growth, instead of mandating parallel controlled clinical trials.
- Specify clearly the FSMPs that apply to single group studies.

7.2 Adopt Hierarchical Management to Verify FSMP Clinical Effectiveness

Concern

Although premarket clinical trials are required under the *Administrative Measures for the Registration of FSMP* for 13 disease-specific FSMPs, they provide barely any scientific or objective reflections of the actual effectiveness of such products in nutritional therapy for patients.

²⁰ *Announcement of CFDA About the Release of Technical Guiding Principles of Paediatric Group Drug Clinical Test* (No. 48 of 2016), former China Food and Drug Administration (CFDA), 7th March 2016, viewed 20th April 2021, <<https://www.nmpa.gov.cn/xxgk/gtg/qtggtg/20160307164401912.html>>

Assessment

Most of the imported disease-based FSMPs currently on the China market have been sold in many other markets for several years and have been clinically observed during that time. The industry recommends recognising foreign clinical application data for products that meet Chinese national food safety standards without requiring any adjustments, to avoid wasting resources on repeating clinical trials in China.

For instance, the specifications for the category ‘food protein intolerance’ of FSMP in the *National Food Safety Standard General Rules for Food for Special Medical Purposes* (GB 29922-2013) is similar to the specifications for the category ‘FSMP for infants (zero to 12 months) with milk protein allergies’ in *National Food Safety Standard Infant Food for Special Medical Purposes* (GB 25596-2013). As clinical studies are not required in the registration of infant FSMP, it should also not be required in the registration of hypoallergenic formulas for toddlers over a year old. Older infants (6 to 12 months) and young children over one year old have started eating other foods, which makes FSMP clinical studies on this population increasingly difficult to carry out due to increased diet diversity.

As for renal-specific formulas, ordinary nutrient-complete formula cannot be used as a control group in the clinical study process, as it increases health risks. Patients with kidney disease are required to avoid or reduce the intake of certain nutrients or ingredients, such as protein, potassium, calcium and phosphorus. Ordinary nutrient-complete formula is not adjusted according to the metabolism characteristics of kidney disease patients, and is therefore not suitable for them to use long-term as it increases the risk to their health, especially outpatients for whom the daily dosage cannot be controlled.

When establishing clinical regulations, it is therefore recommended that both scientific and clinical research are combined to design a scientific and reasonable evaluation plan that conforms to a patient's usage habits, rather than simply adopting the clinical trial method used in medicine and blindly expecting excellent performance and non-inferiority of effectiveness indicators.





Recommendations

- Waive clinical trials or conduct post-marketing clinical data collection for hypoallergenic formulas for toddlers over one year old.
- Compare the non-inferiority indicators for renal-specific formulas by using before and after comparisons (i.e., single-arm) or the renal-specific formula of an approved overseas product rather than clinical trials of FSMP.
- Consider the fact that FSMP are only clinical nutritional support products, and design reasonable clinical observation indicators.

Abbreviations

AMR	Administration for Market Regulation
CFDA	China Food and Drug Administration
COVID-19	Coronavirus Disease 2019
DHA	Docosahexaenoic Acid
FSMP	Food for Special Medical Purpose
MOH	Ministry of Health
NHC	National Health Commission
NHFPC	National Health and Family Planning Commission
R&D	Research and Development
SAMR	State Administration for Market Regulation

Automotive Working Group

Key Recommendations

1. Passenger Vehicles

1.1 Create a Predicable, Non-discriminative and Balanced Legislative Environment that is Conducive to the Sustainable Development of New Energy Vehicles (NEVs) 🌐 4

- Ensure international automotive manufacturers can participate in the drafting and revision of new policies and regulations.
- Provide lead-time of at least four to five years for automotive manufacturers to plan and react to released policies and planning documents.
- Provide the same incentives and equal rights for imported and locally-produced NEVs.
- Ensure technology neutrality without distinction between electronic vehicle classes, and equal access to registration plates at the regional level.
- Extend the 2020–2022 NEV subsidies, purchase tax exemption and vessel taxes to 2023 and beyond.
- Prohibit local governments from issuing fragmented implementation measures or unique requirements that restrict the purchase of NEVs.
- Unify policies, regulations and additional test requirements at the central and local levels.
- Enhance standards related to charging infrastructure to keep pace with NEV development.
- Formulate guidelines, implementation regulations and concrete incentive policies for charging infrastructure.
- Promulgate a NEV credit policy for 2024 and beyond, with a milestone to review and fine-tune the policy based on the development of the NEV market.
- Coordinate NEV credit and carbon emission management policies to avoid unnecessary burdens for enterprises.

1.2 Establish a Consistent Legislative and Policy Environment to Promote Intelligent and Connected Vehicle (ICV) Development 🌐 2

- Accelerate the pace of legislation related to ICVs and clarify a timetable to help enterprises better plan their product launches.
- Intensify the legal exchange mechanism between the European Union and China to facilitate the sharing of their experiences in the development of ICV legislation.
- Provide special guidance for ICV-related data-handling processes.
- Formulate the definition of and classification standards for ICV-related data, as the automotive industry goes through digital transformation.
- Assign a working group to develop a proposal for a sound and cooperative management scheme with regard to ICV-related data (personal/non-personal, sensitive/non-sensitive data).
- Establish a communication mechanism with the ICV 2035 Promotion Group.
- Develop ICV infrastructure in the pilot cities' clusters, and work towards a viable business model for the promotion of nationwide ICV infrastructure.
- Ensure that the final implementation measures of the Cybersecurity Law provide automotive companies reasonable scope to share information overseas that is crucial to the development of ICVs, as long as it does not have a tangible impact on national security.
- Consider lifting restrictions, where possible, on access to non-sensitive, high-definition



maps, to allow businesses to collect their own data on roads.

- Clarify regulatory requirements for the uploading of geographical information.

1.3 Provide Foreign Companies with Equal Access to Policy- and Standards-drafting Processes

- Ensure foreign companies have equal access to policy- and standards-drafting processes.
- Engage foreign companies in discussions at the policy-planning stage.

2. Commercial Vehicles

2.1 Recognise Optimised Vehicle Specifications in the Regulation of Commercial Vehicles (CVs) 2

- Engage foreign companies in discussions at the beginning of the process of drafting and updating regulations for CVs.
- Implement only one national standard covering CVs.
- Publish recommended standards (GB/T) and industry standards under the World Trade Organization Technical Barriers to Trade publication system as mandatory standards.
- Grant sufficient lead time for manufacturers to adapt to new regulations.
- Unify market access requirements and implementation procedures.
- Simplify the registration process for the issuance of transport licences.

2.2 Minimise the Carbon Footprint of CVs 2

- Use GB 1589-2016 to optimise transport units in cities and to strive for long vehicle combinations;
- Implement proper road classification and allow for different lengths and gross combination weight, depending on road and bridge conditions.
- Amend standard GB 1589-2016 to allow for more than six axles.
- Calculate the carbon footprint of vehicles as carbon dioxide (CO₂) emissions (energy consumption) per tonne kilometre.
- Include in the government plans and roadmaps the use of biofuel by commercial vehicles to reduce CO₂ emissions.

2.3 Allow Heavy Duty CV Workshops and Dealerships to be Registered on Commercial Land

- Amend relevant national and local legislation so that heavy-duty CV dealerships and workshops can be legally registered on industrial land.

Introduction to the Working Group

The automotive industry is a crucial driver of economic growth by itself, and closely linked with a wide array of upstream and downstream industries. For decades, it has contributed to China's development by generating employment opportunities and sharing expertise, and by providing mobility for people and goods, without which modern societies could not function. Today, as China strives for industrial transformation and upgrading, the automotive industry is committed to developing sustainable mobility solutions, while maintaining its vital 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. It works closely with the Auto Components Working Group, which consists of more than 80 European companies involved in the manufacture of automotive-components, machine tools for production of 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 EU Member State levels.



Recent Developments

In the updated 2020 version of the *Special Administrative Measures for Foreign Investment Access (Negative List 2020)*,¹ foreign ownership restrictions on special vehicle, new energy vehicles (NEV) and commercial vehicle manufacturing were removed, and foreign investors were permitted to establish two joint ventures (JVs) to produce vehicle products in the same category. However, in the National Development and Reform Commission's (NDRC's) *Administrative Provisions on Investment in the Automotive Industry*, released in December 2018, *de facto* restrictions on new investment in automotive manufacturing through certain requirements remain in place.²

In August 2020, the Ministry of Industry and Information Technology (MIIT) promulgated the *New Energy Vehicle Production Enterprises and Product Access Management Regulations*.³ The waiving of the requirement for auditing NEV manufacturers' research and development (R&D) capabilities and relaxing the entry threshold for production is a positive reform development, which should bring fresh impetus to the NEV industry and unleash more market vitality.

On November 2nd 2020, the *New Energy Vehicle Industry Development Plan (2021–2035)* was published by the State Council.⁴ This plan is a top-level development blueprint which not only aims to create a more market-orientated and sustainable NEV and intelligent connected vehicle (ICV) industry, but also acts as a guideline for the comprehensive transformation of the country's automotive industry and market into part of a holistic, inter-connected eco-system that includes the transport, energy, and information and communication technology industries. Coordination among relevant national and local government departments will be necessary to ensure the *NEV Industry Development Plan* is effectively implemented.

¹ *Special Administrative Measures for Foreign Investment Access (Negative List) (2020 Edition)*, Ministry of Commerce, June 2020, viewed 15th May, <<http://images.mofcom.gov.cn/www/202006/20200624145659916.pdf>>

² *Provisions for the Administration of Investment in the Automotive Industry*, NDRC, 18th December 2018, viewed 2nd June 2020, <<https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/201812/W020190905495164515512.pdf>>

³ *New Energy Vehicle Production Enterprises and Product Access Management Regulations*, MIIT, 19th August 2020, <http://www.gov.cn/xinwen/2020-08/19/content_5535780.htm>

⁴ *Notice on the issuance of the Development Plan for the New Energy Vehicle Industry (2021–2035)*, State Council, 20th October 2020, viewed 2nd November 2020, <http://www.gov.cn/zhengce/content/2020-11/02/content_5556716.htm>

In July 2020, the MIIT released the *Parallel Management Measures on Corporate Average Fuel Consumption (CAFC) and NEV Credits for 2021–2023 (Dual Credits Measures 2021–2023)*. However, the policy for 2024–2025, which is crucial for industry players to plan future production and sales targets, is still missing. The aim of the *Dual Credits Measures* is to increase market share of CAFC and NEV credits, but a considerably higher market share is not achievable by market forces alone, making government incentives necessary.

The revised *Intelligent Vehicle (IV) Innovative Development Strategy* was promulgated in February 2020.⁵ Compared with the previous version, it sets fewer rigid targets, replacing explicit quantitative indicators with more generic requirements. In April 2017, the MIIT issued the *Guidelines for the Construction of the Standards System of the National Vehicle Networking Industry (Vehicle Intelligent Management)*. This document guides standardisation for the management of intelligent network vehicle registration, authentication and safety, road operation management and the co-management of roads and vehicles. It also promotes the development and application of vehicle networking technology with regard to public security-related issues in traffic management.⁶

Key Recommendations

1. Passenger Vehicles

1.1 Create a Predictable, Non-discriminative and Balanced Legislative Environment that is Conducive to the Sustainable Development of NEVs

Concern

The lack of transparency and equal treatment in policy implementation, combined with stricter requirements on the supply side and the lack of clarity on incentive policies on the demand side, as well as increasing need to harmonise charging infrastructure, green energy and vehicles, creates market uncertainty for NEV developers.

⁵ *IV Innovative Development Strategy*, NDRC, 24th February 2020, viewed 2nd June 2020, <<https://www.ndrc.gov.cn/xxgk/zcfb/tz/202002/P020200224573058971435.pdf>>

⁶ *Guidelines for the Construction of National Industrial Standard System for Internet of Vehicles (Intelligent Connected Vehicles)*, MIIT, 27th December 2017, viewed 29th December 2020, <https://www.miit.gov.cn/zwgk/zcwj/wjfb/zh/art/2020/art_dd83902198af456c850e54206adf7aaa.html>



Assessment

Policy transparency and predictability

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. Manufacturers need long-term policies that are clearly communicated. In the absence of a predictable way to understand whether a NEV product will be able to fulfil new regulatory requirements, original equipment manufacturers (OEMs) will remain cautious about investing in and developing new models.

Unequal policies

NEV subsidy policies for units manufactured in China and those that are imported are different: central and local subsidies are currently only provided for NEVs made in China. This unequal treatment makes it extremely difficult for foreign manufacturers to reach their NEV targets. The imbalance is exacerbated by the fact that, in the EU, subsidies are available for both imported and locally manufactured NEVs.

There is a trend towards abandoning ‘technology neutrality’, as the government is only promoting electric cars. For example, some provinces and municipalities have introduced different licence plate policies for battery electric vehicles (BEVs) and plug-in hybrid electric vehicles (PHEVs). Both BEVs and PHEVs play vital roles in electrification of the automotive industry and should be treated equally. NEV policies should therefore be consistently implemented nationwide without special local requirements.

Subsidies and incentives (national level)

In 2021, the State Council released policies to incentivise NEV consumption, including the extension of the NEV purchasing subsidy and the exemption of purchase tax of NEVs (PTE).⁷ Such policies aim to allow manufacturers time to recover losses and market share post-COVID-19. However, the establishment of incentive thresholds for granting subsidies and PTE, as well as new technical requirements, were sometimes released without prior notice and without sufficient lead time, which disrupted manufacturers’ pre-set production schedules for launching new NEV products.

⁷ The State Council promoted three automotive consumption incentive measures (Extension policies of the NEV financial subsidy and PTE to 2022), March 31st 2020, viewed March 30th 2021, <http://www.gov.cn/guowuyuan/2020-04/01/content_5497748.htm>

Licence plate quotas and restrictions (local level)

To promote the sales of NEVs, many local governments lifted restrictions on NEV licence plate quotas. However, there are exemptions. For example, in Beijing, there is still an annual quota in place, which substantially restricts purchases.

There are other instances of fragmented policy implementation and differing requirements at the local level with regard to automotive manufacturers’ access to free licence plates. The lack of unified requirements will furthermore hinder NEV consumption.

Charging infrastructure

The growth of electric vehicle (EV)-charging infrastructure is largely determined by government planning and targets. The *Guidance for Developing Electric Vehicle Charging Infrastructure (Guidance)* was issued jointly in October 2015 by the NDRC, the National Energy Administration (NEA), the MIIT, and the Ministry of Housing and Urban Development (MOHURD).⁸ However, with the *Guidance* having expired at the end of 2020, new targets are expected to be released with new plans and concrete implementation measures.

The *NEV Development Plan 2021–2035* included a 20 per cent NEV market share target for 2025. As the number of NEVs increase, challenges to the development and rolling out of charging infrastructure—such as harmonisation of standards, and coordination among power grids, vehicles and the infrastructure itself—may emerge.

NEV credits

The *Dual Credits Measures 2021–2023* were released in 2020, but post-2024 rules have not yet been released publicly. This can impact the healthy development of the automotive industry, which relies on a stable and predictable regulatory environment to plan production schedules.

The *NEV Development Plan 2021–2035* outlines a proposal to connect the *Dual Credits Measures* and China’s emissions trading scheme. It is important to clarify as early as possible how these two systems will be integrated to give manufacturers the lead time they need to achieve compliance.

⁸ *Guidance for Developing EV Charging Infrastructure for 2015–2020*, NEA, 9th October 2015, viewed 2nd April 2021, <http://www.nea.gov.cn/134828653_14478160183541n.pdf>





Recommendations

- Ensure international automotive manufacturers can participate in the drafting and revision of new policies and regulations.
- Provide lead-time of at least four to five years for automotive manufacturers to plan and react to released policies and planning documents.
- Provide the same incentives and equal rights for imported and locally produced NEVs.
- Ensure technology neutrality without distinction between EV classes, as well as equal access to registration plates at the regional level.
- Extend the 2020–2022 NEV subsidies, PTE and vessel taxes to 2023 and beyond.
- Prohibit local governments from issuing fragmented implementation measures or unique requirements that restrict the purchase of NEVs.
- Unify policies, regulations and additional test requirements at the central and local levels.
- Enhance standards related to charging infrastructure to keep pace with NEV development.
- Formulate guidelines, implementation regulations and concrete incentive policies for charging infrastructure.
- Promulgate a NEV credit policy for 2024 and beyond, with a milestone to review and fine-tune the policy based on the development of the market.
- Coordinate NEV credit and carbon emission management policies to avoid unnecessary burdens for enterprises.

1.2 Establish a Consistent Legislative and Policy Environment to Promote Intelligent and Connected Vehicle (ICV) Development



Concern

Over the past few years, the Chinese Government has made considerable progress in developing the potential of ICVs, however, policy and regulatory challenges remain around topics related to the Road Traffic Law, data, infrastructure, high-definition (HD) mapping, and the overall legal and legislative framework.

Assessment

Revision of the Road Traffic Safety Law

China's draft revisions to the Road Traffic Safety Law include modifications for autonomous driving, and the roll-out of a regional pilot programme to demonstrate

the country's level of ICV development.⁹ To create a clear and compliant legislative environment for ICVs, it is necessary to further accelerate the revision process of the Road Traffic Safety Law.

The initiation of revisions to the Road Traffic Safety Law and the release of the *Regulations on the Management of Intelligent Connected Vehicles in the Shenzhen Special Economic Zone (Draft for Comment)*,¹⁰ are both positive initiatives, but the working group believes that more can be done, such as regarding the respective liabilities of manufacturers and drivers, and a detailed classification for automated driving.

Implementation of data-related laws in the field of ICVs

Connectivity is essential for ICV development in China, in which data is generated and used to ensure connectivity. China is progressing towards implementing a coherent data framework through the Cybersecurity Law, the draft Personal Information Protection Law and the draft Data Security Law. However, rules related to manufacturers' data collection, application and cross-border transmission remain unclear.

Access to Chinese national programmes, working groups and policymaking processes

The MIIT established an internal ICV 2035 Promotion Group in the middle of March 2021, under the coordination of the ministry's Equipment Industry Development Centre. Through this forum, Chinese automotive industry institutions—including the China Association of Automobile Manufacturers, the China Society of Automotive Engineers and the China Automotive Technology and Research Centre—discuss topics of relevance for ICV development over the next three years, such as homologation, eco-system, operating systems and cybersecurity. It is believed the ICV 2035 Promotion Group will play a significant role in developing relevant policies, national projects and technical roadmaps. It is therefore important to engage *all* stakeholders in the processes mentioned above, to ensure a smooth transition towards the introduction of ICVs.

⁹ *Implementation Rule of Road Traffic Safety Law of People's Republic of China*, State Council, October 2017, viewed 15th May 2021, <http://www.gov.cn/gongbao/content/2019/content_5468932.htm>

¹⁰ *Shenzhen Municipal Government solicits comments for the draft Shenzhen ICV Management Rules*, Shenzhen Municipal Government, 25th March 2021, viewed 15th May, <https://www.sohu.com/a/457216345_320888>





Infrastructure planning

Sound infrastructure is integral to establishing a seamless network for ICVs in China. A well-established ICV infrastructure framework will reduce costs and encourage enterprises to invest. However, in an addition to the absence of a national plan for *Vehicle to Everything (V2X)*¹¹ infrastructure, detailed infrastructure goals have still not been established. Local governments and enterprises are also concerned about redundant capacity in ICV infrastructure before the industry has reached commercial maturity, due to the high costs involved.

High definition (HD) mapping

Foreign companies face stringent regulations with regard to obtaining geographical information and HD mapping for automated vehicles. The development of autonomous driving is dependent upon the ability to gather high volumes of data on traffic conditions. However, due to the restrictions on data-gathering in China, highly-automated driving (HAD) maps—necessary for autonomous driving—are scrambled on foreign products, with the on-board scramblers causing unknown localisation shifting. This negatively impacts positioning, control accuracy and the reliability of automated driving systems, resulting in a serious reduction in safety.

Furthermore, an automated driving (AD) vehicle will play the role of a perception terminal for dynamic maps operated by the map supplier. The mapping itself is done by the mapping suppliers, and the map-learning task is accomplished jointly by the mapping suppliers and the vehicle, without the vehicle having to conduct surveying and mapping. Preventing AD vehicles from collecting data will prevent dynamic maps from being able to update in real time, which will have a negative influence on AD vehicle positioning and accident precaution mechanisms.

Legislative and policy environment

It is of paramount importance to ensure that different ministries coordinate in order to maximise the efficiency and effectiveness of ICV policy formulation. Overlapping tasks often cause confusion and ambiguity for both enterprises and users.

¹¹ V2X refers to the information exchange between the car to the outside world. Car networking has established a new direction of automotive technology development by integrating global positioning system (GPS) navigation technology, vehicle-to-car AC technology, wireless communication and telesensing technology, and achieved compatibility between manual and autonomous driving.

Recommendations

- Accelerate the pace of legislation related to ICVs and clarify a timetable to help enterprises better plan their product launches.
- Intensify the legal exchange mechanism between the EU and China to share their experiences in the development of ICV legislation.
- Provide special guidance for ICV-related data-handling processes.
- Formulate the definition of and classification standards for ICV-related data, as the automotive industry goes through digital transformation.
- Assign a working group to develop a proposal for a sound and cooperative management scheme with regard to ICV-related data (personal/non-personal, sensitive/non-sensitive data).
- Establish a communication mechanism with the ICV 2035 Promotion Group.
- Develop ICV infrastructure in the pilot cities' clusters, and work towards a viable business model for the promotion of nationwide ICV infrastructure.
- Ensure that the final implementation measures of the Cybersecurity Law provide automotive companies reasonable scope to share overseas information that is crucial to the development of ICVs, as long as it does not have a tangible impact on national security.
- Consider lifting restrictions, where possible, on access to non-sensitive HD maps, to allow businesses to collect their own data on roads.
- Clarify regulatory requirements for the uploading of geographical information.

1.3 Provide Foreign Companies with Equal Access to Policy- and Standards-drafting Processes

Concern

Foreign companies still do not have equal access to policy and standards drafting processes, despite this being a requirement stipulated in both the Standardisation Law and the Foreign Investment Law.

Assessment

At present, China's automobile industry development still requires proper policy support. Formulation of and changes to policy directly affect the interests of automobile companies. When existing policies change or new ones are introduced, foreign automotive manufacturers need to adjust their business practices to meet compliance requirements. Considering that it usually takes years for an automotive product to go





from R&D to production and marketing, it is therefore extremely important to involve both domestic and foreign companies in the policy-drafting process from the very beginning. Although the Chinese Government has actively improved the formulation and issuing process of new policies in recent years, there is still a gap in the level of participation of foreign companies in important policy-drafting processes compared to major domestic companies.

During the process of drafting policies that will have an impact on the automotive industry, both domestic and foreign companies should be invited by the relevant department to discuss the content in the interests of developing a workable and sustainable regulatory environment, and a fair, competitive market.

Recommendations

- Ensure foreign companies have equal access to policy- and standards-drafting processes.
- Engage foreign companies in discussions at the policy-planning stage.

2. Commercial Vehicles

2.1 Recognise Optimised Vehicle Specifications in the Regulation of Commercial Vehicles (CVs) 2

Concern

Regulators fail to recognise the specific nature of CVs, which hampers industry development.

Assessment

Although CVs have wheels and an engine, and are often used on public roads, they are not the same as passenger vehicles. While the sales volume of heavy-duty CVs is less than five per cent of that of passenger vehicles, the way CVs are regulated has more far-reaching implications for society as a whole. This is mostly because CVs are essential for efficient transportation – they are used by companies to transport goods and people, and to provide other vital services. Such companies are often highly specialised, and need very specific, tailor-made vehicles to provide optimal services, as well as to maximise their revenue in the process.

Specialist vehicles play an important role in upholding critical functions in our increasingly modernised society:

they consist of a chassis that carries a specialised superstructure to provide dedicated services. Examples include refuse collectors, fire engines, construction vehicles, recovery vehicles, vacuum tanks, bridge inspection vehicles, sky lifts, cranes and snow ploughs. As a consequence, CVs comprise a much wider variety of models and variants compared to passenger vehicles, yet China's vehicle homologation and registration system makes no distinction between them. The system is also overly complicated, slow and costly, which delays the time to market for vehicles that could provide crucial services to society. In addition, when new regulations are introduced too quickly, the launch of new technologies is delayed and stock management of CVs becomes impossible. It is furthermore superfluous to have an additional testing system to qualify for transport licences, as all necessary testing should only be done in the China Compulsory Certificate (CCC) system.

By continuing to regulate CVs in the same way as passenger vehicles, without taking into account the vast differences between these distinct categories, overall sector development will be held back and the profitability of the Chinese transportation industry as a whole will suffer. The homologation and certification system must be designed in such a way that time to market for CVs is kept at a minimum. Only then will the transport industry operate with optimised solutions.

As a member of the World Trade Organization (WTO), China is obligated to invite WTO member states' comments on new national 'mandatory' standards (*guobiao*, or GB) that have the binding force of technical regulations. In the working group's opinion, the category of technical standards thus made public under the Technical Barriers to Trade (TBT) publication procedure should be extended to cover 'recommended' standards (GB/T) and industry standards, as they often become mandatory in practice by executive order.

The working group also recommends that companies be given a minimum of 48 months to prepare for implementation of new rules and regulations, as short transition times result in immense costs and complications,¹² for example, as happened with introduction of the China V, China VIa and China VIb.

¹² *China Light Duty Emissions*, TransportPolicy.net, 20th April 2020, viewed 2nd June 2020, <<https://www.transportpolicy.net/standard/china-light-duty-emissions/>>





Recommendations

- Involve the automotive industry early in the process of drafting and updating regulations for CVs.
- Implement only one national standard covering CVs.
- Publish recommended standards (GB/T) and industry standards under the WTO/TBT publication system as mandatory standards.
- Grant sufficient lead time for manufacturers to adapt to new regulations.
- Unify market access requirements and implementation procedures.
- Simplify the registration process for the issuance of transport licences.

2.2 Minimise the Carbon Footprint of CVs

Concern

While passenger vehicle fuel consumption is measured per vehicle, CV fuel consumption should be in relation to its payload (fuel consumption per tonne kilometre (tKm) or volume (cubic metre) km), which should be reflected when designing related regulations.

Assessment

Although modern society cannot survive without transportation, there is a serious need to minimise the environmental impact of the sector. Regulators, OEMs, operators and consumers therefore need to work together to reduce the negative effects of transportation: this must become an integral part of corporate social responsibility.

The lowest-hanging fruit when it comes to reducing the carbon footprint is to use larger transport units, i.e., fewer engines to transport more goods. Regardless of whether transport is moving on highways or through cities, the transport unit should always be as large as possible, while adhering to all relevant standards.

The standard *GB 1589-2016*¹³ allows the in-city use of vehicles with a total weight of 31 tonnes, length of 12 metres and up to four axles. Within the limits of allowed outer dimensions and axle loads, society and industry should always seek optimised transport solutions in and outside of cities. It does not make sense to encourage many small vehicles to complete a task that can be completed by fewer and more energy-efficient vehicles.

¹³ *Limits of dimensions, axle load and masses for motor vehicles, trailers and combination vehicles*, SAMR, 26th July 2016, viewed 2nd June 2021, <<http://c.gb688.cn/bzgk/gb/showGb?type=online&hcno=4D4FEB86F718FA6C4E2F8A0BB0EC9AC2>>

In other countries, up to 12 axles and over 100 tonnes gross combination weight (GCW) are allowed on certain routes, which provides even greater opportunities to carry more goods with fewer engines.¹⁴

Another option is promoting use of biogas, a renewable fuel that does not contribute to a net increase of carbon dioxide (CO₂) in the atmosphere, as opposed to the fossil fuel natural gas. A biogas system is part of a circular economy industrial chain,¹⁵ and the use of biogas and other forms of biofuels are proven technologies in the commercial vehicle and transport sectors in Europe. Furthermore, the use of biofuels made from waste, such as sludge, food waste and other organic waste, is a reliable and well-proven way to effect an immediate reduction in CO₂ emissions from commercial vehicles.

Recommendations

- Use *GB 1589-2016* to optimise transport units in cities and to strive for long vehicle combinations.
- Implement proper road classification and allow for different lengths and GCW, depending on road and bridge conditions.
- Amend standard *GB 1589-2016* to allow for more than six axles.
- Calculate the carbon footprint of vehicles as CO₂ emissions (energy consumption) per tKm.
- Include in the government plans and roadmaps the use of biofuel by CVs to reduce CO₂ emissions.

2.3 Allow Heavy Duty CV Workshops and Dealerships to be Registered on Commercial Land

Concern

Although many CV workshops and dealerships have been established on industrial land, this arrangement is not strictly legal, which has led to widespread uncertainty in the industry and an unwillingness to make long-term investments.

Assessment

CVs need professional, timely service and repair in

¹⁴ Enough empirical studies show that this has no negative impact on road safety – rather the opposite; *High Capacity Transport, Towards Efficient, Safe and Sustainable Road Freight*, OECD, 2nd May 2019, viewed 2nd June 2020, <<https://www.itf-oecd.org/high-capacity-transport>>

¹⁵ Biogas from municipal wastewater purified and upgraded to contain a high proportion of methane can be used as vehicle fuel and is an example of a circular economy industrial chain: See: Smart City Sweden website, viewed 2nd June 2021, <<https://smartcitysweden.com/focus-areas/climateenergy-environment/biogas/>>





order to ensure optimised uptime, safety and low emissions. Currently, heavy-duty truck dealerships and workshops can only be legally registered on commercial land, i.e., the same land that is used by passenger car dealers. Such land is both much more expensive and closer to city centres than industrial land. This is counter-intuitive from an operational point of view, as it leaves CV dealers too far from their customer base, i.e., commercial businesses and industries, and results in increased numbers of heavy trucks having to travel through city areas, which has both traffic congestion and pollution implications.

Strictly speaking, the vast majority of existing heavy-duty CV dealerships and workshops are currently illegal, because they have been established on industrial land without the proper licences. This situation has created a lot of uncertainty, and consequently companies are unwilling to make long-term investments in high-quality CV dealership and service operations.

Recommendation

- Amend relevant national and local legislation so that heavy-duty CV dealerships and workshops can be legally registered on industrial land.

Abbreviations

AD	Automated Driving
BEV	Battery Electric Vehicles
CAFC	Corporate Average Fuel Consumption
CV	Commercial Vehicle
EU	European Union
EV	Electric Vehicle
GCW	Gross Combination Weight
HAD	Highly Automated Driving
HD	High Definition
ICV	Intelligent and Connected Vehicle
IPR	Intellectual Property Right
IV	Intelligent Vehicle
JV	Joint Venture
km	Kilometre
MIIT	Ministry of Industry and Information Technology
NDRC	National Development and Reform Commission
NEA	National Energy Administration
NEV	New Energy Vehicle
OEM	Original Equipment Manufacturer
PHEV	Plug-in Hybrid Electric Vehicle
PTE	Purchase Tax Exemption
R&D	Research and Development
TBT	Technical Barriers to Trade
V2X	Vehicle to Everything
WTO	World Trade Organization





Auto Components Working Group

Key Recommendations

- 1. Mandate Snow Tyre Usage During the Cold Season of Low-temperature Areas to Improve Road Safety and Reduce Societal Costs of Accidents**
 - Promulgate in a timely manner China's national standards for snow tyres to regulate snow tyre products and their use in the Chinese market.
 - Form snow tyre legislation to mandate the usage in China's low-temperature areas to improve road safety and reduce impact on society.
- 2. Promote the Development of the Intelligent Connected Vehicle (ICV) industry, and Facilitate the Implementation of Relevant Testing Standards**  **2**
 - Accelerate the development of test regulations and establish a complete test evaluation system.
 - Actively cooperate with multinational companies to jointly develop test standards and realise experience-and data-sharing.
 - Facilitate cross-border data flows to allow continuous improvement of design, operations and maintenance of ICVs.
- 3. Allow the Import of Rejected Auto Parts from Overseas Markets for Quality Assessment by Analysis Centres Based in China**
 - Release annual quotas to companies with relevant qualification to import rejected auto parts from overseas markets to conduct quality inspection and analysis.
 - Allow qualified companies to dismantle the rejected parts and ship their detached components to domestic and overseas sub-suppliers for in-depth analysis.

Introduction to the Working Group

The auto components industry complements the automotive industry in helping to provide mobility for people and goods, essential in today's inter-connected 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, contributing to 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, which 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 remanufacturing and recycling.

The Auto Components Working Group was created in 2000, the year the European Chamber was established. 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. This working group has fostered ties with various organisations and governmental bodies in Europe and China.





Recent Developments

Market Development

The Auto Climate Index (ACI)¹ of China in the first and second quarter of 2020 was quite low at 6 and 15 respectively, after the coronavirus disease 2019 (COVID-19) hit in the first half of the year,² but recovered to a normal range of 54 in the third quarter and 46 in the fourth as the automobile industry gradually returned to normal operations and continued to rank first globally.³

Due to the pandemic, auto production and sales in 2020 shrunk 2 per cent and 1.9 per cent year-on-year respectively, with 25.2 million vehicles produced and 25.3 million sold, a decline of 5.5 per cent and 6.3 per cent from the previous year. In terms of market segments, passenger vehicle production and sales volumes reached 19.9 million and 20.1 million units respectively, down 6.5 per cent and 6 per cent year-on-year. Sedan production and sales volumes decreased by 10 per cent and 9.9 per cent respectively. However, sport utility vehicle (SUV) production and sales volumes increased by 0.1 per cent and 0.7 per cent year-on-year, exceeding sedan growth rates for the first time. One bright spot during the year was the substantial growth in commercial vehicle production and sales, driven by factors such as the phasing out of National III emission standards vehicles, stricter enforcement of speed and load limit regulations, and infrastructure investment.⁴ Commercial vehicle production and sales volumes reached 5.2 million and 5.1 million in 2020, a year-on-year increase of 20 per cent and 18.7 per cent respectively, marking a record high.⁵

Furthermore, monthly sales volumes of NEVs in 2020 have shown significant year-on-year growth since July 2020. Annual market sales were better than expected,⁶

with 1.3 million units produced and 1.3 million sold, a year-on-year increase of 7.5 per cent and 10.9 per cent respectively. This increase converted the growth rate into a positive rate, compared to 2019's negative rate. Specifically, for battery electric vehicles (BEVs), production and sales volumes each totalled 1.1 million, up 5.4 per cent and 11.6 per cent year-on-year respectively. Figures stood at 260,000 and 251,000 for plug-in hybrid electric vehicles (PHEVs), an increase of 18.5 per cent for production and 8.4 per cent in sales over the previous year, while fuel cell electric vehicles (FCEVs) production and sales volumes both reached 1,000 units, down 57.5 per cent and 56.8 per cent respectively on 2019.⁷ Auto exports began to recover in September from the downturn during the first eight months of the year, with export volumes hitting record highs for two consecutive months in November and December.

Policy Environment

Carbon neutrality for the auto industry

On 22nd September 2020, President Xi Jinping stated in his speech at the 75th General Debate of the United Nations General Assembly: "China will increase its nationally determined contributions, adopt more powerful policies and measures, and strive to reach its peak carbon dioxide emissions by 2030, and strive to achieve carbon neutrality by 2060."^{8&9} The *China Automobile Low Carbon Action Plan (CALCP) 2020 Research Report* stated that the average full life-cycle carbon emissions for a single vehicle in China decreased year-on-year between 2010 and 2019. However, full life-cycle carbon emissions for mass-produced passenger vehicles were still significant, at about 620 million tonnes of carbon dioxide equivalent (CO₂e). Gasoline vehicles contribute 94.7 per cent of total passenger vehicle carbon emissions compared to those powered by other fuel types, amounting to 580 million tonnes of CO₂e.¹⁰

¹ Under the guidance and support of the Ministry of Industry and Information Technology (MIIT), the National Bureau of Statistics, and the China Machinery Industry Federation, the China Association of Automobile Manufacturers (CAAM) implemented the internationally accepted climate index to create the Chinese ACI system, based on the actual development of the domestic auto industry.

² CAAM Holds a Press Conference in Beijing in January 2021, MIIT, 13th January 2021, viewed 10th March 2021, <http://www.caam.org.cn/chn/1/cate_3/con_5232917.html>

³ 2020 Automotive Industry Development Status, MIIT, 13th January 2021, viewed 10th March 2021, <http://www.caam.org.cn/chn/4/cate_39/con_5232916.html>

⁴ How Long can the National III Emission Standards Vehicle Stay On the Road?, Sohu, 26th September 2019, viewed 17th June 2021, <https://www.sohu.com/a/297673950_120026935>

⁵ The CAAM Holds a Press Conference in Beijing in January 2021, MIIT, 13th January 2021, viewed 10th March 2021, <http://www.caam.org.cn/chn/1/cate_3/con_5232917.html>

⁶ 2020 Automotive Industry Development Status, MIIT, 13th January 2021, viewed 10th March 2021, <http://www.caam.org.cn/chn/4/cate_39/con_5232916.html>

⁷ The CAAM Holds a Press Conference in Beijing in January 2021, MIIT, 13th January 2021, viewed 10th March 2021, <http://www.caam.org.cn/chn/1/cate_3/con_5232917.html>

⁸ Carbon neutral means that the total greenhouse gas emissions produced by organizations, groups, and individuals, either directly or indirectly, within a certain period of time are offset by planting trees, conserving energy, and reducing emissions to achieve "zero" carbon dioxide emissions.

⁹ Annual Installed Capacity Significantly Increases, Energy Storage World Forum, viewed 17th June 2021, <<https://energystorageforum.com/news/energy-storage/annual-installed-capacity-significantly-increases>>

¹⁰ Carbon Emissions from Passenger Vehicles in China Decreased Year-on-Year in the Past Decade, Tanjiaoyi, 4th September 2020, viewed 3rd March 2021, <<http://www.tanjiaoyi.com/article-31864-5.html>>





The government, automobile companies, auto components manufacturers and research institutions have all made efforts in recent years to realise carbon neutrality in China's auto industry. The *Development Report on China's Automotive Industry (2020) (2020 Automotive Blue Book)*, published in December 2020, recommended a three-phase development strategy of "peak carbon emissions by 2028, a plan for achieving near-zero emissions by 2050, and a plan for achieving carbon neutrality by 2060".¹¹ Long Guoqiang, deputy director of the Development Research Centre of the State Council, said: "NEV technical innovations, the deepening of the reform of the auto industry system, and the expansion of transparency will help the auto industry move on the right track to carbon neutrality."¹² In addition, the topic of the 7th China EV100 Forum 2021 was 'Automotive and Transportation Transformation under the Goals of Peaking Carbon Emissions and Carbon Neutrality'.¹³

Carbon emissions in the automotive industry originate from industrial supply, production and manufacturing, as well as the supply and use of automobiles, therefore the industry needs to reduce carbon emissions throughout a product's entire life cycle to achieve carbon neutrality.¹⁴ The European Union (EU) plans to establish a unified life-cycle carbon emissions assessment statistical system by 2023, under which the emissions of every imported car to the EU market must be calculated and published. It is inevitable that this trend of quantifying and managing the entire life cycle carbon emissions of passenger cars will become global as decarbonisation efforts increase.

NEVs

The NEV industry welcomed the publication by the MIIT on 8th March 2021 of several catalogues, including the *Catalogue of Recommended Models for the Popularisation and Use of New Energy Vehicles* (second batch in 2021), *Catalogue of the Energy-saving and New-energy Vehicle Models Entitled to Vehicle and Vessel Tax Reduction and Exemption* (24th batch),

and the *Catalogue of New-Energy Automobile Models Exempt from Vehicle Acquisition Tax* (40th batch).¹⁵

The MIIT also published the *Decision to Amend the Regulations on the Market Access for New Energy Vehicle Manufacturers and Products* on 24th July 2020, removing the requirements on design and development capabilities for NEV manufacturers, and allowing those that are struggling to maintain normal production 24 months before they have to issue a special public notice, instead of the original 12 months.¹⁶

The Ministry of Finance (MOF), the MIIT, the Ministry of Science and Technology (MOST), and the National Development and Reform Commission (NDRC) jointly issued the *Notice on Improving the Financial Subsidy Policy for the Popularisation and Use of NEVs (Notice)* on 31st December 2020, which reduced NEV subsidies by 20 per cent for 2021. Subsidies for vehicles used in public transport and other areas were only lowered by 10 per cent to accelerate the transition of that sector. The *Notice* indicated that while test standards for NEVs in China will be updated in 2021, prior to their issuance and implementation, products tested based on the old standard will benefit from the existing subsidies, provided they meet the technical threshold requirements. In order to apply for a purchase subsidy, an organisation must declare a minimum of 10,000 passenger and 1,000 commercial NEVs.¹⁷ Meanwhile, in April 2020, the MOF, the State Taxation Administration (STA) and the MIIT decided to exempt NEVs—including pure electric vehicles (PEVs), PHEVs (which incorporates extended-range vehicles) and FCVs—from purchase tax between 1st January 2021 and 31st December 2022.¹⁸

The General Office of the State Council issued the *New Energy Vehicle Industry Development Plan (2021–2035) (Plan)* in November 2020, according to which the average power consumption of new passenger PEVs will be reduced to 12 kilowatts per hour (kWh)/100

11 *Three-phase Strategy to Achieve Carbon Neutrality 2020 Automotive Blue Book*, ifeng.com, 28th December 2020, viewed 3rd March 2021, <<http://auto.ifeng.com/c/81kbrDltUEG>>

12 *Ibid.*

13 *Opportunities and Challenges of Automotive and Transportation Transformation under the Goals of Peaking Carbon Emissions and Carbon Neutrality*, Sina, 19th January 2021, viewed 3rd March 2021, <<http://finance.sina.com.cn/tech/2021-01-19/doc-ikftssan8232136.shtml>>

14 *How Can China's Auto Industry Reduce Carbon Emissions to Quickly Achieve Carbon Neutrality?*, ICARBT, 6th December 2020, viewed 3rd March 2021, <<https://baijiahao.baidu.com/s?id=1685333945602496682&wfr=spider&for=pc>>

15 *Announcement*, MIIT, 8th March 2021, viewed 11th March 2021, <https://www.miit.gov.cn/zwgk/zcwj/wjfb/gg/art/2021/art_46c42489a9ff4a72a99918eead556176.html>

16 *Interpretation of Decision to Amend the Regulations on the Admission of New Energy Vehicle Manufacturers and Products*, Department of Industrial Policy and Regulation, 30th July 2020, viewed 9th March 2021, <https://www.miit.gov.cn/zwgk/zcjd/art/2020/art_2f945287540f4761a4bd62cec9213d89.html>

17 *Notice on Improving the Financial Subsidy Policy for the Popularisation and Use of NEVs*, MOF, MIIT, MOST and NDRC, 31st December 2020, viewed 10th March 2021, <http://www.caam.org.cn/chn/9/cate_99/con_5232808.html>

18 *Notice of Purchase Tax Exemption for NEVs*, MOF, State Tax Administration (STA) & MIIT, 16th April 2020, viewed 9th March 2021, <http://www.caam.org.cn/chn/9/cate_99/con_5229898.html>





kilometres by 2025.¹⁹ The *Plan* stipulates that NEV sales should make up about 20 per cent of the total sales of new vehicles, and indicates that there will be large commercial use of highly autonomous vehicles in limited areas and for specific purposes by 2025.²⁰ By 2035, the *Plan* aims for PEVs to be the main force driving new vehicle sales, for public sector vehicles to all be electric, FCVs to be commercially available, and highly autonomous vehicles to be used on a large scale.²¹

Intelligent vehicles

The future of intelligent vehicles is gradually becoming clearer. Eleven departments, including the NDRC and the MIIT, jointly issued the *Strategies for the Innovative Development of Intelligent Vehicles* at the end of February 2020, which defined intelligent vehicles as "a new generation of vehicle equipped with advanced sensors and devices, using artificial intelligence and other new technologies, capable of autonomous driving, and which gradually becomes an intelligent mobile space and client device." The strategies also laid out a clear blueprint for the Chinese autonomous vehicle industry.²²

However, semiconductor chips, which are vital for intelligent vehicles, are currently in short supply. According to Bernstein Research, the global auto chip shortage in 2021 is expected to result in the decrease of production of 24.5 million vehicles, equivalent to nearly five per cent of the annual global vehicle production over the last decade.²³ As China has the largest car market, it has been severely impacted by the shortages. In the working group's opinion, industry players need to implement an auto component purchasing system and build a resilient supply chain for the chip industry.²⁴ In response to the chip shortage, the MIIT published the *Automotive Semiconductor Supply and Demand Docking Manual* on 26th February 2021, which includes 568 products from 59 semiconductor companies. The *Manual* covers 10 categories such as processors, control chips, power chips and communication chips,

with 53 product sub-categories. Moreover, it contains information on an additional 1,000 product requirements from 26 automotive and component companies, both domestic and foreign-invested.²⁵ The working group welcomes this publication, and believes that this bridge between the supply side and the demand side will help to shorten the supply chain and alleviate the chip shortage.

Stabilising consumption

To reduce the pandemic's impact on the industry, the government took a multi-pronged approach to stabilising and expanding automobile consumption. Eleven departments, including the NDRC and the MOST, jointly issued the *Several Policies for Stabilising and Expanding Automobile Consumption* in April 2020, which recommended implementing the deadline for transition to China's VI emission standards on particle number (PN) limits for light-duty vehicles, accelerating the retirement of scrapped and old diesel trucks, improving trade of used vehicles, and increasing consumer credit support for private automobiles.²⁶ On 14th December 2020, the STA and the MIIT jointly issued the *Announcement on Administration Issues on the Vehicle Acquisition Tax Exemption for Special-purpose Vehicles Fitted with Specialised Equipment*, which went into effect on 1st January 2021.²⁷

Key Recommendations

1. Mandate Snow Tyre Usage During the Cold Season of Low-Temperature Areas to Improve Road Safety and Reduce Societal Costs of Accidents

Concern

The lack of existing regulation to mandate the usage of snow tyres in complex road conditions of snow and slush in China's low-temperature regions²⁸ significantly increases tyre-related²⁹ crashes and fatalities.

19 *New Energy Vehicle Industry Development Plan (2021-2035)* Issued by the General Office of the State Council, Xinhua, 2nd November 2020, viewed 10th March 2021, <http://www.gov.cn/xinwen/2020-11/02/content_5556762.htm>

20 Ibid.

21 Ibid.

22 *11 Departments Jointly Issue the Strategies for the Innovative Development of Intelligent Vehicles*, People's Daily, 13th March 2020, viewed 9th March 2021, <http://www.xinhuanet.com/auto/2020-03/13/c_1125708176.htm>

23 *Ten Questions about China's Chips: We can build an atomic bomb, but we can't build a small chip?*, qqttech, 10th March 2021, viewed 10th March 2021, <https://mp.weixin.qq.com/s/c_UbBKVYKNGXrbTdvfpw>

24 Ibid.

25 Ibid.

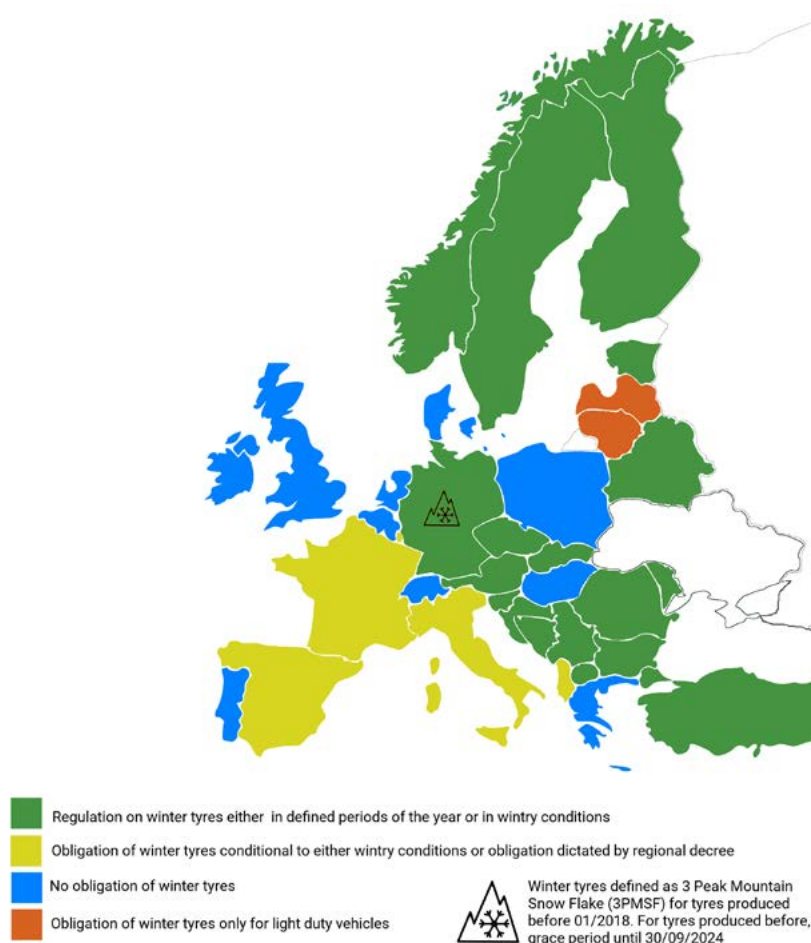
26 *Notice by 11 Departments on Several Policies for Stabilising and Expanding Automobile Consumption*, CCTV.com, 30th April 2020, viewed 10th March 2021, <<http://news.cctv.com/2020/04/30/ART1bXyoD3QEspW65pox5gVJ200430.shtml>>

27 *Two Departments: Vehicle Acquisition Tax Exemption for Special-purpose Vehicles from 2021*, CAAM, 14th December 2020, viewed 10th March 2021, <http://www.caam.org.cn/chn/9/cate_107/con_5232678.html>

28 China's low-temperature areas refer to Heilongjiang, Jilin and Liaoning provinces, the northern part of Xinjiang and Inner Mongolia Autonomous Region, among others.

29 Tyres not designed for the usage's purpose (non-winter tyres), normal tyres.



SNOW TYRE OBLIGATIONS ACROSS EUROPE³⁰

Assessment

In the colder regions of China, complex snow and ice conditions are common. The tread compound of normal tyres tends to stiffen and lose traction and grip in low temperatures, which makes accelerating, cornering and braking less reliable and riskier on snowy and icy roads. Therefore, the promotion of snow tyres and the formulation of legislation and standards to mandate snow tyre usage is of paramount importance to ensure driving safety under snowy road conditions.

Snow tyres are specially developed for use during winter, with a soft rubber compound and tread pattern designed to deliver excellent grip and driving performances in complex winter road conditions such as snow and ice, with significantly improved braking distance. Their use is crucial to avoid sideslip and

ensure driving safety. According to a survey by the China In-Depth Accident Study of the China Automotive Technology and Research Centre, snow tyre usage led to a significant decline in car accidents (occurring twice as less) and fatalities (nearly three times less).³¹

Road Condition	Tyre Category	Number of Accidents	Accident Ratio
Snow/ice	Snow tyre	36	1 (benchmark)
	Normal tyre	55	2

Road Condition	Tyre Category	Fatal Accidents	Fatal Ratio
Snow/ice	Snow tyre	6	1 (benchmark)
	Normal tyre	14	3.055

³⁰ Winter tyres obligations across Europe, July 2019, ETRma, viewed 16th March 2021, <<https://www.etrma.org/key-topics/tyre-regulations/>>

³¹ The source of this data comes from member company independent survey project.





Currently, snow tyres are already mandatory³² during winter in many European countries (including Austria, Finland, Sweden and Norway) to ensure driving safety. The working groups recommends that China introduce a similar policy in the northern region where necessary.

Recommendations

- Promulgate in a timely manner China's national standards for snow tyres to regulate snow tyre products and their use in the Chinese market.
- Form snow tyre legislation to mandate the usage in China's low-temperature areas to improve road safety and reduce the negative impact on society.

2. Promote the Development of the Intelligent Connected Vehicle (ICV) Industry, and Facilitate the Implementation of Relevant Testing Standards 2

Concern

The safety testing standards for ICVs are still not united and relevant laws and regulations need further improvement.

Assessment

In recent years, ICVs have become the strategic direction for the development of the global automotive industry, as well as at the national level in China. Many domestic and foreign companies have invested extensive labour and material resources in ICV technology, including autonomous driving and Vehicle to X (V2X) sensor technology.³³

On 24th February 2020, the NDRC issued the *Innovative Development Strategy of Intelligent Vehicles*, which proposes to improve technical standards and test evaluation technology, and to enact relevant laws and regulations for intelligent vehicle testing.³⁴ Test standards and evaluation systems are essential to the industrialisation of ICVs. As the intelligent network industry develops, test standards also need to evolve. Testing the safety of ICVs is more complicated than that of general vehicles; however, traditional test standards and methods and advanced driver assistance system

functional tests still apply for ICVs. In addition, ICVs also must comply with international standards,³⁵ such as those for adaptive cruise control, autonomous emergency braking, forward collision warning, lane departure warning and lane-keeping assist.³⁶ In China, the current relevant laws and regulations for intelligent vehicle testing need to be improved, and uniform test standards for ICVs enforced. Failure to do so restricts the quantitative production of ICVs and the further development of the industry.

Taking ICV sensors as an example, V2X can easily detect data at a range of up to a kilometre, while the current range of radar and visual sensors is generally about 200 metres.³⁷ In addition, V2X will also solve intelligent vehicles' blind spots problem. The technological advancement stems from the extension of sensors; that is, numerous sensors placed on the side of the road to transmit perception results to the vehicle, which will reduce internal vehicle sensing costs and challenges, and improve capacity beyond the field of vision.

As an 'over-horizon sensor', V2X is limited by bandwidth and processing performance, and ICV ability to process information from nearby vehicles is limited. For instance, when there is a large number of nearby vehicles (such as a parking lot), selectively processing data poses a great challenge for ICVs. In terms of safety, for an ICV with V2X to be approved for mass production, the relevant test standards need to be implemented as soon as possible. In addition, the ICV sensors still face many technical bottlenecks; for example, in central business districts, the high number of WiFi facilities may interfere with the ICV sensors, leading to safety risks. Moreover, it is difficult for a single route to test all technical requirements of sensors in all scenarios, and the wide variety of Chinese roads also makes it impossible to exhaust all possibilities during testing. That means the formulation of relevant test standards and promoting the marketisation of ICVs needs to be accelerated.

32 The 'mandatory' notice can vary, depending on the country involved, and the map is updated regularly.

33 *A Brief Introduction to V2X*, Zhihu, 30th December 2019, viewed 17th June 2021, <https://zhuanlan.zhihu.com/p/100217165?utm_source=wechat_session>

34 *Innovative Development Strategy of Intelligent Vehicles*, NDRC, 24th February 2020, viewed 19th March 2021, <<https://www.ndrc.gov.cn/xxgk/zcfb/tz/202002/P020200224573058971435.pdf>>

35 (WP.29/GRVA) Working Party on Automated/Autonomous and Connected Vehicles (1st session), United Nations Economic Commission for Europe, 25th September 2018, viewed 19th March 2021, <<https://unece.org/transport/news/unece-and-china-increase-cooperation-un-vehicle-regulations>>

36 *Hu Zhaozheng: Testing is an Urgent Problem to be Solved in the Intelligent Connected Automobile Industry*, Sohu, 3rd September 2019, viewed 22nd March 2021, <https://www.sohu.com/a/342444867_383324>

37 *In-depth Report: The Internet of Vehicles Welcomes a Key Policy Window and the Demonstration Area is in Full Swing*, 5G Industry Application, 28th February 2020, viewed 22nd March 2021, <https://mp.weixin.qq.com/s/bHVnKY2_-4Ym27TYpgBrkQ>





Intelligent networking is the future of the automotive industry. Leading multinational companies (MNCs) have invested a lot in innovation and developing this sector, and have accumulated considerable amounts of best practices. The experience and data of MNCs can play a vital role in the development of high-quality intelligent network technology in China. The Auto Components Working Group recommends inviting MNCs to share their relevant experiences and participate in designing Chinese test standards. Involving MNCs and facilitating cross-border data flows can also help them adjust the technical direction and test scope of their products for the Chinese market in a timely manner, continuously improve their operations and maintenance procedures, and nurture the development of the ICV industry in China.

Recommendations

- Accelerate the development of test regulations and establish a complete test evaluation system.
- Actively cooperate with MNCs to jointly develop test standards and realise experience- and data-sharing.
- Facilitate cross-border data flows to allow continuous improvement of design, operations and maintenance of ICVs.

3. Allow the Import of Rejected Auto Parts from Overseas Markets for Quality Assessment by Analysis Centres Based in China

Concern

According to Chinese laws and regulations,³⁹ rejected auto parts from overseas markets are regarded as 'electromechanical waste products' and cannot be imported for dismantling and analysis.

Assessment

The automobile industry has become an essential pillar for China's economy. The newly developed sections of the industry also play an important role in its entire industrial chain. According to CAAM statistics, the

annual sales revenue of the auto components industry exceeded Chinese yuan (CNY) 4 trillion and will exceed CNY 5 trillion in 2021.³⁹

These analysis centres conduct technical analysis on auto parts rejected by OE manufacturers to figure out the reasons why the part malfunctioned, which led to its rejection. They not only help a company improve its product quality and technical capabilities but can also assist in the establishment of a quality management system in China for domestic auto parts. In addition, analysing rejected parts from overseas markets can help Chinese subsidiaries enhance their understanding of product application and environments in other regions. It will also allow these China-based centres bring their R&D capabilities closer to the technical level of the corporate headquarters. Therefore, analysis of rejected auto parts from overseas markets is key to the industrial advancement and market development of Chinese companies.

Moreover, in recent years, China Customs has consistently emphasised the need to improve customs clearance efficiency to optimise the import/export business environment. R&D is a top priority for MNCs, and the facilitation of the import and export of R&D materials and analysis of parts plays a decisive role in boosting the economy.

Through innovative systems and mechanisms, strengthened coordination and interconnection, improved legal guarantees, and benchmarking against advanced international standards, China can create a stable, fair, transparent, and predictable environment for various entities to invest in and start businesses.

Rejected auto components are divided into three types:

1. Those produced in China and supplied to domestic automobile manufacturers;
2. Those produced in China and supplied to overseas automobile manufacturers; and
3. Those produced overseas and supplied to an overseas manufacturer.

In China, types 2 and 3 are regarded as 'electromechanical waste products' and their imports are forbidden, meaning that Chinese auto component companies cannot analyse rejected parts from overseas markets. According to the *Administrative Procedures on Goods of Temporary Entry and Exit (Administrative*

³⁹ *Customs Law (2017 Amendment)*, Standing Committee of the National People's Congress, 4th November 2017, viewed 10th March 2021, <www.customs.gov.cn/customs/302249/302266/302267/1880958/index.html>; *Administration of Goods Temporarily Imported or Exported*, General Administration of Customs (GAC), 14th February 2007, viewed 10th March 2021, <www.gov.cn/ziliao/flfg/2007-03/05/content_542492.htm>; *Administrative Procedures for the Import of Electromechanical Products*, Ministry of Commerce, GAC and State Administration of Quality Supervision, Inspection and Quarantine, 20th December 2001, viewed 10th March 2021, <www.mofcom.gov.cn/article/swfg/swfgbf/200212/20021200058698.shtml>





Procedures), if the parts enter China through temporary import and export, they must be re-exported within a specified time, and the inbound and outbound status of goods should remain the same. However, in-depth analysis of the rejected parts will require disassembly. If component issues are involved, the components (the percentage can be as high as 60 per cent of the part) also need to be disassembled and sent to downstream suppliers—which may be located overseas as well as in China—for a more in-depth analysis, but the *Administrative Procedures* do not allow components to be disassembled from the main body and shipped separately.

Under the *Regulation on Repair, Replacement and Refund of Private Cars (3R Regulations)*, manufacturers are liable for the repair, replacement and return of components in relation to certain quality issues. Auto components sold abroad also need to comply with overseas regulations. However, as the *Administrative Procedures* do not currently allow for the importation or disassembly of rejected parts for analysis, not only are the operations of individual companies affected but also the development of international business is impeded. As domestic auto component enterprises continue to expand their overseas markets, they will also face the same dilemma when attempting to return parts to China for quality analysis.

Recommendations

- Release annual quotas to companies with relevant qualifications to import rejected auto components from overseas markets to conduct quality inspection and analysis.
- Allow qualified companies to dismantle rejected parts and ship their components to domestic and overseas sub-suppliers for in-depth analysis.

Abbreviations

ACI	Auto Climate Index
BEV	Battery Electric Vehicle
CAAM	China Association of Automobile Manufacturers
CALCP	China Automobile Low Carbon Action Plan
CIDAS	China In-Depth Accident Study
CNY	Chinese Yuan
CO ₂ e	Carbon Dioxide Equivalent
COVID-19	Coronavirus Disease 2019
EU	European Union
EV	Electric Vehicle
FCEV	Fuel Cell Electric Vehicle
FCV	Fuel Cell Vehicle
ICV	Intelligent Connected Vehicle
MIIT	Ministry of Industry and Information Technology
MNC	Multinational Company
MOF	Ministry of Finance
MOST	Ministry of Science and Technology
MOU	Memorandum of Understanding
NDRC	National Development and Reform Commission
NEV	New Energy Vehicle
OE	Original Equipment
PEV	Pure Electric Vehicles
PHEV	Plug-in Hybrid Electric Vehicle
PN	Particle Number
R&D	Research and Development
STA	State Taxation Administration
SUV	Sport Utility Vehicle
V2X	Vehicle to X
VAT	Value-added Tax





Cosmetics Working Group

Key Recommendations

1. Ensure a Smooth Transition Period when the Cosmetics Supervision and Administration Regulation (CSAR) Implementing Regulations are Introduced

- Implement streamlining and delegation in secondary legislation to establish an efficient supervision system based on risk management, with companies bearing the responsibility for product quality and safety.
- Provide sufficient transition periods for major regulatory changes that affect the industry, with consideration given to the different requirements of European Union regulations, and develop flexible policies to ensure the transition is as smooth as possible.

2. Encourage Innovation in the Cosmetics Industry to Boost its Development

2.1 Comprehensive and Scientific Management System for Cosmetics Ingredients

- Develop an evaluation, reference and adoption process under the leadership of the National Medical Products Administration (NMPA), to supplement the new policy for new ingredients management under the framework of the CSAR, in order to allow the import and use of high-risk ingredients approved in other economic entities and to promote product innovation in China.

2.2 Management and Surveillance Mechanisms for Personalised Products

- Establish management and surveillance mechanisms for personalised cosmetics that include administrative provisions on registration and notification, production and sales, in order to promote the development of and meet the demand for personalised cosmetics in China.
- Adopt, as the principles of management and surveillance mechanisms for personalised products, 'clear responsible manufacturer', 'controllable quality and safety', and 'product traceability'.
- Establish standards for quality and safety management with reference to different personalisation scenarios and risk control points that may involve product quality and safety.

2.3 Modern Risk Management System and Alternative Animal Test Methods

- Promote the establishment and popularisation of alternatives to animal testing, and formulate detailed guiding rules for the implementation of innovative, non-test assessment methods such as Threshold of Toxicological Concern and read-across.
- Phase out the requirement to submit animal test data for registration of cosmetics in those special cases where such data still need to be submitted.

3. Ensure the Smooth Implementation of the Provisions for the Management of Cosmetics Registration and Notification Dossiers

3.1 Transparent and Unified Evaluation Standards

- Formulate detailed, transparent and consistent criteria for the evaluation of cosmetics, as well as guidelines to allow manufacturers to compile registration dossiers.
- Conduct investigations and surveys prior to introducing new evaluation requirements and then publicly notify companies before such review requirements are implemented.



3.2 Capacity Training for Evaluators and Manufacturers, and Improving Communication Between Different Stakeholders

- Increase different forms of training by authoritative lecturers, such as formal in-person training sessions, online interpretations and questions-and-answer (Q&A) sessions, to provide an official interpretation of the regulations and consistent answers to specific questions.
- Establish an open consultation and communication mechanism for different stakeholders to support the evaluation and registration of cosmetics.
- Establish a Q&A section on the NMPA's website, sharing information on common challenges in the registration process and providing an authoritative interpretation of regulations and provisions.

4. Improve the Management of Efficacy Claims and Labelling

4.1 Administration of Efficacy Claim Evaluation

- Extend the application scope of the guiding principle of equivalent evaluations to all product efficacies, not only multi-colour cosmetics products.
- Accept an applicant's rationale as to why minor differences in formulas do not affect efficacy, and allow for slight adjustments of ingredients in formulas.
- Allow manufacturers to select the most suitable test methods for efficacy evaluation, unless prescribed by mandatory national standards or technical guidelines.

4.2 Administration of Labelling

- Establish guidelines for the application of electronic labels to all sizes of cosmetics packaging.
- Allow the approach of foldable labels and consider all visible areas of the sheet as visible panels.
- Allow the Chinese label to reflect selected efficacy claims from the original label, and allow any information that is required to be identified by the laws and regulations of the region of origin to be either noted on, or covered by, the Chinese label.

5. Establish a Well-organised Post-market Surveillance System

5.1 Scientific and Sound Adverse Effects Monitoring Rules for Cosmetics Product Categories

- Establish adverse reaction reporting principles that are suitable to the cosmetics industry and an individual product's characteristics, and adopt a system of classified and graded reports instead of each complaint being handled as an adverse reaction.

5.2 Fair Quantitative Rating System of Cosmetics Manufacturers

- Rate enterprises according to the overall notification of manufacturer either every six months or one year.
- Take into consideration the percentage of annual or semi-annual notification opinions, rather than the total number of notifications, when calculating notification quality.

Introduction to the Working Group

Cosmetics include daily-use chemical products intended to be applied externally to parts of the human body—such as skin, hair, nails and lips—for the purposes of cleansing, protecting, beautifying or grooming.¹ They

are used by individuals to improve both appearance and well-being. Although once thought of as luxury products, most people now consider cosmetics a daily necessity. Thus, creating a sustainable cosmetics industry will help to improve people's quality of living.

The Cosmetics Working Group consists of more than 70 members, including a large number of internationally

¹ *Regulations on the Supervision and Administration of Cosmetics* (in Chinese), State Council, 29th June 2020, viewed 22nd April 2021, <http://www.gov.cn/zhengce/content/2020-06/29/content_5522593.htm>





well-known cosmetics brands with a diverse range of business models. The majority of members are industry leaders and have established research and development (R&D) as well as production facilities in China. 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:

- present the interests of European cosmetics companies and facilitate information exchange among members, professional associations and regulatory bodies;
- promote sustainable and healthy development of China's cosmetics industry, and contribute to the formation of an efficient, fair and transparent regulatory environment; and
- ensure consumer safety.

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 ensure that the domestic market becomes stronger, and provide Chinese consumers access to a variety of new and advanced products.

Recent Developments

As a result of the coronavirus disease 2019 (COVID-19) pandemic, the growth rate of China's overall retail sales of consumer goods slowed sharply in 2020. However, China's cosmetics industry maintained relatively resilient development and steady growth. With COVID-19 now mostly under control in China, the domestic cosmetics market is quickly recovering and sales volumes are growing. Also, due to companies changing their business models to cope with the pandemic, live streaming e-commerce is emerging as a new sales model.

According to data from the National Bureau of Statistics of China (NBS), the total retail sales of cosmetics of enterprises above a designated size in China—defined as companies whose main annual business income exceeds Chinese yuan (CNY) 20 million—reached CNY 340 billion in 2020, an increase of 9.5 per cent

compared with 2019.²

The quantity and value of imported beauty cosmetics and toiletries in China continued to rise in 2020; the quantity of exports also continued to grow, though the value declined. From January to December 2020, the value of imported beauty cosmetics and toiletries was approximately CNY 140 billion, representing a cumulative increase of 29.7 per cent;³ meanwhile, the value of exported cosmetics and toiletries was about CNY 29.5 billion, a decrease of 10.6 per cent.⁴

Despite the impact of the pandemic on global supply chains and operations in 2020, the Cosmetics Working Group member companies maintain full confidence in the development of the industry in China. Most members actively participated in the 3rd China International Import Expo 2020, where the latest development trends in global cosmetics technology and product innovations were exhibited, with cosmetics combined with intelligent digital technologies and instruments attracting the most attention.

The most encouraging development for the industry was the promulgation of the long-awaited *Cosmetics Supervision and Administration Regulations* (CSAR) on 29th June 2020, which came into force on 1st January 2021.⁵ Since then, China's supervision and administration of cosmetics has entered a new phase. In the second half of 2020, the National Medical Products Administration (NMPA) published more than ten supporting provisions and drafts concerning registration and notification of cosmetics, supervision of production and operation, sampling for inspection, safety evaluation and adverse reaction monitoring, classification, efficacy claim verification and labelling.

In addition, the *Provisions for the Management of Cosmetics Registration and Notification Dossiers* was promulgated on 1st May 2021, which, at last,

2 *Stable Recovery of the National Economy in 2020, Key Areas Better Than Expected* (in Chinese), NBS, 18th January 2021, viewed 20th April 2021, <http://www.stats.gov.cn/tjsj/zxfb/202101/t20210118_1812423.html>

3 *Volume and Value of Imported Major Commodities in December 2020* (in CNY), General Administration of Customs (GAC), 18th January 2021, viewed 20th April 2021, <<http://www.customs.gov.cn/customs/302249/zfxgk/2799825/302274/302277/302276/3516038/index.html>>

4 *Volume and Value of Exported Major Commodities in December 2020* (in CNY), GAC, 18th January 2021, viewed 20th April 2021, <<http://www.customs.gov.cn/customs/302249/zfxgk/2799825/302274/302277/302276/3516030/index.html>>

5 *Regulations on the Supervision and Administration of Cosmetics* (in Chinese), State Council, 29th June 2020, viewed 22nd April 2021, <http://www.gov.cn/zhengce/content/2020-06/29/content_5522593.htm>





conditionally waives the requirement for animal testing of non-special cosmetics imported into China.⁶ This exciting news reflects a breakthrough in the application of equal treatment by the Chinese Government in terms of registration and notification requirements for domestically produced and imported products.

The implementation of the CSAR and its supporting provisions will guide the improvement of quality management systems of companies, encourage enterprises to increase their investments in R&D and efficacy evaluation, and further enhance the level of quality and safety assurance of China's cosmetics industry.

The Cosmetics Working Group will continue to support the formulation and revision of provisions and standards by the regulatory authorities, offer expert know-how for the formulation and implementation of supporting regulations, and actively cooperate with the authorities to smoothly implement the new regulations. The Cosmetics Working Group expects the regulatory authorities to continue with an inclusive approach to the legislative process, fully heed the opinions of the industry, strengthen field visits and investigations, and objectively assess the actual impact of new requirements on the whole process of R&D, production and operations. It is suggested that—in line with the best practices of mature, international markets—the Chinese regulatory authorities should, during the extremely intensive promulgation of regulations, minimise the impact of such regulations on the launch of new products. This can help to ensure high-quality development of the cosmetics industry, while promoting smooth implementation of new regulations.

Key Recommendations

1. Ensure a Smooth Transition Period when the Cosmetics Supervision and Administration Regulation (CSAR) Implementing Regulations are Introduced

Concern

Without a smooth transition period, significant legislation changes under the CSAR will have a tremendous

impact on the whole cosmetics industry, which may hinder or even prevent normal product launches.

Assessment

The promulgation of the CSAR demonstrated marked progress in administrative streamlining and decentralising authority, and an improvement in China's risk-based classification management system, all of which are conducive to innovation and upgrading cosmetics R&D. The CSAR encompasses a system of registration and notification, which improves the compliance level of the entry threshold of cosmetics production and operations as a whole. However, the effective implementation of the CSAR requires prompt formulation of supporting regulations and smooth transition.

There are several major new requirements under the CSAR—including the definition and scope of cosmetics, the supervision of products with special efficacies and ingredients, and labelling specifications—that will shape the supervisory framework and have a long-term impact on the industry. Full consideration should be given to the potential impact of these new regulations on companies and the industry in general, as well as the differences between the laws and regulations of China and Europe. Only with policies that prevent short-term industry fluctuations can the regulations be implemented satisfactorily, and to the benefit of companies, consumers and the industry as a whole.

Recommendations

- Implement streamlining and delegation in secondary legislation to establish an efficient supervision system based on risk management, with companies bearing the responsibility for product quality and safety.
- Provide sufficient transition periods for major regulatory changes that affect the industry, with consideration given to the different requirements of European Union (EU) regulations, and develop flexible policies to ensure the transition is as smooth as possible.

2. Encourage Innovation in the Cosmetics Industry to Boost its Development

2.1 Comprehensive and Scientific Management System for Cosmetics Ingredients

Concern

During the process of updating China's prohibited, restricted and permitted substances list, no clear

⁶ Provisions for Management of Cosmetic Registration and Notification Dossiers (in Chinese), National Medical Products Administration, 4th March 2021, viewed 17th May 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210304140747119.html>>





systematic assessment system or decision-making mechanism for high-risk ingredients was established, which will hold back cosmetic product innovation in China.

Assessment

The promulgation of the CSAR and the secondary provisions related to the management of new ingredients has established a completely new administrative system for such materials, providing a feasible way for market access of low-risk ingredients. However, for high-risk ingredients, including those already approved in other countries, there is still no smooth pathway for registration in China.

In most other economies around the world, cosmetics ingredients with special efficacies—such as ultraviolet light absorbers, preservatives and hair dyes—receive approval via a positive list. With comprehensive information provided through safety studies, the ingredients included in the list have all passed scientific evaluation conducted by authoritative organisations in each respective country. Because these high-risk ingredients are urgently needed for manufacture of finished products, their evaluation is usually initiated by the government or the industry. For declarations of high-risk ingredients in other parts of the world, companies that share a common interest will often also share data and costs for evaluation as normal practice. However, this practice has not yet been adopted in China, making it difficult for individual companies to make these declarations due to a lack of comprehensive data and the high costs associated with the process.

Given the fact that such ingredients have been authoritatively reviewed and widely used in many countries for many years, a special access mechanism should be established to answer the common demand of China's cosmetics industry, and to provide legal support for market access of these ingredients in China.

Recommendation

- Develop an evaluation, reference and adoption process under the leadership of the NMPA to supplement the new policy for new ingredients management under the framework of the CSAR, in order to allow the import and use of high-risk ingredients approved in other economic entities and promote product innovation in China.

2.2 Management and Surveillance Mechanisms for Personalised Products

Concern

China does not formulate and implement corresponding regulations and standards based on the nature and classification of personalised cosmetics, which runs counter to the State Council's principle of encouraging innovation and impedes the development of the cosmetics industry, while also failing to meet growing consumer demand for personalised products.

Assessment

In an era of increasingly service-orientated economies across much of the world, personalised services are emerging as a dominant market trend. Consumers are more likely to choose cosmetics according to, for example, their own skin conditions, among other personal preferences. A vast increase in consumer requirements for specific cosmetics has resulted, with personalised products now a fast-growing consumption segment for customers globally.

Cosmetics companies no longer target consumers just by age, gender or skin type, as taking a more personalised approach enables the provision of more targeted products. It also improves the accuracy of consumer information gathered in order to deepen studies on consumer behaviour. Consumers are increasingly able to benefit from special experiences and interactions during the purchasing process, while gaining a better understanding of brands through personal involvement in the customisation of products. Across the globe, many different types of personalised products are being developed, with some being integrated with new technologies such as digitisation. During the China International Import Expos, cosmetics companies showcased numerous personalised products that embody the latest international innovative technologies. However, despite these products being quality and safety assured in foreign markets, as well as welcomed by consumers, they are restricted in China by current domestic cosmetics regulations.

Recommendations

- Establish management and surveillance mechanisms for personalised cosmetics that include administrative provisions on registration and notification, production and sales, in order to promote the development of and meet the demand for personalised cosmetics in China.





- Adopt, as the principles of management and surveillance mechanisms for personalised products, 'clear responsible manufacturer', 'controllable quality and safety', and 'product traceability'.
- Establish standards for quality and safety management with reference to different personalisation scenarios and risk control points.

2.3 Modern Risk Management System and Alternative Animal Test Methods

Concern

Due to a lack of detailed guidelines, as well as varying levels of capability among both regulators and companies, evaluating and implementing the *Technical Guidelines for Cosmetics Safety Assessment* is extremely challenging, particularly with regard to innovative assessment methods like the Threshold of Toxicological Concern (TTC) and read-across.⁷

Assessment

On 9th April 2021, the NMPA issued the *Technical Guidelines for Safety Assessment of Cosmetics (2021 Version)*,⁸ which adopts the widely-used principle of weight of evidence and modern safety assessment methods and tools, including TTC, read-across/chemical grouping and other popular non-testing assessment methods. This demonstrates that China's cosmetics safety evaluation procedure is now in line with advanced, international safety evaluation concepts and methods. However, the supervision enforcement authorities, technical review experts and many cosmetics enterprises in China are not familiar with these innovative assessment methods. Most enterprises are unable to conduct comprehensive safety assessments due to varying levels of technical capability. Meanwhile, supervision enforcement authorities still lack enough experience to review the assessment reports submitted by the few enterprises that do have assessment capabilities.

By late 2020, most major economies have either

banned or are in the process of setting up a timeline to ban animal testing for cosmetics' market approval. China is the only country which mandatorily requires animal testing for the registration of cosmetics. On 4th March 2021, the NMPA published the *Provisions for Management of Cosmetics Registration and Notification Dossiers*, which exempt enterprises from submitting toxicological animal test data for ordinary cosmetics, including imported ordinary cosmetics, that meet certain requirements. This is another important milestone in China's gradual quest to replace compulsory animal testing. However, for special cosmetics, cosmetics that use new ingredients within the three-year monitoring period, and cosmetics for use by infants and children, as well as new ingredients to Chinese market, a number of compulsory toxicological animal tests are still required for registration.

Recommendations

- Promote the establishment and popularisation of alternatives to animal testing, and formulate detailed guiding rules for the implementation of innovative, non-test assessment methods such as TTC and read-across.
- Phase out the requirement to submit animal test data for registration of cosmetics in those special cases where such data still need to be submitted.

3. Ensure the Smooth Implementation of the Provisions for the Management of Cosmetics Registration and Notification Dossiers

3.1 Transparent and Unified Evaluation Standards

Concern

Due to significant changes to requirements following the implementation of the *Provisions for the Management of Cosmetics Registration and Notification Dossiers*, local Medical Products Administrations have not yet been able to apply unified criteria for registration of finished products and ingredients, which increases companies' operational burdens and impacts their marketing plans.

Assessment

There is a long-standing problem in that product reviewers in different regions of China have inconsistent review criteria. In addition, in the new *Provisions for the Management of Cosmetics Registration and Notification Dossiers*, the NMPA has promulgated new requirements

⁷ Read-across is when the already available data of a data-rich substance (the source) is used for a data-poor substance (the target) that is considered similar enough to the source substance to use the same data as a basis for safety assessment. *Read-Across with Computational and In vitro Data*, Elisabet Berggren, DG Joint Research Centre & European Commission, viewed 28th June 2021, <<https://www.toxicology.org/events/shm/fda/docs/4%20SOT%20FDA%20Berggren%20Read-Across.pdf>>

⁸ *The Technical Guidelines for Safety Assessment of Cosmetics (2021 Version)* (No. 51 of 2021), NMPA, 9th April 2021, viewed 21st April 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210409160436155.html>>





for the registration dossier, including specification of ingredients, samples from trial-production and efficacy claims on packaging, among others. The requirements have changed considerably, so it is necessary to formulate detailed and clear interpretations for the requirements of each section of the registration dossier in a timely manner, and to determine nationwide unified criteria for review. New understanding of regulations and the process for implementing related requirements thereof should be communicated to companies in advance, to allow them to effectively prepare materials that meet the requirements. It would also be beneficial for local supervisors to uniformly review the requirements, so as to avoid wasting resources.

Recommendations

- Formulate detailed, transparent and consistent criteria for the evaluation of cosmetics, as well as guidelines to allow manufacturers to compile registration dossiers.
- Conduct investigations and surveys prior to introducing new evaluation requirements and then publicly notify companies before such review requirements are implemented.

3.2 Capacity Training for Evaluators and Manufacturers and Improving Communication Between Different Stakeholders

Concern

There is currently a lack of systematic training, and no sufficient communication channels between regulators and the industry, for implementation of the new requirements under the *Provisions for the Management of Cosmetics Registration and Notification Dossiers*, leading to different interpretations of the regulations by different manufacturers, and delays to both registrations and implementation of the new regulations.

Assessment

Due to major changes in the new regulations, stakeholders are having difficulties understanding and interpreting them. Following the promulgation of various regulations, a large amount of training was provided by third parties; however, interpretations of the regulations were neither consistent nor authoritative, meaning the quality of the training was not assured. It is essential that such regulations be properly interpreted, so that enterprises can understand the various requirements and achieve compliance.

Communication between manufacturers and regulators is currently insufficient due to, among other reasons, a lack of personnel, which leads to delays in providing feedback to manufacturers. With the implementation of new regulations, there will be further need for consultation to ensure the smooth registration and notification of cosmetics.

Recommendations

- Increase different forms of training by authoritative lecturers, such as formal in-person training sessions, online interpretations and questions-and-answer (Q&A) sessions, to provide an official interpretation of the regulations and consistent answers to specific questions.
- Establish an open consultation and communication mechanism for different stakeholders to support the evaluation and registration of cosmetics.
- Establish a Q&A section on the NMPA's website, sharing information on common challenges in the registration process and providing an authoritative interpretation of regulations and provisions.

4. Improve the Management of Efficacy Claims and Labelling

4.1 Administration of Efficacy Claim Evaluation

Concern

The ban on applying the read-across method for efficacy evaluations of similar products is inconsistent with global norms, and results in the need for repetitive tests that increase companies' costs and put pressure on their limited testing resources.

Assessment

The read-across evaluation method of similar formulas is an important basic principle and a practical tool in the R&D of cosmetic products. It is widely used by the cosmetics industry in both China and internationally in efficacy and safety evaluation. This method can be used for test formulas and marketing formulas at the R&D stage. In order to meet the needs of consumers for varied products, manufacturers often develop multiple flavours or colours of a product based on the same basic formula. In addition, once the EU change regulations on cosmetics preservatives, manufacturers often need to slightly adjust the formulas of preservatives. However, it is important to understand that such slight changes in essences, pigments and





preservatives will not affect the efficacy of a product.

If all products need to be tested for efficacy as required under the *Guidelines for Cosmetics Efficacy Claim Evaluation*,⁹ it will not only be inconsistent with current industry practices, but also put great pressure on already limited inspection and testing resources, resulting in an increase of testing costs and the delay of product launches. According to incomplete statistics from Cosmetics Working Group member companies, the testing costs of each enterprise will increase by hundreds of thousands, or even millions, of *renminbi* under this requirement. Moreover, repeated unnecessary tests will not bring any benefits to consumers. On the contrary, the increase in costs will eventually be passed on to them.

Recommendations

- Extend the application scope of the guiding principle of equivalent evaluations to all product efficacies, not only multi-colour cosmetics products.
- Accept an applicant's rationale as to why minor differences in formulas do not affect efficacy, and allow for slight adjustments of ingredients in formulas.
- Allow manufacturers to select the most suitable test methods for efficacy evaluation, unless prescribed by mandatory national standards or technical guidelines.

4.2 Administration of Labelling

Concern

Certain new requirements in the *Administrative Measures of Cosmetics Labelling*¹⁰ are inconsistent with global practices, and could result in an increased burden being placed on enterprises and delays to market for all products, possibly even presenting a *de facto* trade barrier for imported cosmetics.

Assessment

New requirements have been added to the *Administrative Measures of Cosmetics Labelling (Measures)*, providing more detail relating to the content and format of cosmetics labels, such as the full ingredients labelling method, guide words, and the printing of the Chinese name and date of expiry of cosmetics on the primary innermost packaging. However, companies encounter

many practical difficulties in the implementation of these regulations, including the following:

1. The printing area is limited, not only on small-sized products, but also on many normal-sized products.
2. The Chinese name of a product, especially that of special cosmetics, can only be printed after being approved by the NMPA, hence the production cycle will be prolonged and the time to market delayed.
3. Imported products to be sold in China cannot use uniform packaging designed for the global market, requiring re-labelling of cosmetics to take place after import, which will increase product quality risks and trade costs.

Although companies can try to increase their labelling space by expanding the outer box, cosmetic packaging also needs to comply with the mandatory national standard *GB 23350 Restrictions on Excessive Packaging Requirements for Food and Cosmetics*.¹¹ Therefore, if relying only on traditional forms of labelling, the problem of insufficient labelling space cannot be fully resolved. There are currently no restrictions on foldable labels in the *Regulations* or the *Measures*, and such labels are widely used in the global cosmetics industry. However, the legality of foldable labels is still open to interpretation at all levels of regulation and industry, and it can be expected that there will be controversy and confusion during future inspections.

It is a global trend that electronic labels have been applied in other industries like medicines and medical devices. Electronic appliances and communication tools have a high penetration rate among Chinese consumers, hence in China the conditions are ripe to introduce electronic labelling for cosmetics. Electronic labelling would meet supervisors' information acquisition requirements and allow traceability of consumer use, while also helping with anti-counterfeiting of products. Furthermore, it would reduce the amount of waste packaging materials, benefitting the environment.

In addition, the *Measures* stipulate that the product safety and efficacy claims on the Chinese label of an imported product should correspond to the relevant contents of the original label. Since the regulations and management of cosmetics varies widely in different

⁹ *Guidelines for Cosmetics Efficacy Claim Evaluation* (in Chinese), NMPA, 9th April 2021, viewed 21st April 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210409160321110.html>>

¹⁰ *Administrative Measures of Cosmetics Labelling*, NMPA, 9th April 2021, viewed 21st April 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210603171933181.html>>

¹¹ *Restrictions on Excessive Packaging Requirements for Food and Cosmetics*, MIIT, 5th March 2020, viewed 1st July 2021, <http://www.gdcdc.cn/upfile/2020/03/20200306164707_441.pdf>





countries, other countries and regions have not put forward similar requirements for imported cosmetics. This provision is equivalent to a disguised mandatory requirement that the labels of foreign original packaging of imported cosmetics must meet the requirements of Chinese regulations. If there are discrepancies, manufacturers must design labels only for export to China, which will seriously impact their global supply chains and logistics.

Recommendations

- Establish guidelines for the application of electronic labels to all packaging sizes of cosmetics.
- Allow the approach of foldable labels and consider all visible areas of the sheet as visible panels.
- Allow the Chinese label to reflect selected efficacy claims from the original label, and any information that is required to be identified by the laws and regulations of the region of origin to be either noted on, or covered by, the Chinese label.

5. Establish a Well-organised Post-market Surveillance System

5.1 Scientific and Sound Adverse Effects Monitoring Rules for Cosmetics Product Categories

Concern

Applying the same post-marketing surveillance procedures to cosmetics, which are low-risk products, as to high-risk products such as pharmaceuticals will result in a high number of reported products that have an extremely small chance of producing adverse effects, which would be a significant waste of administrative resources.

Assessment

Cosmetics are fast-moving consumer products, with each single product having a large number of users. There are various reasons for consumers' dissatisfaction with these products, many of which may be unrelated to product quality. Even in cases where a consumer's skin does not adapt to a cosmetic product, most irritations are mild and do not constitute a health or safety problem. In addition, consumers are not specialists and may report subjective impressions and complaints instead of objective, science-based adverse reactions. However, manufacturers are still obliged to

follow up each individual case and determine whether a complaint really constitutes an adverse reaction.

Direct reporting of suspected adverse reactions is leading to huge and unsubstantiated information in the adverse reactions database. It will not be possible for monitoring institutions to verify them one by one, leading to low quality and low regulatory efficiency, and making it impossible to effectively identify products with real quality issues. Focussing on serious adverse reactions is more important and would be a more efficient use of resources.

Recommendation

- Establish adverse reaction reporting principles that are suitable to the cosmetics industry and an individual product's characteristics, and adopt a system of classified and graded reports instead of each complaint being handled as an adverse reaction.

5.2 Fair Quantitative Rating System of Cosmetics Manufacturers

Concern

The draft rating criteria within the *Guidelines for the Quantitative Classification Management of General Cosmetics (Pilot)*¹² are not reasonable, as they propose that companies' ratings be based on the absolute number of comments received from the notification authority, which will disproportionately impact larger companies that have a greater volume of products for notification.

Assessment

In January 2020, the NMPA released an internal notice on the *Guidelines for Quantitative Classification Management of General Cosmetics (Pilot)* to initiate a pilot programme for the quantitative grading management of domestic general cosmetics. The aim is to establish a sound administrative accountability system through product notification and post-market inspection, with rating scores being provided by the authorities. Companies will be classified based on their scores and will receive corresponding levels of supervision, with different requirements imposed while undergoing product notification.

¹² Notice of Implementing the Guidelines for Quantitative Classification Management of General Cosmetics, Cosmetic Business Industry Association of Hunan Province, 24th December 2019, viewed 21st April 2021, <<http://www.hxmycba.com/Policies.asp?id=447&newstype=22>>





According to Article 7 of the *Pilot*, if the number of notifications exceeds 30, and when the formal examination of notification material fails or problems are found in examinations that take place after notification, each product will be deducted either 0.2 or 0.4 points (from an initial score of 75). Usually, a large enterprise has numerous brands and products. Because of this, the absolute number of notification opinions may be correspondingly larger, while the percentage of its total products is not necessarily high. Taking the absolute number of filing opinions as a factor when considering notification quality is therefore unfair for enterprises with a large number of products. This is not conducive to enterprise development, and if not addressed will hinder healthy competition in the industry.

Recommendations

- Rate enterprises according to the overall notification of the manufacturer either every six months or one year.
- Take into consideration the percentage of annual or semi-annual notification opinions, rather than the total number of notifications, when calculating notification quality.

Abbreviations

CNY	Chinese Yuan
COVID-19	Coronavirus Disease 2019
CSAR	Cosmetics Supervision and Administration Regulations
EU	European Union
GAC	General Administration of Cosmetics
NBS	National Bureau of Statistics of China
NMPA	National Medical Products Administration
Q&A	Questions-and-answers
R&D	Research and Development
TTC	Threshold of Toxicological Concern





Energy Working Group

Key Recommendations

1. Enhance the Role of Gas in China's Energy Transition Roadmap

1.1 Speed up the Transition from Coal to Gas in China's Energy Mix

- Clarify the role of gas in achieving carbon neutrality in China's energy regulations.
- Proceed with gas market reform by identifying market authorities; progressing with midstream redesign; clarifying the conditions of third-party access for natural gas (NG) infrastructure; establishing terminal use agreements, tariffs, conditions of capacity attributions and prioritisation, and penalties; and adopting non-discriminatory rules for the sale of infrastructure capacity.
- Clarify midstream NG objectives and timelines, and provide clear guidelines to pipeline operators and shippers.
- Improve downstream competition by giving smaller companies fair and open access to supply, and allowing city gas companies and industrial companies to source directly from gas producers or gas fields.
- Encourage the building of NG infrastructure, with special regard to gas storage, by setting tariffs to cover building costs, while remunerating investors and operators.
- Redesign return mechanisms for gas infrastructure to promote development of new capacity, incentivise management efficiency of existing capacity, and promote innovation in construction and management.
- Clarify market regulation to foster foreign-invested enterprises' (FIEs') direct investments in NG infrastructure (regasification plants, transportation and storage management) to improve security of supply and reduce import needs.
- Promote bulk liquid NG (LNG) supply by setting up national standards in line with international standards.
- Foster transparency by establishing clear data sources of volumes and prices, supporting the development of NG trading platforms, and tools to increase the liquidity and availability of hedging instruments.

1.2 Reduce the Gas Value Chain's Carbon Footprint

- Promote a more transparent, national carbon dioxide (CO₂) trading market with mechanisms to offset emissions.
- Switch from gas production based on coal gasification to biomethane and biogas production from biomasses.

2. Accelerate China's New Energy Reforms

2.1 Boost Investment in District Energy Infrastructure

- Develop a national roadmap for a rapid switch to cleaner fuels to reduce coal use in district energy systems (DESS).
- Develop national pilots for fourth generation district energy networks that employ digital tools to improve efficiency, optimise operations and increase the reliability of energy systems.
- Promote the use of heat pumps in district energy networks, utilising waste heat sources of low



temperatures (below 45 degrees Celsius) in the district heating grid.

- Encourage the development of energy service companies to boost business innovation, improve comprehensive energy and carbon management, and maintain locally-based, tailored solutions.
- Develop DES capacity-building and knowledge-sharing programmes with European companies and institutions.
- Support application of locally available multi-energy sources to improve system flexibility.
- Establish an industrial DES tariff structure with standards of capacity, consumption and connection rates to facilitate investment.
- Set a clear timetable and concrete measures to phase out hydrofluorocarbons refrigerants.

2.2 Ensure Equal Access for European Investment and Technology in the Renewable Energy Sector

- Develop an ancillary market for electricity at the national level (e.g., green certificates, fast frequency response and black start) with a premium for renewable investment, and ensure a level playing field.
- Ensure equal access for European investment and technology in China's renewable energy sector.
- Remove legal constraints on European companies investing in China's renewable sector, for example, by approving track records from outside China in the bidding process for projects.

2.3 Enhance the Hydrogen Supply Chain and Use of Low-carbon Solutions

- Enact in the *Special 14th Five-year Plan (14FYP) for Energy Development* the role of hydrogen as a needed energy carrier, not dangerous chemical gas, to reduce greenhouse gas (GHG) emissions and increase energy security.
- Implement relevant mechanisms to incentivise the large-scale production of low-carbon (e.g., nuclear) or renewable-based hydrogen by electrolysis of water using curtailed electricity.
- Define and simplify specific safety regulations that are harmonised at the national level for hydrogen production, distribution, storage (e.g., liquid hydrogen) and usage (e.g., hydrogen refuelling stations).
- Promote medium and long-distance hydrogen transportation using liquid hydrogen and/or pipelines.
- Implement regulations in accordance with international bodies for liquid hydrogen as a way to efficiently transport hydrogen and to reduce ownership costs.
- Allow on-board storage type IV vessels to increase hydrogen storage density.
- Encourage the use of hydrogen in fuel cells and develop a widespread and sustainable distribution network that utilises different types of transportation.
- Promote hydrogen usage for power generation, for blending into natural gas pipelines and for highly-polluting industries such as steel or cement.
- Adopt a certification scheme aligned with international standards (such as CertifHy in Europe) to define low carbon and/or renewable hydrogen.

2.4 Develop New, High-quality Power Infrastructure

- Enact overall planning and coordination, and set up a standard system for new power infrastructure that can integrate with traditional facilities.
- Accelerate the application of digital technology in the power system and the upgrading of smart power installations.
- Encourage digital transformation from both the distribution- and demand-side.
- Provide policy schemes to incentivise a wide deployment of decentralised power generation,





and to facilitate microgrid penetration, and the use of energy storage.

- Promote green power grid products such as sulfur hexafluoride-free switchgears.
- Manage the speed of China's energy transition to ensure energy security while building up a stable, safe, affordable and low-carbon new power infrastructure.

2.5 Take an Integrated Approach Towards Net-zero Cities

- Apply energy-saving and emission reduction technologies to high-emitting sectors such as manufacturing, construction and transportation, thus developing low-carbon industries, green buildings, sponge cities and e-mobility.
- Shift to renewable energy as primary energy sources and increase electrification of final energy consumption, while using digitalisation to integrate urban planning, design and operations.
- Optimise demand-side flexibility, accelerate the transition to e-mobility and decarbonise heating and cooling systems.
- Strengthen collaboration in both public and private areas throughout the city value chain, including infrastructure, real estate owners and developers, mobility, equipment and technology providers, and utilities.
- Implement both national- and regional-level policies and financing mechanisms to support the integration of green solutions.
- Establish a system of common technical standards with which to evaluate and assess environmental sustainability in a consistent and transparent way.

2.6 Set Clear Targets and Policies for the Development of Bioenergy 2

- Recognise the role of bioenergy in securing energy supply and achieving decarbonisation targets.
- Define national policies and guidelines for the development of biofuels and biogas (for electricity production), with binding short- and medium-term targets.
- Identify a portfolio of subsidies that provinces can adopt to foster the development of cellulosic bioethanol, biodiesel, biogas and biomethane plants.
- Accelerate government efforts to achieve the E10 policy target nationwide.
- Promote the development of biodiesel by policy mandate, such as the rollout of a nationwide B5 policy.

2.7 Promote Green Renovations of Data Centres

- Adopt more aggressive national/regional power usage effectiveness (PUE) design targets for new sites and major expansions.
- Promote zero-carbon internet data centres (IDCs) by using physical and virtual solutions, such as virtual power purchase agreements (VPPAs).
- Establish an integrated management platform for data centres and utilise big data as the foundation for the application of new technologies, integrated energy utilisation and sustainable development of data centres.
- Encourage and guide the closure of inefficient data centres, and free relevant energy quota for further development of sustainable data centres.
- Take multi-dimensional considerations to encourage the comprehensive utilisation of excess heat from data centres and the utilisation of renewable energy.





Carbon Market Sub-working Group

1. Increase the Accuracy and Transparency of Carbon Emissions Monitoring, Reporting and Verification in China's National Emissions Trading System (ETS) 3

- Enhance the reliability of GHG data, and the transparency of methods for collecting GHG data at the enterprise level.
- Ensure that penalties for non-compliance in emissions reporting and failure to submit allowances are set at an adequate level to deter entities from defaulting.
- Promote consistent nationwide requirements for GHG data disclosure.
- Establish a regulation on the oversight and compulsory disclosure of information by enterprises, followed by a corresponding incentive and penalty mechanism.

2. Clarify Requirements for the Participation of Non-compliance Entities in the National ETS, to Avoid Creating Systematic Risks that Undermine the Stability and Credibility of the Market

- Clarify the requirements for non-compliance entity participation as soon as possible.
- Create an environment where compliance entities can choose a legal and reliable path to procure trading or advisory services.

3. Facilitate Government, Civil Society and Business Exchanges between the European Union (EU) and China to Reinforce Cooperation in line with China's 2060 Carbon Neutrality Target and the EU Green Deal 3

- Utilise the EU-China ETS Dialogue and Cooperation Platform, the EU-China Energy Cooperation Platform and other bilateral initiatives to share best practices in carbon markets and decarbonisation.
- Hold regular exchanges with EU counterparts at all levels regarding climate change and low carbon policies in line with the Paris Agreement, the United Nation's Sustainable Development Goals, and China's 2030/2060 carbon reduction targets and climate and energy actions highlighted in the 14FYP.
- Create an accessible, transparent and business-friendly market for both European and Chinese businesses that offers them opportunities to be part of joint solutions for China's climate policy agenda.

Introduction to the Working Group

The Energy Working Group is composed of more than 100 equipment manufacturing and energy infrastructure companies, service providers and consultants along the energy supply chain. The working group cooperates closely with the European Commission and proactively participates in the European Union (EU)-China Energy Cooperation Platform. The working group also collaborates with the China Electric Power Planning and Engineering Institute, taking part in the China-Europe Energy Innovation Cooperation Initiative. The

Energy Working Group is pleased to provide detailed recommendations derived from EU technology, solutions and applications that can be used to address some of the fundamental challenges China is facing.

Recent Developments

In September 2020, President Xi Jinping announced that China will aim to hit peak emissions before 2030 and achieve carbon neutrality by 2060. This announcement is a significant step in the fight against climate change, as China is the world's biggest emitter





of carbon dioxide (CO₂), responsible for around 28 per cent of global emissions.

In line with President Xi's pledges, the State Council Information Office released a white paper titled *Energy in China's New Era* in December 2020,¹ presenting the achievements and goals in building a clean, low-carbon, safe and efficient energy system, and strategies and policies for future reform. Similarly, on 22nd February 2021, the *Guiding Opinions on Accelerating the Establishment and Improvement of a Green and Low-Carbon Circular Development Economic System (Guiding Opinions)*² were published. The *Guiding Opinions* emphasise enforcement by encouraging all regions and departments to "seriously organise and implement" the regulations.

During the Two Sessions 2021, China's top legislature passed the *Outline of the 14th Five-year Plan (2021–2025) (14FYP)*,³ setting a carbon intensity reduction target of 18 per cent, and an energy intensity reduction target of 14 per cent. The 14FYP still contains multiple references to coal and other fossil fuel development, albeit under "clean and efficient utilisation" conditions.⁴ The working group expects to see the transition from coal to gas and other renewables accelerate, and a carbon cap set at sectoral and provincial levels in China's *Special 14FYP for Energy Development*.

Key Recommendations

1. Enhance the Role of Gas in China's Energy Transition Roadmap

1.1 Speed up the Transition from Coal to Gas in China's Energy Mix

Concern

China still relies heavily on coal power, and the role of natural gas (NG) in its energy transition roadmap has

not been fully acknowledged or valued.

Assessment

Demand for NG in China is set to increase by seven to nine per cent annually to reach up to 500 billion cubic metres (bcm) by 2025, and domestic NG production is expected to continue to grow rapidly.⁵ In comparison with coal, NG is a more reliable, cleaner and safer energy source. If coupled with carbon capture, utilisation and storage (CCUS), NG could be considered a stable energy source.

Boosting the NG share in the energy mix remains crucial for China to increase its baseload energy flexibility, improve energy efficiency and reduce energy intensity. However, China's current NG transportation, distribution network and storage capacity are unable to satisfy the growth in demand and energy transition.⁶ At the end of 2020, the country had around 14.1 bcm of underground storage capacity, falling short of the target set in the 13FYP and insufficient to avoid supply shortages in winter.⁷

Positive signs for energy sector reform came with the creation of a pipeline company, the China Oil and Gas Piping Network Corporation (PipeChina), which separates transmission and sales businesses, allowing for more market competition for third parties.⁸ In addition, China's top NG buyers⁹ will have to share crucial infrastructure,¹⁰ indicating a focus on supply security. Further clarification on PipeChina's development objectives and timelines are needed to help foreign-invested enterprises (FIEs) engage in the NG market.

If China is to meet its ambitious climate targets, the working group believes the most advanced solutions and best practices of FIEs should be introduced into

1 Full Text: *Energy in China's New Era*, Information Office of the State Council, 21st December 2020, viewed 22nd May 2021, <<http://www.scio.gov.cn/zfbps/ndh/42312/Document/1695298/1695298.htm>>

2 *Guiding Opinions on Accelerating the Establishment and Improvement of a Green and Low-Carbon Circular Development Economic System*, State Council, 22nd February 2021, viewed 2nd June 2021, <http://www.gov.cn/zhengce/content/2021-02/22/content_5588274.htm>

3 *Outline of the 14th Five-Year Plan (2021–2025) for National Economic and Social Development and the Long-Range Objectives Through the Year 2035*, Xinhua, 13th March 2021, viewed 22nd May 2021, <http://www.xinhuanet.com/2021-03/13/c_1127205564.htm>

4 Shi, Yi, *The 14th Five Year Plan sends mixed message about China's near-term climate trajectory*, China Dialogue, 8th March 2021, viewed 23rd May 2021, <<https://chinadialogue.net/en/energy/the-14th-five-year-plan-sends-mixed-message-about-chinas-near-term-climate-trajectory/>>

5 Cornot-Gandolphe, Sylvie, *China's 14th Five-year Plan will reshape its growing gas sector*, Energy Post, 27th January 2021, viewed 26th May 2021, <<https://energypost.eu/chinas-14th-five-year-plan-will-reshape-its-growing-gas-sector/>>

6 China's gas consumption is currently only one third of the US', and its pipeline network length is only one seventh of the US'.

7 *China's Storage Shortage*, Natural Gas World, 12th February 2021, viewed 2nd July 2021, <<https://www.naturalgasworld.com/chinas-storage-shortage-ngw-magazine-85170>>

8 *China Announces Plan to Form National Oil & Gas Pipeline Company*, Bloomberg, 5th March 2019, viewed 2nd July 2021, <<https://www.bloomberg.com/news/articles/2019-03-05/china-announces-plan-to-form-national-oil-gas-pipeline-company>>

9 China National Offshore Oil Corp., China National Petroleum Corp. and Sinopec.

10 *China Forces Energy Giants to Share in Pipeline Reform Preview*, Bloomberg, 23rd June 2020, viewed 2nd July 2021, <<https://www.bloomberg.com/news/articles/2020-06-23/china-forces-energy-giants-to-share-in-pipeline-reform-preview>>





the NG market. The working group welcomes recent government recommendations to speed up and incentivise the development of new storage capacity,¹¹ and the new version of the central pricing catalogue set by the NDRC,¹² which for the first time opens the door to market-driven city-gate gas prices in provinces where competitive conditions are strong enough to allow it. Yet gaps remain; for example, the lack of midstream energy infrastructure to transmit and store NG upsets the delicate balance between centres of production and consumption, the NG system's ability to deal with seasonal changes and peaks in demand, and the possibility of optimising LNG import costs during winter peaks. Although foreign companies have been able to participate in oil and gas exploration in China since May 2020, they still lack midstream access, while indirect barriers such as licensing remain.

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—such as third-party access (TPA) to liquefied NG (LNG) when state-owned enterprises (SOEs) are reluctant to free up terminal and pipeline infrastructures—restrict market opening, damage the diversification of supply and hinder energy transition. Domestic standards should also be reviewed and updated to be in line with international ones to promote LNG development, and distributed energy production should be taken into consideration for the sake of designing efficient grids.

Last but not least, to build up an efficient and competitive NG market, it is necessary to establish clear and shared data sources of volumes and prices, improve the domestic NG trading platform, and connect to the global NG market. Therefore, the working group is pleased to see that Shanghai's regional 14FYP clearly indicates intention to establish an international oil and gas pricing centre.¹³

¹¹ *The State Issued Implementation Opinions to Accelerate the Construction of Natural Gas Reserves*, NDRC, 21st April 2020, viewed 2nd July 2021, <https://www.ndrc.gov.cn/xwdt/xwfb/202004/t20200421_1226216.html>

¹² *Decree of the NDRC No. 31*, NDRC, 13th March 2020, viewed 2nd July 2021, <https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202003/t20200316_1223371.html>

¹³ *The 14th Five-Year Plan of Shanghai Municipality for National Economic and Social Development and the Outline of the 2035 Long-Term Goals*, Shanghai Municipal People's Government, 30th January 2021, viewed 25th May 2021, <<https://www.shanghai.gov.cn/nw/12344/20210129/ced9958c16294feab926754394d9db91.html>>

Recommendations

- Clarify the role of gas in achieving carbon neutrality in China's energy regulations.
- Proceed with gas market reform by identifying market authorities; progressing with midstream redesign; clarifying the conditions of TPA for NG infrastructure; establishing terminal use agreements, tariffs, conditions of capacity attributions and prioritisation, and penalties; and adopting non-discriminatory rules for the sale of infrastructure capacity.
- Clarify midstream NG objectives and timelines, and provide clear guidelines to pipeline operators and shippers.
- Improve downstream competition by giving smaller companies fair and open access to supply, and allowing city gas companies and industrial companies to source directly from gas producers or gas fields.
- Encourage the building of NG infrastructure, with special regard to gas storage, by setting tariffs to cover building costs, while remunerating investors and operators.
- Redesign return mechanisms for gas infrastructure to promote development of new capacity, incentivise management efficiency of existing capacity, and promote innovation in construction and management.
- Clarify market regulation to foster FIEs' direct investments in NG infrastructure (regasification plants, transportation and storage management) to improve security of supply and reduce import needs.
- Promote bulk LNG supply by setting up national standards in line with international standards.
- Foster transparency by establishing clear data sources of volumes and prices, supporting the development of NG trading platforms, and tools to increase the liquidity and availability of hedging instruments.

1.2 Reduce the Gas Value Chain's Carbon Footprint

Concern

Although natural gas is a cleaner, low-carbon and more efficient energy source than coal, it still emits certain amounts of CO₂.

Assessment

On 1st February 2021, China officially launched its national Emissions Trading Scheme (ETS).¹⁴ While

¹⁴ Huw Slater, Wang Shu, Dimitri De Boer, *China's national carbon market is about to launch*, China Dialogue, 29th January 2021, viewed 26th May 2021, <<https://chinadialogue.org.cn/en/climate/chinas-national-carbon-market-is-about-to-launch>>





this will facilitate carbon footprint management to effectively limit emissions, the gas domain is not well covered. The working group believes a transparent national CO₂ market system should be designed and connected to the gas value chain. Various solutions, such as gas decarbonisation or NG usage with CCUS, would be worth studying, with governmental support for development of new business strategies and models.

As well as NG, technical utilisation of biogas is mature enough today for wide commercialisation. Nevertheless, even before the outbreak of the coronavirus disease 2019 (COVID-19), Chinese leaders called for a strengthening of the coal industry through 'clean coal'.¹⁵ The working group believes that 'clean coal' should only act as an intermediate step in a clean-energy transition, and be combined with less polluting methods such as biogas or biomethane.

Despite China's ambitious target for biogas production by 2030,¹⁶ a lack of clear incentive policies and a shortage of a stable feedstock supply has led to biogas development lagging far behind this plan. European industries have a wealth of experience in biogas production, utilisation and market development, ready for China to tap into. Such cooperation would help China develop more transparent, stable and implementable guidelines, along with clear technical standards and incentive policies, that could incubate a mature market for biogas.

Recommendations

- Promote a more transparent, national CO₂ trading market with mechanisms to offset emissions.
- Switch from gas production based on coal gasification to biomethane and biogas production from biomasses.

2. Accelerate China's New Energy Reforms

2.1 Boost Investment in District Energy Infrastructure

Concern

Despite district energy systems (DESS) potential to play a key role in energy transition and decarbonisation within urban development, district heating remains dominated by coal as a fuel source while district cooling

systems are largely absent from Chinese cities.

Assessment

District energy is part of China's carbon neutrality solution and urban development strategy, and is widely recognised as a sustainable, cost-effective heating and cooling solution through the provision of hot water/steam to heat buildings and chilled water to cool buildings.

The district heating market is growing substantially, with the largest total area located in North China. Meanwhile, inefficient individual heating systems and the low number of energy-saving buildings contribute significantly to carbon emissions and overall air pollution. Therefore, increasing the share of district heating in northern China above the current level of 55 per cent would help to support China's overall environmental ambitions.

District cooling demand in China has increased rapidly in line with its rapid urbanisation, and the demand for cooling public and commercial buildings is estimated to account for a large amount of total electricity generation. At present, the main technologies utilised for cooling are large-scale centralised electric compression chillers and individual electric compression chillers.

Modern DESs can provide reliable heating and cooling, plus domestic water services, while improving energy efficiency. However, the current district heating systems are inefficient, while district cooling systems are largely absent. For instance, in terms of the district heating transmission and distribution network, more than 30 per cent of the total generated heat is wasted to ensure the most distal users' comfort.¹⁷ The main reason for this wastage is a lack of automatic control measures. Comprehensive digital solutions could include a full-range solution, such as energy metering, hydraulic dynamic balancing, automatic control, valves, and artificial intelligence (AI)-based operation/management system, coupled with enforcement of pay-per-use regulations.

Solutions must also be tailored to meet local needs. Decentralised generation can blend into the urban landscape and incorporate energy from renewable

¹⁵ Xu, Wei, *Premier Urges Wider Access in Oil Sector*, China Daily, 12th October 2019, viewed 2nd July 2021, <<https://www.chinadaily.com.cn/a/201910/12/WS5da1134da310cf3e3557004c.html>>

¹⁶ *China biogas production increase to 20 bcm in 2030*, Silk Road News, 24th December 2019, viewed 26th May 2021, <<https://silkroadnews.org/cn/news/2030-200-d11>>

¹⁷ *China Building Energy Saving Annual Development Research Report*, Tsinghua University Building Energy Conservation Research Centre, 2017, viewed 2nd July 2021.





sources, including biomass, geothermal, and reclamation of waste industrial heat. Seas, rivers and lakes can also be used as sources of fresh and cooling water, and therefore help to cool service-sector and public buildings. Therefore, the development of energy service companies (ESCOs), to boost business innovation with locally-based, tailored solutions, is highly recommended.

China recently approved the Kigali Amendment to the Montreal Protocol, a significant step to phase down hydrofluorocarbons (HFCs) production and consumption.¹⁸ China produces almost 70 per cent of global refrigerating equipment that contains HFCs, and most of the world's HFCs chemicals. Following the Kigali Amendment, China should take immediate action to phase out the use of HFC refrigerants, and encourage the use of new-generation hydrofluoroolefins (HFO) refrigerants¹⁹ as a more environmentally friendly alternative.

Recommendations

- Develop a national roadmap for a rapid switch to cleaner fuels to reduce coal use in DESs.
- Develop national pilots for fourth generation district energy networks that employ digital tools to improve efficiency, optimise operations and increase the reliability of energy systems.
- Promote the use of heat pumps in district energy networks, utilising waste heat sources of low temperatures (below 45 degrees Celsius) in the district heating grid.
- Encourage the development of ESCOs to boost business innovation, improve comprehensive energy and carbon management, and maintain locally-based, tailored solutions.
- Develop DES capacity-building and knowledge-sharing programmes with European companies and institutions.
- Support application of locally available multi-energy sources to improve system flexibility.
- Establish an industrial DES tariff structure with standards of capacity, consumption and connection rates to facilitate investment.

¹⁸ HFCs are man-made organic compounds composed of fluorine and hydrogen atoms, frequently used in air conditioning and as refrigerants, which contribute to global warming.

¹⁹ HFOs are unsaturated organic compounds composed of hydrogen, fluorine and carbon, which have zero ozone depletion potential and low global warming potential.

- Set a clear timetable and concrete measures to phase out HFC refrigerants.

2.2 Ensure Equal Access for European Investment and Technology in the Renewable Energy Sector

Concern

European companies require a level playing field when competing with Chinese companies in the renewable energy sector.

Assessment

Currently, China's renewable energy market is split into two layers – one for SOEs and the other for small Chinese and foreign private enterprises. The second layer have less market access and face more constraints to develop, own or operate renewable assets. Removing these legal constraints at all administrative levels would greatly incentivise foreign investment (direct or indirect), and facilitate the deployment of innovative solutions developed by small Chinese and foreign private enterprises.

China's electricity generation market is already very competitive. Low electricity prices for end consumers result in low revenues for power generation companies. In addition to high investment costs and an often-changing regulatory environment, foreign companies (particularly, small and medium-sized enterprises) investing in China's renewable sector face a range of other challenges. For example, for European investors in China's renewable sector, their minimum profitability threshold²⁰ is significantly higher than that of SOEs, a situation that is exacerbated when feed-in tariff (FIT) payments are delayed.²¹ This is best illustrated by certain solar power projects in northwest China that face bankruptcy due to long delays to subsidy payments.²²

The working group therefore recommends that the relevant authorities develop an ancillary market for electricity supply at the national level. An ancillary market is based on specific solutions required by grid operators to stabilise or guarantee electricity supply,

²⁰ The break-even point at which a business becomes profitable.

²¹ A feed-in tariff (FIT) is a policy designed to support the development of renewable energy sources by offering long-term contracts and guaranteed prices to renewable energy producers.

²² *Chinese subsidy backlog 'leaves solar projects facing bankruptcy'*; South China Morning Post, 12th October 2018, viewed 26th May 2021, <<https://www.scmp.com/news/china/politics/article/2168270/chinese-subsidy-backlog-leaves-solar-projects-facing-bankruptcy>>





which can be provided by generation companies through existing or new investment in equipment and assets. Within the ancillary market, subsidies such as feed-in premiums for renewable energy investment should be offered to both European and Chinese generation companies.²³ The ancillary market option has already been mentioned in a recent National Energy Administration (NEA) document.²⁴ Its adoption will not only facilitate grid management but also allow companies to deliver compelling business cases for renewable assets.

At present, the financing of renewable energy projects in China relies mostly on bank loans and corporate bonds. Removing legal constraints on foreign direct investment, and providing more market access to FIEs, would not only introduce new market players, but also new, innovative financing models.

Lastly, most provinces have implemented competitive tendering processes to determine which projects sponsored by different developers to include in their annual construction plan, a pre-condition for a project to be approved. Many such tendering rules have a score-based system to measure a developer's 'track record' in the renewable energy industry. However, only track records within China can currently be assessed, with international records not being taken into consideration. This prevents international players from being able to compete fairly with major Chinese SOEs.

Recommendations

- Develop an ancillary market for electricity at the national level (e.g., green certificates, fast frequency response and black start) with a premium for renewable investment, and ensure a level playing field.
- Ensure equal access for European investment and technology in China's renewable energy sector.
- Remove legal constraints on European companies investing in China's renewable sector, for example, by approving track records from outside China in the bidding process for projects.

²³ A feed-in premium (FIP) is a type of price-based policy instrument whereby eligible renewable energy generator companies are paid a premium subsidy in addition to the wholesale price.

²⁴ *Guidance for Local Governments to Manage Wind and Solar Project Development in 2021*, NEA, 11th May 2021, viewed 27th May 2021, <http://zfxgk.nea.gov.cn/2021-05/11/c_139958210.htm>

2.3 Enhance the Hydrogen Supply Chain and Use of Low-carbon Solutions

Concern

China has now embraced the essential role that hydrogen can play in the process of decarbonisation, however onerous or missing regulations are slowing down the proper scale-up of the supply chain, and not enough has been done to develop low-carbon hydrogen solutions.

Assessment

The use of hydrogen aligns well with China's national strategic priorities, such as decarbonisation, self-sufficiency and energy independence, improvement of the overall energy system and becoming a leader in clean industry. However, hydrogen production is still based on fossil fuels; its ability to reduce GHG emissions and increase energy security will be maximised through low-carbon and renewable production. In this respect, it is necessary to provide a level-playing field to leverage the plurality of resources available in China.

Throughout 2020, China has strongly and steadily increased its ambitions regarding hydrogen industry development. At the beginning of 2020, hydrogen was for the first time included in the Energy Law.²⁵ Soon after, China increased its target for the deployment of fuel cell electric vehicles (FCEVs)²⁶ through a reinforcement of the new energy vehicles (NEVs) national mandate.

At the local level, a large number of provinces and cities have issued their hydrogen strategies, with clear targets for FCEVs and infrastructure deployment (production, transport and distribution). At the national level, pilot cities have been set up, attracting a large number of city alliances²⁷ with the expectation that support (subsidies, land, tax exemptions) will be provided.²⁸ Finally, both local and foreign companies are actively investing across the entire value chain, deploying the latest technologies related to green hydrogen

²⁵ *Announcement on the Public Consultation on the Energy Law (Draft for Comments)*, NEA, 10th April 2020, viewed 1st June 2021, <http://www.nea.gov.cn/2020-04/10/c_138963212.htm>

²⁶ FCEVs are electric vehicles that use hydrogen fuel cells instead of batteries for energy storage.

²⁷ City alliances are groups of cities that join together to develop a shared strategy. A total of 21 alliances representing 84 cities applied to be part of the hydrogen pilot scheme.

²⁸ Previous subsidies mainly focussed on FCEV deployment, while the latest also includes research and development (R&D), production and distribution infrastructure.





production, conditioning (industrial scale liquefaction),²⁹ hydrogen refuelling stations³⁰ and FCEV manufacturing. The working group expects that the *Special 14FYP for Energy Development* will include a dedicated national hydrogen strategy, clarifying the future development of the industry.

There are several steps China must take to support the hydrogen supply chain. First, hydrogen must be redefined as an 'energy carrier' rather than as a 'hazardous chemical' when used as industrial feedstock. Second, regulations regarding high pressure and liquid hydrogen transportation must be implemented to foster an efficient and scalable supply chain while decreasing end-users' cost. Third, to further promote FCEVs, China needs to intensify efforts on deploying infrastructure, as well as facilitating increases in hydrogen density by upgrading on-board storage to Type IV vessels and hence improving FCEV competitiveness. Finally, China's numerous codes and standards on hydrogen production, distribution and usage should be simplified and aligned with those already issued by internationally recognised bodies, such as the International Standards Organization,³¹ to create a more sustainable and globally competitive market.

China also needs to decarbonise hydrogen production, which is currently mainly based on fossil fuels without carbon capture. Options include promoting schemes such as using renewable energy for water electrolysis, biomethane reforming and capturing existing low carbon off-gases. To further enhance such schemes, China will need to allow direct renewable energy sourcing (off-grid or through certificates) and set up a certification scheme aligned with international standards, such as the EU's CertifHy,³² to define low-carbon and renewable hydrogen production.

Hydrogen also has great potential to decarbonise heavy polluting industries. For instance, in the power sector, a hydrogen-based system can be used as a systemic 'buffer' for harmonising continuous production from fossil fuels, nuclear plants and intermittent production

from renewables to optimise electricity supply and demand patterns.³³ Therefore, re-electrification from green or low-carbon hydrogen should be promoted, starting with pilot schemes. In addition, in the heating sector, legislation, standards and remunerations to blend hydrogen into natural gas pipelines should be introduced.³⁴ Finally, more support is needed to develop hydrogen usage as a feedstock for heavily polluting industries such as steel, cement and glass.

Recommendations

- Enact in the *Special 14FYP for Energy Development* the role of hydrogen as a needed energy carrier, not a dangerous chemical gas, to reduce GHG emissions and increase energy security.
- Implement relevant mechanisms to incentivise the large-scale production of low-carbon (e.g., nuclear) or renewable-based hydrogen by electrolysis of water using curtailed electricity.
- Define and simplify specific safety regulations that are harmonised at the national level for hydrogen production, distribution, storage (e.g., liquid hydrogen) and usage (e.g., hydrogen refuelling stations).
- Promote medium and long-distance hydrogen transportation using liquid hydrogen and/or pipelines.
- Implement regulations in accordance with international bodies for liquid hydrogen as a way to efficiently transport hydrogen and to reduce ownership costs.
- Allow on-board storage type IV vessels to increase hydrogen storage density.
- Encourage the use of hydrogen in fuel cells and develop a widespread and sustainable distribution network that utilises different types of transportation.
- Promote hydrogen usage for power generation, for blending into natural gas pipelines and for highly-polluting industries such as steel or cement.
- Adopt a certification scheme aligned with international standards (such as CertifHy in Europe) to define low carbon and/or renewable hydrogen.

29 Large-scale hydrogen liquefaction is one of the most significant processes in storing hydrogen as a liquid.

30 Ningjing Liu, *Sinopec to Build 1,000 Hydrogen Refuelling Stations by 2025*, Seneca ESG, 23rd February 2021, viewed 5th July 2021, <<https://www.senecaesg.com/blog/sinopec-to-build-1000-hydrogen-fueling-stations-by-2025/>>

31 ISO/TC 197 Hydrogen Technologies, ISO, n.d., viewed 2nd July 2021, <<https://www.iso.org/committee/54560.html>>

32 Project Description, CertifHy, n.d., viewed 2nd July 2021, <<https://www.certifyhy.eu/project-description/project-description.html>>

33 *Harnessing the Full Power of Renewable Energy with Hydrogen*, European Commission, 29th August 2016, viewed 2nd July 2021, <<https://ec.europa.eu/programmes/horizon2020/en/news/harnessing-full-power-renewable-energy-hydrogen>>

34 McDonald, Jeff and Robinson, J.; *Platts Expands Hydrogen Assessments; Efforts to Blend with Natural Gas Increasing*, S&P Global Platts, 1st April 2020, viewed 2nd July 2021, <<https://www.spglobal.com/platts/en/market-insights/latest-news/natural-gas/040120-platts-expands-hydrogen-assessments>>





2.4 Develop New, High-quality Power Infrastructure

Concern

China's existing power system is still based on carbon-intensive fossil fuels, and there is a lack of overall coordination and uniform technical standards in its digital upgrading process.

Assessment

As China unveils its pathway towards its 2030/2060 vision, one of the strategic shifts will be to deepen reforms and build up “a new power system based on new energies”.³⁵ If renewables become major energy sources in the power mix, it will pose challenges to the real-time balance of the existing power system. Issues such as increasing disruptions, randomness and intermittence need to be addressed.

Digital technology would enable the energy grid to adapt to the large-scale and high-proportion grid connection and consumption requirements of new energy. It would also support the broad connection of interactive and mobile facilities, such as distributed energy, energy storage and electric vehicles, in order to better coordinate source-network-load-storage and upgrade the power grid to become a smarter and broader energy internet.

While China's ‘new infrastructure’ proposal has led to a lot of digitalisation movement in the power sector, much of it has occurred without a clear roadmap or coordination among the various players. Hasty investments and redundant construction will quickly lead to problems such as overcapacity, a focus on construction at the expense of operations, and poor integration with traditional infrastructure. Alongside the digital upgrading of the main power grid, the digitalisation of power distribution and demand-side response is equally important and requires due attention and investment.

Another vital aspect is the development of energy equipment technologies. The working group recommends first putting in place a smarter energy-production system that can make the large-scale utilisation of renewables feasible; and then green

power equipment technologies. Currently, 95 per cent of China's power grids use traditional switchgear technology, which contains the world's strongest GHG: sulphur hexafluoride (SF6).

Last but not least, China needs to balance its energy security and the 2030/2060 goals. Too rapid an energy transition can cause problems such as power shortages. For example, at the time of writing, in Guangdong Province, many companies (domestic and foreign) are subject to power cuts imposed since mid-May 2021, which is having a significant, negative impact on their business operations. This is likely to continue in the coming months, and could well spread beyond the Guangdong region.

Recommendations

- Enact overall planning and coordination, and set up a standard system for new power infrastructure that can integrate with traditional facilities.
- Accelerate the application of digital technology in the power system and the upgrading of smart power installations.
- Encourage digital transformation from both the distribution- and demand-side.
- Provide policy schemes to incentivise a wide deployment of decentralised power generation, and to facilitate microgrid penetration, and the use of energy storage.
- Promote green power grid products such as SF6-free switchgears.
- Manage the speed of China's energy transition to ensure energy security while building up a stable, safe, affordable and low-carbon new power infrastructure.

2.5 Take an Integrated Approach Towards Net-zero Cities

Concern

An integrated approach to urban and energy planning is necessary in order to boost energy efficiency while decarbonising cities and urban infrastructures.

Assessment

Cities account for most carbon emissions and energy use, mainly from residential and commercial buildings, electricity consumption and transportation. Challenges related to the provision of water and sewage systems, power, gas supplies and other essential services have also escalated in response to the growth of urban

³⁵ *Building a New Electricity System Based on New Energy and Accelerating Carbon Emission Trading*, China Energy News, 16th March 2021, viewed 27th May 2021, <<https://baijiahao.baidu.com/s?id=1694404857032937323&wfr=spider&for=pc>>





populations. Therefore, the working group recommends taking an integrated approach to the planning of urban infrastructures in order to increase energy efficiency, while reducing costs and carbon emissions.

AI, big data, fifth generation mobile technology (5G) and robotics are valuable and innovative solutions for safeguarding energy supply, as well as decarbonising cities and buildings. China has released an ambitious digital transformation plan for the next five years and beyond; however, digital penetration in its industries is still lower than the global average. Despite the increasing focus on maximising energy efficiency in smart cities, factories, buildings, data centres and public transportation, progress on these fronts has, for the most part, taken place in isolation.

An integrated energy approach, defined by the World Economic Forum as ‘systemic efficiency’,³⁶ is recommended. Systemic efficiency encompasses clean electrification, smart digital technology, and efficient buildings and infrastructure, along with a circular economy approach.³⁷ To make this work, it is necessary to create a common language and integrated tools for authorities, investors and stakeholders, as well as a system of common standards with which to evaluate and assess environmental sustainability in a consistent and transparent way. These common standards should be measurable and traceable, making it possible to benchmark and guide actions. The integration process needs to be gradual, starting from the central government down to different administrative levels.

Drawing on the Sustainable Development Goals of the United Nations, the working group recommends applying energy-saving, green solutions throughout the urban design and building process, supported by stakeholders across the value chain, thus developing low-carbon industries, green buildings, sponge cities and e-mobility.

Recommendations

- Apply energy-saving and emission reduction technologies to high-emitting sectors such as manufacturing, construction and transportation, thus developing low-carbon industries, green buildings,

sponge cities and e-mobility.

- Shift to renewable energy as primary energy sources and increase electrification of final energy consumption, while using digitalisation to integrate urban planning, design and operations.
- Optimise demand-side flexibility, accelerate the transition to e-mobility, and decarbonise heating and cooling systems.
- Strengthen collaboration in both public and private areas throughout the city value chain, including infrastructure, real estate owners and developers, mobility, equipment and technology providers, and utilities.
- Implement both national- and regional-level policies and financing mechanisms to support the integration of green solutions.
- Establish a system of common technical standards with which to evaluate and assess environmental sustainability in a consistent and transparent way.

2.6 Set Clear Targets and Policies for the Development of Bioenergy

Concern

The development of bioenergy use in China is unclear and hampered by the lack of clarity in national guidelines that are necessary to ease implementation at the regional level.

Assessment

Straw, an abundant agricultural waste in China, is a biomass raw material that can generate multiple types of bioenergy, with cellulosic bioethanol as one of the main products. Cellulosic ethanol—regarded as a second-generation biofuel—is produced from fibrous lignin contained in straw. With food security a top concern in China, promoting cellulosic ethanol will help to diversify China’s energy mix.

Cellulosic ethanol is a good substitute for traditional gasoline in the transportation sector. If the E10 (where 10 per cent biofuel ethanol is added into gasoline) policy³⁸ continues to advance in China, and the annual consumption of biofuel ethanol reaches nine million tonnes, crude oil imports can be reduced by around 27 million tonnes, which should in turn cut CO₂ emissions

36 *Net Zero Carbon Cities: An Integrated Approach*, World Economic Forum, 11th January 2021, viewed 2nd June 2021, <http://www3.weforum.org/docs/WEF_Net_Zero_Carbon_Cities_An_Integrated_Approach_2021.pdf>

37 A circular economy produces zero waste by reusing or recycling waste into new products.

38 *The Plan for Expanding Biofuel Ethanol Production and Promoting Ethanol Usage in Motor Vehicles*, NEA, 13th September 2017, viewed 2nd July 2021, <http://www.nea.gov.cn/2017-09/13/c_136606035.htm>





by 21 million tonnes,³⁹ almost double that traditional biofuels can achieve. However, preliminary research and achieving economies of scale in cellulosic ethanol production will be a long process requiring continuous capital investment. This means that, in the short-term, large-scale production is not economically feasible. Government support and subsidies are therefore necessary to facilitate large-scale production of cellulosic ethanol, which will foster a mature market for biofuel.

Biodiesel is a renewable and clean-burning fuel that produces much fewer toxic pollutants and GHGs than petroleum diesel. Biodiesel can also provide alternatives to fossil fuels in the transportation sector, and can be used in existing diesel engines with little or no modifications required. Animal fats, vegetable oils, used cooking oils and high-acidity oils are all good raw materials to produce biodiesel. An enzymatic process helps convert these tougher oils into biodiesel and improve production rates, while significantly reducing pollution caused by harsh chemicals.

Biodiesel has already helped several countries to reduce their dependence on foreign oil reserves.⁴⁰ Many Chinese biodiesel producers are retrofitting their plants to run an enzymatic process. In terms of application, either pure biodiesel can be used (B100), or it can be blended with petro-diesel. In Europe, a B5 (5 per cent biodiesel, 95 per cent petroleum diesel) mandate is implemented in many countries. However, in China, Shanghai has been the only city to implement the B5 mandate so far. The development of biodiesel is key to China's green transition in the transportation and agricultural sectors; a nationwide B5 mandate would accelerate this transition.

Clear policies are required to support the bioenergy production during this early phase, with different types of subsidies for the permit process, construction and operations of new power plants. Robust bioenergy production could contribute towards both security of supply and decarbonisation targets.

Recommendations

- Recognise the role of bioenergy in securing energy

39 Overview of Biofuel Ethanol and Ethanol Gasoline Promotion and International Practice, China Petroleum and Chemical Industry Federation (CPCIF), July 2019

40 Does Security of Supply Drive Key Biofuel Markets in Asia? International Energy Agency, 21st October 2019, viewed 5th July 2021, <<https://www.iea.org/articles/does-security-of-supply-drive-key-biofuel-markets-in-asia>>

supply and achieving decarbonisation targets.

- Define national policies and guidelines for the development of biofuels and biogas (for electricity production), with binding short- and medium-term targets.
- Identify a portfolio of subsidies that provinces can adopt to foster the development of cellulosic bioethanol, biodiesel, biogas and biomethane plants.
- Accelerate government efforts to achieve the E10 policy target nationwide.
- Promote the development of biodiesel by policy mandate, such as the rollout of a nationwide B5 policy.

2.7 Promote Green Renovations of Data Centres

Concern

China needs to set more aggressive national and regional power usage effectiveness (PUE)⁴¹ design targets for new sites and major expansions, and create more incentives for zero-carbon internet data centres (IDCs).

Assessment

The growth of the digital economy and the advent of China's new infrastructure initiative requires the construction of IDCs nationwide.⁴² In 2019, China had about 74,000 data centres, 23 per cent of the global total. The last three years have seen China's investment in data centre software and hardware increase by an average of 15 per cent per year – almost twice the global average rate.⁴³ In 2018, according to a joint report by Greenpeace and North China Electric Power University, data centres consumed 161 billion kilowatt hours of electricity, which equated to two per cent of China's total usage and more than Shanghai consumed that year.⁴⁴ Moreover, 73 per cent of electricity consumed was generated from coal and procured from the grid. According to the report, most of the data centres had not yet actively attempted to procure renewable energy.

41 PUE is an important industry metric for measuring the energy efficiency of a data centre's infrastructure under normal operating conditions.

42 An IDC is a physical facility that provides organisations with a centralised hub for storage, processing and management for a vast amount of data, and consists of electrical, cooling and network architecture that can house large groups of servers and networking equipment.

43 Wang He and Ye Ruiqi, *The climate cost of China's digital infrastructure rush*, China Dialogue, 15th April 2020, viewed 27th May 2021, <<https://chinadiologue.net/en/cities/11960-the-climate-cost-of-china-s-digital-infrastructure-rush/>>

44 *Powering the Cloud: How China's Internet Industry Can Shift to Renewable Energy*, Greenpeace and North China Electric Power University, 2019, viewed 20th June 2021, <https://www.greenpeace.org/static/planet4-eastasia-stateless/2019/11/7bfe9069-7bfe9069-powering-the-cloud_-_english-briefing.pdf>





In line with China's 2060 carbon neutrality targets, Chinese data centre operators will need to clean up their energy supply by building or investing in wind and solar generation, buying energy directly from renewable generators and buying 'green certificates'.⁴⁵ The working group finds the lack of scaled procurement of renewable energy in China's data centre industry concerning. In 2018, only 23 per cent of the sector's power came from renewables, and only a few cities have planned for joint development of renewables and data centres. One example is Zhangjiakou in Hebei, a national-level pilot city for renewable energy and one of the host cities of the 2022 Winter Olympics, which aims to see at least 90 per cent of local data centre power come from renewables by 2025.⁴⁶

At present, data centres in China can procure renewable energy via physical or virtual renewable power purchase agreements (PPAs).⁴⁷ Virtual PPAs (VPPA) are easily scalable and enable buyers to meet their renewable energy goals quickly and efficiently. For example, Fifth Third Bank was able to meet its 100 per cent renewable energy goal with just one VPPA.⁴⁸

Recommendations

- Adopt more aggressive national/regional PUE design targets for new sites and major expansions.
- Promote zero-carbon IDCs by using physical and virtual solutions, such as VPPAs.
- Establish an integrated management platform for data centres and utilise big data as the foundation for the application of new technologies, integrated energy utilisation and sustainable development of data centres.
- Encourage and guide the closure of inefficient data centres, and free relevant energy quota for further development of sustainable data centres.
- Take multi-dimensional considerations to encourage the comprehensive utilisation of excess heat from data centres and the utilisation of renewable energy.

Abbreviations

14FYP	14 th Five-year Plan
5G	Fifth Generation Mobile Technology
AI	Artificial Intelligence
bcm	Billion Cubic Metres
CCUS	Carbon Capture, Utilisation and Storage
CO ₂	Carbon Dioxide
COVID-19	Coronavirus Disease 2019
DES	District Energy Systems
ESCO	Energy Service Company
ETS	Emissions Trading Scheme
EU	European Union
FCEV	Fuel Cell Electric Vehicles
FIE	Foreign-Invested Enterprise
FIT	Feed-in Tariff
GHG	Greenhouse Gas
HFC	Hydrofluorocarbons
HFO	Hydrofluoroolefins
IDC	Internet Data Centre
LNG	Liquefied Natural Gas
NDRC	National Development and Reform Commission
NEA	National Energy Administration
NEV	New Energy Vehicle
NG	Natural Gas
PPA	Power Purchase Agreements
PUE	Power Usage Effectiveness
PV	Photovoltaic
SF ₆	Sulphur Hexafluoride
SOE	State-owned Enterprises
TPA	Third-Party Access
US	United States

⁴⁵ Green certificates are instruments similar to renewable energy credits used in Europe.

⁴⁶ *The climate cost of China's digital infrastructure rush*, China Dialogue, 15th April 2020, viewed 27th May 2021, <<https://chinadialogue.net/en/cities/11960-the-climate-cost-of-china-s-digital-infrastructure-rush/>>

⁴⁷ Within a physical PPA contract, the corporate buyer takes ownership of the electrons produced by the renewable energy project, while within a virtual PPA contract, the corporate buyer does not own and is not responsible for the physical electrons generated by the project.

⁴⁸ Rachit Kansal, *Introduction to the Virtual Power Purchase Agreement*, Rocky Mountain Institute, 2019, viewed 20th June 2021, <<https://rmi.org/insight/virtual-power-purchase-agreement/>>





Carbon Market Sub-working Group

Introduction to the Sub-working Group

The Carbon Market Sub-working Group aims to contribute to creating a fair and predictable business environment so that international and local companies can exchange and cooperate on a level playing field on issues related with China's carbon market and overall decarbonisation. The sub-working group also wishes to share its emissions trading system (ETS) experiences from other markets, particularly the European Union (EU) ETS, with its Chinese partners, and to promote the development and integration of clean energies, while supporting China in its low-carbon and energy transition. It is a sub-working group of the European Chamber's Energy Working Group and consists of 110 member companies 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 provides support to relevant Chinese stakeholders on the development of a well-functioning national carbon market, which will serve to reduce China's carbon dioxide (CO₂) emissions in synergy with the country's efforts to deal with other environmental and economic issues. With the pilot markets still in operation and the national ETS launched in 2021, the working group is focussed on enhancing understanding and providing recommendations from the perspective of European business in China.

Recent Developments

On 22nd September 2020, at the United Nations General Assembly, President Xi Jinping pledged that China would peak emissions before 2030, and achieve carbon neutrality by 2060.¹ In line with these pledges, the Ministry of Environment and Ecology (MEE) and the State Council have issued a number of key regulatory documents that allow for trading in China's national ETS to begin. The documents include guidelines and rules covering: allowance allocation; legal compliance and

institutional arrangements; monitoring, reporting and verification of emissions (MRV); and data transparency.

In order to regulate the emissions allowance allocation to enterprises, on 30th December 2020, the MEE issued the *2019–2020 Implementation Programme for National Carbon Emissions Trading Quota Setting and Allocation (Power Generation Industry)* and the *List of Covered Entities for 2019–2020 National Carbon Emissions Trading Quota Management*.² The allowance allocation programme defines the list of entities in the power generation sector that are participating, and mentions for the first time that responsibility for carbon emissions control at the national level has now been transferred to enterprises. This is of great significance for promoting supply-side structural reforms targeting energy conservation and emissions reduction, as well as high-quality economic development that does not sacrifice either the environment or people's health,³ because the entities covered by the ETS will have compliance obligations. This will engender more stringent adherence to regulations and incentivise decarbonisation actions at the enterprise level.

The MEE's ETS regulation (*Management Measures*) governing China's national carbon market came into force on 1st February 2021, with the first compliance cycle starting in January 2021 and due to end on 31st December 2021. More than two thousand power companies have been allocated allowances, making it the world's largest ETS.⁴ Other key emitting industries are expected to be included later, once stable operation of the power sector ETS has been achieved.

The *Management Measures* provide a high-level interim regulatory framework for carbon emission allowance allocation, registration, trading and settlement, emissions reporting and verification activities, as well

1 Full text of Xi's statement at the General Debate of the 75th Session of the United Nations General Assembly, Qishi, 23rd September 2020, viewed 19th Jun 2021, <http://en.qstheory.cn/2020-09/23/c_538398.htm>

2 *Notice on List of Covered Entities for 2019–2020 National Carbon Emissions Trading Quota Management*, MEE, 30th December 2020, viewed 21st May 2021, <http://www.mee.gov.cn/xxgk/xxgk03/202012/t20201230_815546.html>

3 *Meeting on Carbon Market Administrative Policy*, MEE, 5th January 2021, viewed 21st May 2021, <http://www.mee.gov.cn/ywdt/hjynews/202101/t20210105_816140.shtml>

4 *The First Implementation Cycle of the National Carbon Market was Officially Launched*, Xinhua, 6th January 2021, viewed 21st May 2021, <http://www.gov.cn/xinwen/2021-01/06/content_5577348.htm>





as the supervision and management of these activities. Provincial Environment and Ecology Bureaus collected information from participating entities for the opening of accounts in the registry and exchange platform, which was submitted to the MEE.

The MEE has established a three-tiered governance structure: it is the national authority that sets the rules and oversees the system, sharing joint oversight of trading activities with other regulators; provincial Environment and Ecology Bureaus oversee the implementation of these rules; and municipal-level authorities take on local management duties.

On 29th March 2021, the MEE officially released the *Enterprises Greenhouse Gas (GHG) Emissions Report Verification Guidelines (Trial)*,⁵ after seeking public comment at the end of 2020.⁶ In the final version, three chapters on verification principles and legal basis, re-verification and information disclosure have been added. The *Guidelines* place emphasis on avoiding conflicts of interests of third parties, data quality control and information disclosure. It also requires onsite checks to take place for all major emitting entities, except those that meet certain conditions. It includes eight verification procedures, compared to six in the draft, and offers clearer and more detailed requirements on the review of documents. The monitoring plan set out in the *Guidelines*, renamed the 'Data Quality Control Plan', categorises operators into three categories with different verification requirements. If operators meet certain requirements for two consecutive years, they can obtain a waiver for onsite inspections. This updated plan also adds a new chapter addressing information disclosure regarding verification.

On 29th March 2021, the MEE released the *Guidelines on Enterprises' Greenhouse Gas Emissions Accounting and Reporting of Power Generation Facilities*,⁷ after

a round of public consultation at the end of 2020.⁸ Compared to the draft for consultation, the main changes include the following:

- The requirements and overall procedures of GHG accounting for operators have been further clarified.
- Data quality management and quality control plans, access to production data, regular reporting and information disclosure have been strengthened.
- The 'monitoring plan' has been renamed the 'Data Quality Control Plan',⁹ and has a focus on data quality.
- Requirements on monitoring have been enhanced and rules on sampling, capacity of labs and the retention of records have been imposed.
- Methodology is simplified by only looking at generation units, rather than legal persons.
- Monthly GHG data reporting and an annual report for the previous year to be submitted by 31st March of each year are now required.
- A new chapter that specifically addresses information disclosure has been added.
- Operators are required to disclose their annual GHG reports, including CO₂ emissions of each generation unit and total CO₂ emissions.

The MEE also set requirements for retrospective reporting of 2020 GHG emissions data.¹⁰ The purpose is two-fold: to get accurate data on the power sector for allowance allocation and surrender; and to obtain data from other key sectors to prepare for the extension of the national ETS and improve allocation methodologies for the respective sector. The requirements cover enterprises in the power, petrochemicals, chemicals, building and construction, iron and steel, non-ferrous metals, paper and pulp, and aviation sectors, which have annual emissions of over 26,000 tonnes of CO₂ equivalent in any year between 2013 to 2020 ("major emitting entities"). For the power sector, the scope of coverage includes those listed in the official allocation

5 *Notice of Enterprises Greenhouse Gas Emissions Report Verification Guidelines (Trial)*, MEE, 29th March 2021, viewed 23rd May 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/202103/t20210329_826480.html>

6 *Call for Comments on Guidelines on Greenhouse Gas Verification for Enterprises (Trial) (Draft for Comments)*, MEE, 16th December 2020, viewed 21st May 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/202012/t20201216_813413.html>

7 *Guidelines on Enterprises Greenhouse Gas Emissions Accounting and Reporting of Power Generation Facilities*, MEE, 29th March 2021, viewed 23rd May 2021, <<http://www.mee.gov.cn/xxgk2018/xxgk/xxgk05/202103/W020210330581117072208.pdf>>

8 *Call for Comments on the National Environmental Protection Standard Guidelines for Accounting Methods and Reporting of Greenhouse Gas Emission of Enterprises Power Generation Facilities (Draft for Comments)*, MEE, 3rd December 2020, viewed 21st May 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/202012/t20201203_811443.html>

9 *Data Quality Control Plan, Guidelines on Enterprises Greenhouse Gas Emissions Accounting and Reporting of Power Generation Facilities*, MEE, 29th March 2021, viewed 23rd May 2021, <<http://www.mee.gov.cn/xxgk2018/xxgk/xxgk05/202103/W020210330581117072208.pdf>>

10 *Notice on Strengthening the Work Related to the Management of Enterprise Greenhouse Gas Emissions Reports*, MEE, 29th March 2021, viewed 23rd May 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk05/202103/t20210330_826728.html>





plan for 2019–2020, with some new additions for 2020. Local Environmental Protection Bureaus (EPBs) were given the responsibility of updating and submitting by 30th June 2021 the list of major emitting entities in the power sector for 2021 under the management and monitoring of the MEE, and making it publicly available on the website of the EPB.

Enterprises in the power sector are required to submit their emissions data by 30th April each year, verification of which must be completed by third-party verification by 30th June.¹¹ Verification of the allowance quantities are then required to be completed by 30th September to meet the deadline of allowance surrendering by 31st December.

At the same time, enterprises in the petrochemicals, chemicals, building and construction materials, iron and steel, non-ferrous steel, paper and pulp, and aviation industries are also required to submit emissions data by 30th September, to pave the way for the planned ETS expansion within the 14th Five-year Plan (14FYP) period. Reporting requirements do not apply to major emitting entities that cease to meet the threshold or that do not carry out production and operational activities due to suspension, the shuttering of operations or other reasons.

Finally, on 30th March 2021, a draft of the State Council's *Interim Regulation on the Management of Carbon Emissions Trading (Interim Regulation)* was published for comment.¹² The *Interim Regulation*, expected to be implemented this year, will help to fill the legal void which was temporarily filled by the *Interim Rules on Carbon Emission Trading (ETS) Management* issued by the MEE.¹³ Compared to the MEE rules, this State Council regulation addresses inter-ministerial coordination on overall ETS regulatory oversight and imposes higher-level penalties to deter non-compliance. It also leaves space for an absolute cap on allowances and sets more detailed rules on MRV and information disclosure. The public consultation on this updated *Interim Regulation* closed on 30th April 2021.

In terms of reporting, the *Interim Regulation* adds requirements on the content (the emissions data needs to be included in the entity's report by 31st March each year), accountability for data quality and the retention of data records for at least five years (Article 9). In terms of verification, it sets specific timeframes, i.e., provincial EPBs shall conduct verification within 30 working days of the receipt of emissions reports and notify operators of the results within seven working days from the day of verification. It also clarifies that provincial EPBs can purchase services from third-party verifiers through public procurement (Article 10). The revised draft creates new requirements for re-verification by provincial EPBs in case of any disputes on the results claimed by operators (Article 11).

In terms of transparency, while the 2019 regulation only required information disclosure by the MEE, Article 15 of the revised draft adds disclosure requirements for different parties involved in the ETS. Operators are required to publish information on trading and related activities as well as GHG emissions from the previous year (articles 9 and 19). Provincial EPBs should publish information on allowance surrender by operators (Article 19). The registry and the trading exchange are required to disclose information on registration, trading and settlement, as well as information material to the market (Article 19). It is also now clear that all the data will be incorporated into the national emission permitting management information platform.¹⁴

The national registry and the trading platform have been developed, and specific rules governing enterprises' interaction with these two key institutions established prior to the start of trading, which launched on 16th July 2021 with prices remaining modest on the opening day as expected. The registry is currently hosting registration for all 2,225 power companies covered by the national ETS. The system is equipped with different trading modes and can support carbon trading and trading of China Certified Emission Reduction (CCER) rights, energy use rights and emission rights.

The pilot carbon markets in Beijing, Tianjin, Shanghai, Chongqing, Hubei, Guangdong and Shenzhen have shown positive results in terms of emissions reduction. The institutional system has been deepened in these pilot carbon markets to gradually expand sectoral

¹¹ Ibid.

¹² *Call for Comments on Draft of the State Council Interim Regulation on the Management of Carbon Emissions Trading (Interim Regulation)*, MEE, 30th March 2021, viewed 21st May 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/202103/t20210330_826642.html>

¹³ *Regulations on the Management of Carbon Emissions Trading (trial)*, MEE, 31st Dec, viewed 23rd May 2021, <http://www.gov.cn/zhengce/zhengceku/2021-01/06/content_5577360.htm>

¹⁴ Information Management Platform for Permit of Pollutant Emission, MEE, viewed 21st May 2021, <<http://permit.mee.gov.cn>>





coverage while exploring methods to: optimise allowance allocation; improve technical specifications and data quality management of carbon emission monitoring, accounting, reporting and auditing; and strengthen comprehensive measures like management of honouring agreements.¹⁵ Throughout 2020, China's eight regional carbon markets (the seven pilots plus Fujian) continued operating and further developed allocation, offsetting and trading rules. While the pilots will continue to operate parallel to the national ETS, it is anticipated that overlapping entities will be gradually integrated into the national market.

China's carbon market will be a growing area of business for both Chinese and European companies. For much of the remaining work necessary to strengthen the system, and to develop a thriving market ecosystem, the experience and involvement of European companies will be invaluable. The working group looks forward to working proactively with the Chinese authorities to promote an effective and vibrant carbon market that plays a major role in achieving China's carbon neutrality goals in the coming decades.

Key Recommendations

1. Increase the Accuracy and Transparency of Carbon Emissions Monitoring, Reporting and Verification in China's National ETS 3

Concern

Despite the efforts and progress made to improve the accuracy and transparency of emissions data, challenges still exist in areas such as supervision and enforcement, where the risk of fraud may affect stakeholders' trust in the market.

Assessment

Accuracy: improving monitoring, reporting and verification

The reliability of GHG emissions data is the cornerstone of any carbon-pricing policy tool. In order to ensure the credibility of ETS data, it is important that an effective and accountable regulatory framework for MRV is 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 following challenges still exist with respect to China's ETS:

- 1) The 24 technical guidelines issued on MRV need to be modified in response to problems that have arisen in practice. The MRV of GHG emissions is related to many industrial production procedures—including those of some complicated industrial sectors such as chemicals, petrochemicals, steel and cement—that require clear identification and definition of an abundance of factors, boundaries, methodologies and formulas. In the past eight years of measuring GHG emissions since the first guidelines were 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 when modifying technical guidelines relating to the nationwide ETS.
- 2) The supervision of the performance of verification agencies needs to be strengthened. The professionalism, compliance and technical capability of verifiers will affect to a large extent the credibility of the monitoring results. Considering that over 2,000 enterprises are to be included in 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. The draft of the *Interim Regulations* calling for public comments in March 2021 states that provincial governments will secure the verifiers that will check the GHG emissions of entities through public procurement, but more details are yet to be released.¹⁶
- 3) In terms of violations by third-party verifiers, the revised draft cancels fines, instead saying that violations will be recorded in the Corporate Social Credit System, and only bans offending entities from operating verification business for three years (Article 26).¹⁷ This contrasts starkly with the outright ban that was stipulated in the earlier 2019 regulation. Given the expected demand for verification services and the potential shortage of experienced, well-qualified verifiers, there is a risk that insufficient penalties may leave the door open to potential fraud.

¹⁵ *China has Fulfilled 2020 International Commitment to Carbon Sustainability Ahead of Schedule*, Xinhua, 28th November 2019, viewed 21st May 2021, <http://www.xinhuanet.com/energy/2019-11/28/c_1125283156.htm>

¹⁶ *Call for Comments on the Draft of the State Council Interim Regulation on the Management of Carbon Emissions Trading (Interim Regulation)*, MEE, 30th March 2021, viewed 23rd May 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/202103/t20210330_826642.html>

¹⁷ Ibid.





4) The capacity of enterprises in non-pilot regions to conduct 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 much training on MRV having been carried out for enterprises, there is still strong demand for further capacity-building due to the complexity of the process and frequent changes to requirements. As multinational companies can help to improve MRV services overall, it is therefore important that market access for MRV service providers be based on technical capacity and worldwide track record rather than their nationality.

Transparency: promoting the 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 therefore advocates for more transparency in aggregated market activities.

It is encouraging that the State Council's *Interim Regulations* state that carbon emissions data will be incorporated into the national emission permitting management information platform. The MEE, under the State Council, is responsible for regularly disclosing information on carbon emission allowance trading and on the completion status of carbon emission allowances submitted by entities each year.¹⁸

In a well-designed system, the regulator should develop 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 for early detection of 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. In terms of access to information regarding power generation, it should be user-friendly, and companies with large installations should be prevented from profiting from 'inside information'.

Companies that are already engaged in the early stages of evaluating the impact of climate change on their businesses and strategies should be encouraged to share information on their governance and risk management best practices.

There is a range of policies on carbon-related information disclosure across China's provinces. Apart from the pilot carbon markets, five provinces have issued measures on GHG information disclosure. In addition, the central government is including information disclosure in the key performance indicators of local governments. Therefore, all provinces will report the progress of work on disclosure in their annual reports. For the next step, regulations on the compulsory disclosure of information by enterprises should be established, followed by a corresponding incentive and penalty mechanism.

Recommendations

- Enhance the reliability of GHG data, and the transparency of methods for collecting GHG data at the enterprise level.
- Ensure that penalties for non-compliance in emissions reporting and failure to submit allowances are set at an adequate level to deter entities from defaulting.
- Promote consistent nationwide requirements for GHG data disclosure.
- Establish a regulation on the oversight and compulsory disclosure of information by enterprises, followed by a corresponding incentive and penalty mechanism.

2. Clarify Requirements for the Participation of Non-compliance Entities in the National ETS, to Avoid Creating Systematic Risks that Undermine the Stability and Credibility of the Market

Concern

The lack of clarity on how non-compliance entities can participate in the national ETS raises the risk of companies being exposed to loss of investment or fraud.

Assessment

Because it is still unclear how non-compliance entities (i.e., service providers) can participate in China's national carbon market, some small companies may sign deals with compliance entities (i.e., smaller power

¹⁸ Ibid.





plants) to use their trading, registry and bank accounts as a way of accessing the national market. This poses the following risks:

- 1) It could create an invisible barrier to the national market, filtering out larger and law-abiding service providers, leaving compliance entities that need trading and risk management services with limited options.
- 2) Without a clear and legal route to the market, market activity may be effectively forced to go underground, with less regulatory oversight. The probability of companies failing is high, particularly for smaller ones. If small companies operate directly on compliance entities' accounts without oversight, there will be implications for the stability of the whole national market.

Recommendations

- Clarify the requirements for non-compliance entity participation as soon as possible.
- Create an environment where compliance entities can choose a legal and reliable path to procure trading or advisory services.

3. Facilitate Government, Civil Society and Business Exchanges between the EU and China to Reinforce Cooperation in line with China's 2060 Carbon Neutrality Target and the EU Green Deal 3

Concern

In order to achieve their ambitious climate targets, both the EU and China need to incentivise wide-ranging and exclusive exchanges among multiple stakeholders, which will contribute to not only creating political reciprocity between these mega-economies, but also boosting commercial cooperation between EU and China business.

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 in 2015 resulted in the recognition that an important role can and should be played by

local governments, cities, the private sector and civil society.¹⁹ The Paris Agreement entered into force at the end of 2016.²⁰ 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 to propose new plans,²¹ but of course the responsibility for staying the course lies with everyone.

COP15 will be hosted in China in 2021, with the aim of promoting the protection of biodiversity and construction of a global ecological civilisation. Following COP15, the 26th UN Climate Change Conference of the Parties (COP26) will take place in Glasgow from 31st October to 12th November 2021, bringing together heads of state, climate experts and campaigners to discuss coordinated action to tackle climate change. The European Chamber will be represented at the summit.

To overcome the challenges of climate change and environmental degradation, the EU needs a new growth strategy that will transform it into a modern, resource-efficient and competitive economy. The European Green Deal is its plan to make the EU's economy sustainable, building on its strengths as a global leader on climate and environmental measures, consumer protection and workers' rights. Delivering additional reductions in emissions is a huge challenge that will require massive public investment and increased efforts to direct private capital towards climate and environmental action, while avoiding getting stuck in unsustainable practices. The EU's collective expertise in environmental issues means that it must be at the forefront of coordinating international efforts towards building a coherent financial system that supports sustainable solutions. This upfront investment is an opportunity to put Europe firmly on a new path of sustainable and inclusive growth.²²

As the world's largest emitter of CO₂, China has promised to become carbon neutral before 2060, and to begin cutting its emissions within the next ten years.

¹⁹ 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*, 5th June 2017, viewed 23rd May 2021, <<https://www.ft.com/content/27c5bad2-4895-11e7-919a-1e14ce4af89b?mhq5j=e3>>

²⁰ Adoption of the Paris Agreement, UNFCCC, 12th December 2015, viewed 23rd May 2021, <<https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf>>

²¹ 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.

²² Communication from the Commission of The European Green Deal, European Commission, 11th December 2019, viewed 23rd May 2021, <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A52019DC0640>>





According to several influential research groups that work closely with the government on how China could reach carbon neutrality before 2060,²³ China must first begin to generate most of its electricity from zero-emission sources, and then expand the use of this clean power wherever possible, for example switching from petrol-fuelled cars to electric ones. China also needs technologies that can capture CO₂ released from burning fossil fuels or biomass and store it underground, known as carbon capture and storage (CCS), as well as energy storage to integrate wind and solar at scale.

Yet these are not seen as insurmountable challenges. On the contrary, they present an economic opportunity that makes the transition an appealing prospect for China's decision-makers. In the short term, the areas of focus—where China combines economic opportunity with its climate pledge—are clear: they include wind turbine and solar panel manufacturing, battery technologies, as well as hydrogen development and associated applications. For power utilities involved in grid expansion, the energy transition also offers new business opportunities, including scaling up the use of gas in power generation. The 14FYP and other government policy papers will look to develop these areas, as technological progress in innovation and cost reductions will drive advancements in the energy mix from 2050 to 2060.²⁴ The working group calls on the Chinese authorities to publish roadmaps and action plans for carbon peaking and neutrality across various industries as soon as possible, and to consult with key stakeholders, including industry associations, at an early stage of the process regardless of their ownership and nationality.

Comparing the EU Green Deal with the Chinese carbon neutrality target, both parties seem to share many common objectives related to achieving a low-carbon economy. Similarly, both countries are committed to the achievement of the UN's Sustainable Development Goals (SDGs). Of particular relevance are SDG13 (taking urgent action to combat climate change and its impacts), and SDG7 (ensuring access to affordable, reliable, sustainable and modern energy for all).

This common view highlights the significance of reinforced

exchange and cooperation among stakeholder groups, including governments, business, think-tanks, academies and civil societies. Only through ambitious and collective actions can both parties hope to achieve their targets, which will contribute to keeping global temperature increases between 1.5 degrees Celsius (°C) and 2°C above pre-industrial levels, and play a leadership role in creating a net-zero-emissions, sustainable world.

The EU and China have a long-standing cooperation on climate change and have agreed to increase joint efforts. Since 2005, the EU-China Partnership on Climate Change has provided a high-level political framework for cooperation and dialogue.²⁵ This was confirmed in the *2010 Joint Statement* and enhanced in the *2015 Joint Statement* and the *2018 Leaders' Statement*.²⁶ Another flagship cooperation project that illustrates strong bilateral cooperation on climate change is the EU-China ETS Dialogue and Cooperation Platform.²⁷ From 2017 to date, this project has published five policy recommendation reports, and trained more than 14,000 local government and industry representatives in China. The stakeholder network it has established can help to connect EU business with Chinese counterparts to result in value-added cooperation.

Recommendations

- Utilise the EU-China ETS Dialogue and Cooperation Platform, the EU-China Energy Cooperation Platform and other bilateral initiatives to share best practices in carbon markets and decarbonisation.
- Hold regular exchanges with EU counterparts at all levels regarding climate change and low carbon policies in line with the Paris Agreement, the UN's SDGs, and China's 2030/2060 carbon reduction targets and climate and energy actions highlighted in the 14FYP.
- Create an accessible, transparent and business-friendly market for both European and Chinese businesses that offers them opportunities to be part of joint solutions for China's climate policy agenda.

²³ *How China could be carbon neutral by mid-century*, Nature, 19th October 2020, viewed 23rd May 2021, <<https://www.nature.com/articles/d41586-020-02927-9>>

²⁴ *Unpacking China's 2060 carbon neutrality pledge*, Oxford Institute for Energy Studies, December 2020, viewed 23rd May 2021, <<https://www.oxfordenergy.org/wpcms/wp-content/uploads/2020/12/Unpacking-Chinas-carbon-neutrality-pledge.pdf>>

²⁵ *Joint Statement on the 8th China-EU Summit*, Ministry of Foreign Affairs (MFA), 5th September 2005, viewed 23rd May 2021, <<https://www.fmprc.gov.cn/ce/cebe/chn/zozyzcwj/celdrt541016.htm>>

²⁶ *China's Relations with the EU*, MFA, October 2020, viewed 23rd May 2021, <https://www.fmprc.gov.cn/web/gjhdq_676201/gjhdqzz_681964/1206_679930/sbgx_679934/>

²⁷ EU-China Emissions Trading System website, viewed 23rd May 2021, <<https://www.eu-chinaets.org/>>





European Chamber
中国欧盟商会

Abbreviations

°C	Degrees Celcius
14FYP	14 th Five-year Plan
CCER	Chinese Certified Emission Reduction
CCS	Carbon Capture and Storage
CNY	Chinese Yuan
CO ₂	Carbon Dioxide
COP	Conference of the Parties
ECECP	EU-China Energy Cooperation Platform
EPB	Environmental Protection Bureaus
ETS	Emissions Trading System
EU	European Union
GHG	Greenhouse Gas
MEE	Ministry of Ecology and Environment
MFA	Ministry of Foreign Affairs
MRV	Monitoring, Reporting and Verification
SDG	Sustainable Development Goal
UN	United Nations





Fashion and Leather Working Group

Key Recommendations

1. Amend the Product Quality Law

1.1 Remove the Abstract Term ‘Unqualified Product’ and Introduce the Concept of ‘Safe Product’, and Confirm Whether a Product’s Conformity with Mandatory National Standards or a Product Having Unreasonable Risk Can Be Used as Criteria for Judging its Safety and Initiating Administrative Penalties

- Remove the term ‘unqualified product’ and introduce the term ‘safe product’.
- Confirm whether a product's conformity with national standards, or its potential to cause unreasonable risk, can be used as criteria in assessing its safety and initiating administrative penalties.
- Clarify that voluntary standards, given their nature, should not be used as the basis for administrative penalties.

1.2 Confirm that Enterprises Assume Only Civil Responsibility in the Event that Products Fail to Satisfy their Declared Quality Standards

- Clarify that enterprises shall only bear civil liability for a safe product that does not meet their declared voluntary quality standards, and shall not be subject to administrative penalties.

2. Revise the Mandatory National Standard GB 18401 National General Safety Technical Code for Textile Products

- Launch the revision of GB 18401-2010 as early as possible, and consider adjusting the colour fastness criteria for special products, for instance, velvet textile products, ultrafine fabric products, wash-faded products, denim products and dark-coloured products.
- Take the half-grade-difference into consideration as a general safety conformity scale and apply it when judging the conformity of a product.
- Change colour fastness from being a ‘key quality item’ to ‘normal quality item’ when making national, provincial or city-level implementation rules for product inspections, and apply it in product inspections, so facilitate a change in the safety scale and judging standard for product conformity.
- Include the test for dyes and auxiliaries that pose a risk of harming personal health in the safety assessment of mandatory standard GB 18401.

3. Take Resolute Methods to Curb the Sale of Fake Goods Online and Promote Industrial Self-governance

- Call on grassroots courts, especially local intellectual property (IP) courts, to be more proactive in identifying the relevant responsibilities of platforms in individual cases and urging various network platforms, including social media, to actively fulfil their social and legal responsibilities for IP rights (IPR) protection.
- Supervise and encourage courts at all levels throughout China to actively strengthen IPR protection online, by sharing case-studies of ground-breaking judgments.
- Classify platforms (for example, traditional e-commerce and social media platforms) according to modes of query, channels of information display, methods of user access, payment and settlement, and other technical features, and set up proper administrative measures.
- Take heed of and respect effective IPR protection models agreed between rights holders and platforms.



4. Take into Account the Balance Between Business Development and Consumer Information Protection when Formulating Laws and Regulations Related to Personal information

- Integrate the currently fragmented requirements of the *Personal Information Security Specification* into unified and coherent provisions, ensuring that the same definitions, legal concepts and positions, and related technical and organisational measures are used, to facilitate compliance work and reduce compliance costs.
- Implement supervision over various operators by type, especially general e-commerce operators and key infrastructure operators, while adhering to the legislative spirit of the Cybersecurity Law.
- Encourage and promote the reasonable autonomy of enterprises and industries for general e-commerce operations.
- Adopt legislation to provide focussed regulation and stronger control over internet enterprises, government agencies, banks, automobile services providers and real estate agents, which collect and process a large amount of personal information in their daily operations, in order to protect the rights of consumers and for citizens to understand, refuse and delete the kind of personal information that is being collected, used and shared.
- Consider fully the daily management structure and data-sharing needs of multinational companies, and conduct reasonable and effective in-market supervision through internal contracts and corporate commitments, to avoid dampening the enthusiasm of foreign enterprises to invest in China, and any other negative impacts that may accelerate the withdrawal of global supply chains from China.

5. Allow Enterprises to Not Display Product Standard Numbers on Imported Apparel

- Clarify that imported clothing and leather products do not need to be marked with product standard numbers, but should comply with the domestic mandatory national standards.

Introduction to the Working Group

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 for the Chinese market. 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

a business environment that is focussed on safety, environmental protection and innovation. 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 Development

The working group covers a wide range of sectors including textiles, clothing, leather goods and high-end consumer goods. The policy updates from the past year that have had a significant impact on working group members are listed below, and will remain of continued focus for the working group throughout the coming year:

1. Product Quality Law

In April 2019, the State Administration for Market Regulation (SAMR) announced that the Product Quality Law was undergoing revision. Tian Shihong, head of





the leading group for the revision, said that the revised Product Quality Law should become an important safeguard for maintaining quality and consumer safety, to help meet people's desire for a better life and their demand for high-quality products. Aims of the revision include: building a solid bottom line for product safety and quality; allowing the market to play a more decisive role in resource allocation so the government can focus more on its core function; providing a basis to increase corporate responsibility in terms of quality and safety; and bringing greater focus to innovating regulatory mechanisms, optimising the market environment and improving the system for accountability. The revised law should therefore help promote quality improvement and innovation, and modernise China's quality governance system and overall governance capacity.¹

Over the past year, the working group has submitted comments and suggestions on the amendments to the Product Quality Law through two main channels, namely advocacy letters and government meetings. According to the SAMR's 2021 legislative work plan, the draft of the Product Quality Law for public review is expected to be finalised within the year.² The working group will continue to actively participate in the public dialogue on this important piece of legislation.

2. Management Measures for the Circulation of Products Made of Crocodile Leather

On 1st December 2020, the Fisheries Bureau of the Ministry of Agriculture and Rural Affairs (MARA) launched the *National Identification Management System for Farmed Crocodile and Relevant Products (Identification System)* on a trial basis.³ This system is applicable to crocodiles bred in captivity, such as Siamese crocodiles, Nile crocodiles, saltwater crocodiles and other crocodiles included in the *List of National Key Protected Aquatic Wildlife Bred in Captivity*, and products made from them.⁴ After obtaining an Aquatic Wildlife Operating and Utilisation Permit as previously, enterprises can now apply for a specific identification

code through the national Identification System, and products with the code can then be sold and utilised nationwide. Enterprises generally believe that this form of 'product-based' management will reduce the burden of applying for a large number of permits 'by shop', and is also more conducive to facilitating the trading and circulation of products.

3. Measures for the Supervision and Administration of Network Transactions

On 15th March 2021, the SAMR promulgated the *Measures for the Supervision and Administration of Network Transactions (Measures)*.⁵ The *Measures* serve as an important departmental regulation for the implementation of the E-commerce Law.^{6&7} Among other things, they address the regulation of new forms of online trading and make clear provisions on the responsibilities of operators engaged in online trading activities. The working group believes that this will push platform operators to take more responsibility for combatting counterfeit goods on their platforms.

4. Guidelines for the Use and Control of Key Chemicals in Consumer Products

On 19th November 2020, the recommended national standard, *Guidelines for the Use and Control of Key Chemicals in Consumer Products (GB/T 39498-2020) (Guidelines)*,⁸ was officially released, becoming effective on 1st June 2021. After referring to the European Union's (EU's) *Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH)*,⁹ *Standard100 by OEKO-TEX*,¹⁰ the *EN71 Directive*¹¹ and other foreign technical regulations, and combining the chemical indicators in China's existing consumer goods standards, the *Guidelines* list a total of 66 prohibited and restricted chemical substances. The formulation

1 *Revision of the Product Quality Act in full swing*, SAMR, 25th April 2019, viewed 15th April 2021, <http://www.samr.gov.cn/xw/zj/201904/t20190425_293135.html>

2 *Notice of the State Administration of Market Regulation on the Issuance of the Legislative Work Plan for 2021*, SAMR, 2nd April 2021, viewed 15th April 2021, <http://gkml.samr.gov.cn/nsjg/fgs/202104/t20210401_327476.html>

3 *National Identification Management System for Farmed Crocodile and Relevant Products* (registration required), Fisheries Bureau of the MARA, viewed 15th April 2021, <<http://crocodile.cnfm.com.cn>>

4 *List of National Key Protected Aquatic Wildlife Bred in Captivity*, MARA, 29th July 2019, viewed 13th April 2021, <http://www.moa.gov.cn/nybg/2019/201908/202001/t20200109_6334610.htm>

5 *Order of the SAMR (No. 37)*, SAMR, 15th March 2021, viewed 7th April 2021, <http://gkml.samr.gov.cn/nsjg/fgs/202103/t20210315_326936.html>

6 E-commerce Law, The Standing Committee of the National People's Congress (NPC), 31st August 2018, viewed 13th April 2021, <http://www.mofcom.gov.cn/article/zl_dzsw/>

7 *Measures for the Supervision and Administration of Network Transactions*, SAMR, 15th March 2021, viewed 7th April 2021, <http://www.samr.gov.cn/xw/zj/202103/t20210315_326928.html>

8 *Guidelines for the Use and Control of Key Chemicals in Consumer Products*, National Standard Full Text Disclosure System, 19th November 2020, viewed 7th April 2021, <<http://c.gb688.cn/bzgk/gb/showGb?type=online&hcno=0A450E97D7D931BA46782E8C090A20B6>>

9 REACH, European Commission, 24th August 2016, viewed 13th April 2021, <http://ec.europa.eu/environment/chemicals/reach/reach_en.htm>

10 Standard100 by OEKO-TEX, OEKO-TEX, viewed 13th April 2021, <<https://www.oeko-tex.com/en/our-standards/standard-100-by-oeko-tex>>

11 EN71 Directive 2009/48/EC, European Parliament & the Council on the Safety of Toys, 18th June 2009, viewed 14th April 2021, <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32009L0048>>



of this standard is more in line with the development needs of Chinese consumer goods, and provides technical support to improve their quality.

5. Administrative Penalties Law (2021 Revision)

The 2021 revision of the Administrative Penalties Law,¹² as amended and adopted by the Standing Committee (SC) of the National People's Congress (NPC), was published on 22nd January 2021, and came into effect on 15th July 2021. The new law increases penalties in areas related to the safety of public life and health, and also includes flexible enforcement provisions such as 'exemption from penalty for first violations', 'exemption from penalties for goodwill' and 'application of old and lighter penalties'.¹³ The working group notes that many local market surveillance authorities have introduced lists of non-penalties and mitigated penalties for minor offences.^{14,15&16} Such 'penalty-free lists' are increasingly being adopted by more administrative authorities.^{17,18&19} The working group believes these changes represent improvements to the business environment under the rule of law that can further stimulate market dynamics. The working group hopes to see the continuation of such more prudent and inclusive approaches to market regulation of consumer goods, with exemptions from fines for minor offences or a focus on rectification.

- 12 Administrative Penalties Law, NPCSC, 1st March 2021, viewed 27th April 2021, <www.moj.gov.cn/Department/content/2021-01/25/592_3265251.html>
- 13 *Positive Changes Provided by the New Administrative Penalties Law*, SAMR Journal, 6th April 2021, viewed 28th April 2021, <<https://mp.weixin.qq.com/s/9oRVtbbryqlHUcPWH8Eg>>
- 14 *Notice on the Issuance of the List of Exemptions from Penalties for Minor Market Violations*, Shanghai Municipal Bureau of Justice, 14th March 2019, viewed 28th April 2021, <http://sfj.sh.gov.cn/2020jcgk_gfxwj/20201102/df99de8e937149b49e2c87020e54f3e3.html>
- 15 *Notice on the Issuance of the List of Mistake Tolerance and Error Correction for Minor Violations*, Beijing Municipal Administration of Market Supervision, 14th August 2020, viewed 28th April 2021, <http://www.beijing.gov.cn/zhengce/zhengcefagui/202009/t20200909_2042885.html>
- 16 *Provisions on Exemption from Punishment for Minor Violations in the Field of Market Supervision in Jiangsu Province*, Jiangsu Provincial Administration of Market Supervision, 11th December 2019, viewed 28th April 2021, <http://scjgj.jiangsu.gov.cn/art/2019/12/11/art_70316_8841376.html>
- 17 *Notice on the Issuance of the List of Exemptions from Penalties for Minor Violations in the Cultural Market*, Shanghai Municipal Bureau of Justice, 6th March 2020, viewed 28th April 2021, <http://www.ce.cn/culture/gd/202003/06/t20200306_34420426.shtml>
- 18 *List of Non-punishment for Minor Ecological Violations in Zhejiang Province (for Trial Implementation)*, Zhejiang Provincial Department of Ecology and Environment, 30th November 2020, viewed 28th April 2021, <http://sthjt.zj.gov.cn/art/2020/11/30/art_1229116580_2173652.html>
- 19 *Notice on Issuance of the List of Non-punishment for First Violation in Terms of Minor Illegal Taxation Violation in Yangtze River Delta Area*, Shanghai Municipal Tax Bureau of State Taxation Administration, 1st July 2020, viewed 28th April 2021, <<http://shanghai.chinatax.gov.cn/zcfw/zcfgz/hsszc/202007/t454433.html>>

Key Recommendations

1. Amend the Product Quality Law

1.1 Remove the Abstract Term 'Unqualified Product' and Introduce the Concept of 'Safe Product', and Confirm Whether a Product's Conformity with Mandatory National Standards or a Product Having Unreasonable Risk Can Be Used as Criteria for Judging its Safety and Initiating Administrative Penalties

Concern

The concept of 'unqualified product' is too abstract, which results in severe administrative penalties being imposed upon enterprises that make mistakes in labelling.

Assessment

The existing Product Quality Law uses the abstract term of 'unqualified products', which has not been clearly defined. The term has been interpreted differently by various local law enforcement agencies, and the ambiguity that arises has resulted in a scope of 'unqualified products' that is too broad. Therefore, considerable administrative resources that could be used to combat products that are unsafe or pose a risk to people's lives are instead wasted on supervising safe but substandard products, which ultimately does not protect consumers' safety. This also results in companies potentially facing serious administrative penalties for minor labelling defects.

Furthermore, this approach is not in line with certain provisions of the World Trade Organization Agreement on Technical Barriers to Trade (WTO/ TBT).²⁰ For instance, in China, violation of a declared voluntary standard results in classification as an 'unqualified product', for which enterprises are punished for violation of a mandatory standard. However, the WTO/ TBT only allows mandatory standards to be applied in consideration of national security, prohibition of fraud, and health, safety and environmental protection. In the wake of the COVID-19 pandemic, China is trying to construct several international consumer cities or regions, which increases the necessity for a Product Quality Law that is in line with international standards to safeguard the integration of domestic and foreign trade.

20 *Technical Barriers to Trade Agreement*, WTO, 1st January 1980, viewed 14th April 2021, <https://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm>





When comparing foreign and domestic administrative priorities and practices related to product quality, it is clear that the 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)*²¹ and the *REACH*, that deal with carcinogens, mutagens, reproductive toxicity, sensitisation, endocrine disorders and environmental protection; whereas in China there are only two safety-related chemical standards, covering azo and formaldehyde.

Due to this 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 implementation focus is more on non-safety-related standards, which hinders innovation and the development of the industry overall, as companies concentrate on conforming to these requirements. Therefore, the working group recommends the concept of a 'safe product' be adopted, and that a product's conformity with mandatory national standards and its potential unreasonable risk should be confirmed as the criteria for judging its safety, to resolve current challenges faced by the industry.

Challenge 1: When producing and selling products, companies need to indicate a large amount of product information on labels, meaning that production and sales involves many departments (which may include foreign agencies). It is therefore inevitable that some faults or translation errors may occur, resulting in incomplete or inaccurate product labelling information. Currently, due to the lack of a clear specification of 'unqualified products' in the Product Quality Law, companies are often subject to high administrative penalties for minor product label defects unrelated to safety, greatly increasing the burden on companies.

Challenge 2: Current voluntary standards are numerous and categorised in different systems (such as 'local standards', 'industrial standards'). 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 3: Despite the large number of voluntary standards, they often do not actually address certain special characteristics of specific products. For example, the generalised assessment indicators for the colour fastness of leather products in *QB/T1333 Handbag and Knapsack*—the widely applied standard for handbag and knapsack products—did not take into account the special characteristics of suede materials, which led to significantly differing opinions among many experienced testing agencies. Some enterprises faced administrative penalties as a result, which provided a basis for professional claimants to purchase such products with the ulterior motive of demanding large amounts of compensation. It was not until 2018 that special regulations accounting for the special characteristics of suede materials were included in the revised version of *QB/T1333*. In view of the sheer number of voluntary standards, revising them all to take into consideration the special characteristics of all products would be an extremely onerous task.

Challenge 4: Voluntary standards include requirements and assessment methods for general characteristics of detailed product types, and are significantly influenced by the features of existing products, raw materials and technologies. Enterprises that engage in technological innovation (such as new materials or manufacturing process development) or that choose non-harmful, natural colourants over artificial synthetic chemical colourants, may be at risk of administrative penalties and/or being targeted by professional claimants. This leads some enterprises to opt 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 intended to improve product quality.

In the third and fourth 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 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

21 General Product Safety Directive, European Commission, 11th January 2018, viewed 14th April 2021, <https://ec.europa.eu/info/general-product-safety-directive_en>



for simplifying administrative procedures.

Recommendations

- Remove the term 'unqualified product' and introduce the term 'safe product'.
- Confirm whether a product's conformity with national standards, or its potential to cause unreasonable risk, can be used as criteria in assessing its safety and initiating administrative penalties.
- Clarify that voluntary standards, given their nature, should not be used as the basis for administrative penalties.

1.2 Confirm that Enterprises Assume Only Civil Responsibility in the Event that Products Fail to Satisfy their Declared Quality Standards

Concern

The application of administrative penalties on enterprises that fail to satisfy the declared quality standard for a given product is a waste of public resources and overburdens enterprises, as such a failure should only be deemed a breach of contract with consumers.

Assessment

When a product does not meet the quality standards claimed by the enterprise (such as voluntary standards), but still complies with mandatory national standards without imposing unreasonable danger, China's Standardisation Law,²² Contract Law²³ and the Protection of Consumer Rights and Interests Law²⁴ clearly state that the enterprise can be deemed to have broken its commitment to the consumer on product quality, and should be liable for liquidated damages.

If an enterprise is administratively penalised for a product that does not meet the declared quality standards but still meets the definition of a 'safe product' (i.e., complies with national mandatory standards and is not unreasonably dangerous), it unfairly increases enterprises' contractual obligations and responsibilities, and unbalances market regulation. Consumer demand for new products, new materials and new processes is

increasing, which requires enterprises to focus more on reinvention and continual innovation. Therefore, to protect people's health and safety, the revised Product Quality Law should provide enterprises with a relatively fair and reasonable legal environment that fosters production innovation and promotes production quality improvements. Frequent fines would have the opposite effect and hinder the development of enterprises, as well as the overall level of national innovation.

The 2017 revision of the Standardisation Law specifies that compulsory national standards must be implemented, while encouraging the adoption of other standards, such as voluntary, group and enterprise standards. This is a critical step in making administrative management more efficient and aligned with international practices. The working group welcomed the accurate scoping of voluntary standards in the Standardisation Law, and recommends the alignment of revisions to the Product Quality Law, ensuring that voluntary standards are indeed, by definition, 'voluntary', i.e., that the law recognises their nature as standards for regulating civil liability relationships.

Recommendation

- Clarify that enterprises shall only bear civil liability for a safe product that does not meet their declared voluntary quality standards, and shall not be subject to administrative penalties.

2. Revise the Mandatory National Standard GB 18401 National General Safety Technical Code for Textile Products 4

Concern

Including colour fastness of textiles as a compulsory testing item under standard *GB 18401*²⁵ does not make sense as it is merely a burden to enterprises and is in no way related to a product's safety.

Assessment

The mandatory national standard *GB 18401* requires several colour fastness tests, including water resistance, perspiration resistance, dry rubbing resistance and saliva fastness. Colour fastness refers to "the ability of

22 *Standardisation Law*, NPCSC, 4th November 2017, viewed 14th April 2021, <http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-11/04/content_2031446.htm>

23 *Contract Law*, NPCSC, 15th March 1999, viewed 15th April 2021, <http://www.npc.gov.cn/wxzl/wxzl/2000-12/06/content_4732.htm>

24 *Protection of Consumer Rights and Interests Law*, NPCSC, 25th October 2013, viewed 15th April, <http://www.npc.gov.cn/wxzl/gongbao/2014-01/02/content_1823351.htm>

25 *National Standard GB 18401 National General Safety Technical Code for Textile Products*, General Administration of Quality Supervision, Inspection and Quarantine & State Standardisation Administration, 14th January 2018, viewed 14th April 2021, <<http://www.gb688.cn/bzgk/gb/newGbinfo?hcn=52C1F4CBDE863F5095D7C9D17F8E3F71>>





the colour of a textile to withstand various effects during processing and use, expressed in terms of the degree of discolouration and the degree of staining of the lining fabric". It is the consensus of the textile industry that this fastness to dyeing is a physical performance indicator that does not directly affect personal health or the safety of life and property. In other words, it is the dyes and auxiliaries themselves that may have a direct impact on personal health and the safety of life and property, thus relevant authorities should establish a preventive management mechanism for the chemical hazards of dyes and auxiliaries in the entire textile chain. At present, there are no relevant domestic laws, regulations or mandatory assessments that do this.

In other countries' laws and regulations on textiles, the dyeing fastness performance is included in the standards or certifications voluntarily adopted by enterprises, and no mandatory implementation has been made. The chemical risks from dyes and auxiliary substances are assessed and controlled separately.

The short fibres of grinding, lint, velvet and other velvet fabric products are very easily rubbed off. In the rubbing colour fastness test, test institutions hold varying opinions on whether or not short fibres should be taken into account when assessing the staining level, which leads to inconsistent conclusions.

Denim fabric is one of the most popular fabrics in the world, but the characteristics of indigo dyes cause the dye to be absorbed into the cellulose fibres only through van der Waals forces, i.e., physical action, with almost no chemical bonding between the fibres, resulting in a low colour fastness. Although consumers generally accept the wash-fading characteristics of denim fabrics, denim manufacturers continue to strengthen the colour fastness of their fabrics in order to meet *GB 18401* requirements. In order to do so, denim manufacturers constantly strengthen the washing and colour-floating treatment of their blanks and finished products, and increase the finishing process. This generates large amounts of waste water and emissions, which is not conducive to overall environmental protection and meeting sustainable development requirements.

Assessment of colour fastness is always based on a visual measurement by an individual carrying out the test under certain light resources. Different levels of skill and capability of the individual carrying out the test, and

their subjective interpretation, also directly impact test results.

In 2020, the SAMR conducted a project titled 'Verification of the Testing Capacity for Perspiration Resistance Colour Fastness of Textiles and Silk Products (CNCA-20-13)', among national inspection and test institutions. Those participating represented nearly all the leading advanced test laboratories and agencies, including provincial quality supervision and inspection centres, customs technical centres, fabric inspection test laboratories, and civil and foreign test agencies. The results show that 32.8 to 39 per cent of institutions reported a half-grade-difference in the test of the staining level of BNH-2 blue cotton sticky fabric; and 21.5 to 35.9 per cent reported a half-grade-difference with RNH-2 red silk fabric.²⁶ In other words, about one third of the laboratories found a half-grade-difference in the test for perspiration colour fastness. This suggests that a half-grade-difference of colour fastness is an approved scale of conformity.

In the national-, provincial- and city-level market inspections, colour fastness is a key quality item and mandatory test item as per the *Implementation Rules of National Inspections on Product Quality*.²⁷ In cases of non-conformity a product will be determined as unqualified. Despite the half-grade-difference having been verified as an approved scale of conformity, such a result usually causes the product to be downgraded from 'qualified product' to 'unqualified product'. This results in enterprises being punished by market surveillance authorities and the company's credibility being harmed.

Recommendations

- Launch the revision of *GB 18401-2010* as early as possible, and consider adjusting the colour fastness criteria for special products, for instance, velvet textile products, ultrafine fabric products, wash-faded products, denim products and dark coloured products.
- Take the half-grade-difference into consideration as a general safety conformity scale and apply it when judging the conformity of a product.
- Change colour fastness from being a 'key quality

²⁶ *Final Report of Proficiency Testing Programme on Tests for Colour Fastness to Perspiration of Textiles and Silks*, SAMR, September 2020, viewed 15th April 2021, <<http://www.cnca.gov.cn/zl/nlyz/xmss/202009/W020200928369465129012.pdf>>

²⁷ *Implementation Rules of National Inspections on Product Quality*, SAMR, 31st July 2020, viewed 15th April 2021, <http://gkml.samr.gov.cn/nsjg/zljdj/202007/t20200731_320439.html>





item' to 'normal quality item' when making national-, provincial- or city-level implementation rules for product inspections, and apply it in product inspections, to facilitate a change in the safety scale and judging standard for product conformity.

- Include the test for dyes and auxiliaries that pose a risk of harming personal health in the safety assessment of mandatory standard GB 18401.

3. Take Resolute Methods to Curb the Sale of Fake Goods Online and Promote Industrial Self-governance 🗣️ 3

Concern

There has been an increase in e-commerce and social media platforms selling fake goods, and the lack of effective enforcement regulations and rules is harming the legitimate rights of a growing number of right holders.

Assessment

Over the last few years, the e-commerce industry has developed dramatically in both the number and format/structure of platforms and businesses, while various innovative promotion methods have also emerged, placing increasingly higher demands on companies conducting daily supervision and administration. Combatting the sale of fake products through social media is quite different than through e-commerce platforms. For instance, the openness of e-commerce platforms to user access means online platform owners and intellectual property right (IPR) holders themselves can run searches and monitor content, while it is more difficult to effectively supervise social media due to the levels of confidentiality involved. This makes selling counterfeit goods via, for example, WeChat Moments more convenient for perpetrators, with sales volumes potentially far exceeding that of other online platforms.

On 24th August 2020, the Judicial Committee of the Supreme People's Court (SPC) adopted the *Official Reply on Several Issues Concerning the Application of Law to Disputes over Internet-related IPR Infringement*,²⁸ which requires network platforms to bear joint liability with network users and platform operators for any expanded damages caused through the fault of the network platform.

²⁸ *Official Reply on Several Issues Concerning the Application of Law to Disputes over Internet-related IPR Infringement*, SPC, 12th September 2020, viewed 14th April, <<http://www.court.gov.cn/fabu-xiangqing-254921.html>>

On 10th September 2020, the SPC issued the *Notice Regarding Issuing Guiding Opinions on the Trial of Intellectual Property Civil Cases Involving E-commerce Platforms*,²⁹ which further increases and clarifies the responsibilities and obligations of platforms to prevent and protect IPR in their daily business activities. The *Notice* emphasises that if the platform operator "knows" or "should know" that a business owner operating on the platform infringes upon IPR, it should take necessary measures following the principle of "reasonable prudence"; the reasonableness of the measures taken by platform operators has also been further clarified and refined therein. The *Measures for the Supervision and Administration of Network Transactions*,³⁰ which came into effect on 1st May 2021, further refine the management responsibilities of e-commerce platforms for the review and registration of operators on the platform, and stipulates that operators of third-party trading platforms must take necessary measures to protect the rights of the exclusive use of registered trademarks and the name rights of companies.

The above approval and notice from the SPC, as well as the administrative measures of the SAMR, demonstrate the Chinese authorities' determination to proactively regulate online IPR infringement. However, given the increasing influence of major domestic e-commerce platforms, it remains to be clarified through real case studies how court judges at all levels, as well as market surveillance authorities, understand and interpret the spirit of the regulations and practice them in daily cases in an effort to make relevant platforms more proactive in protecting IPR.

Recommendations

- Call on grassroots courts, especially local IP courts, to be more proactive in identifying the relevant responsibilities of platforms in individual cases and ensure various network platforms, including social media, actively fulfil their social and legal responsibilities for IPR protection.
- Supervise and encourage courts at all levels throughout China to actively strengthen IPR protection online, by sharing case-studies of ground-breaking judgments.

²⁹ *Notice from the Supreme People's Court regarding Issuing Guiding Opinions on the Trial of Intellectual Property Civil Cases Involving E-commerce Platforms*, SPC, 10th September 2020, viewed 14th April 2021, <<http://www.court.gov.cn/fabu-xiangqing-254931.html>>

³⁰ *Measures for the Supervision and Administration of Network Transactions*, SAMR, 15th March 2021, viewed 14th April 2021, <http://www.gov.cn/zhengce/zhengceku/2021-03/16/content_5593226.htm>





- Classify platforms (for example, traditional e-commerce and social media platforms) according to modes of query, channels of information display, methods of user access, payment and settlement, and other technical features, and set up proper administrative measures.
- Take heed of and respect effective IPR protection models agreed between rights holders and platforms.

4. Take into Account the Balance Between Business Development and Consumer Information Protection when Formulating Laws and Regulations Related to Personal information

Concern

With the rapid increase of e-commerce, formulating too many rules and regulations that heavily restrict the collection of consumer information will obstruct certain businesses from effectively operating, while hindering development and innovation in e-commerce due to a lack of necessary data.

Assessment

During 2019 and early 2020, drafts of numerous regulations and rules on personal information were issued or released for comments, showing that the supervision and administration of personal information by businesses in China is being increasingly strengthened.³¹ In March 2020, the latest version of the *Information Security Technology Personal Information Security Specification* was released.³² In addition, the Personal Information Protection Law is currently under drafting and review.³³

However, each agency issuing these rules and regulations has formulated them in isolation, leading to different legal definitions for the same thing, inconsistent

management granularity, overlapping legislation and a fragmented regulatory framework. As a result, businesses need to spend a lot of human and material resources to interpret various rules and regulations, leading to significant confusion and uncertainty in terms of their application. The working group therefore urges consistent regulations on data security and personal information protection. In this regard, the *Personal Information Security Specification* garnered a great deal of public feedback, resulting in a final published version with more balanced, detailed and specific requirements.

The working group therefore calls for a return to the legislative intent of the Cybersecurity Law,³⁴ by removing filing requirements for the extensive collection of important data or sensitive personal information, and requiring approval only for the transfer of important data overseas that meets certain thresholds (such as magnitude or risk level). In other cases, the enterprise should be allowed to conduct periodical, internal self-examinations.

The working group is highly concerned about how laws and regulations related to the protection of personal information are promulgated. On one hand, the illegal collection and sale of personal information in society (such as with cameras and face-recognition technology and equipment) are not effectively controlled. On the other hand, in the business environment—especially in e-commerce activities—without the reasonable collection of consumers' personal information, some business activities, or the rapid development and innovation in e-commerce, will be hindered, disrupting the consumer experience. Due to the development of the Internet and big data, data security and privacy issues are particularly urgent for Internet companies (critical information infrastructure operators). However, applying rules introduced to regulate the data activities of Internet enterprises indiscriminately to all industries will cause problems. The working group strongly recommends that the purpose and value orientation of the supporting legislation should be clarified within the framework of the Cybersecurity Law.

On 21st October 2020, the Legislative Affairs Commission of the NPCSC issued the Personal Information Protection Law (Draft for Public Comments) (Draft for Comments), which includes rules on processing

31 *Cybersecurity Review Measures (Draft for Comments)*, Cyberspace Administration of China (CAC), 24th May 2019, viewed 15th April 2021, <http://www.moj.gov.cn/news/content/2019-05/24/zlk_235516.html>; *Data Security Management Measures (Draft for Comments)*, CAC, 28th May 2019, viewed 27th April 2021, <http://www.moj.gov.cn/news/content/2019-05/28/zlk_235861.html>; *Personal Information Outbound Security Assessment Approach (Draft for Comments)*, CAC, 13th June 2019, viewed 15th April 2021, <http://www.moj.gov.cn/news/content/2019-06/13/zlk_3225812.html>; *Determination of illegal and unlawful collection and use of personal information by app*, CAC, Ministry of Industry and Information Technology, Ministry of Public Security, SAMR, 30th December 2019, viewed 14th April 2021, <http://www.cac.gov.cn/2019-12/27/c_1578986455686625.htm>

32 *Information Security Technology Personal Information Security Specification*, National Information Security Standardisation Technical Committee, 24th January 2018, viewed 15th April 2021, <<https://www.tc260.org.cn/front/postDetail.html?id=20180124211617>>

33 *Personal Information Protection Law (Draft)*, NPC Legal Affairs Committee, 21st October 2020, viewed 15th April 2021, <<http://www.npc.gov.cn/npc/c30834/202104/3d1ca681b09e48d7a0159386d155d594.shtml>>

34 *Cybersecurity Law*, NPC, 7th November 2016, viewed 15th April 2021, <http://www.npc.gov.cn/wxzl/gongbao/2017-02/20/content_2007531.htm>





personal information, the cross-border provision of personal information and the rights and obligations of individuals, as well as personal information processors and their partners. The Draft for Comments seeks to regulate the processing and application of personal information in a comprehensive manner.

However, some provisions in the Draft for Comments need to be further refined in a reasonable way, for example:

“Article 38: Where a personal information processor truly needs to provide personal information to any party outside the territory of the People’s Republic of China for business needs, among others, at least one of the following conditions shall be satisfied:

(3) A contract has been concluded with the overseas recipient, agreeing on both parties’ rights and obligations, and supervision is conducted to ensure that personal information processing activities of the overseas recipient meet the personal information protection standards provided in this law.”

It is hoped that the government can issue specific contract templates for enterprises to refer to by setting the relevant implementation rules or standards. In another example, Article 39 stipulates that the transmission of personal information to any party outside the territory of China shall require the enterprise to obtain an individual’s separate consent. The working group suggests that enterprises should only need to obtain authorisation subject to certain notification conditions, so as to meet the requirements of multinational corporations (MNCs) that transmit large amounts of information on a daily basis.

Recommendations

- Integrate the currently fragmented requirements of the *Personal Information Security Specification* into unified and coherent provisions, ensuring that the same definitions, legal concepts and positions, and related technical and organisational measures are used, to facilitate compliance work and reduce compliance costs.
- Implement supervision over various operators by type, especially general e-commerce operators and key infrastructure operators, while adhering to the legislative spirit of the Cybersecurity Law.

- Encourage and promote the reasonable autonomy of enterprises and industries for general e-commerce operations.
- Adopt legislation to provide focussed regulation and stronger control over internet enterprises, government agencies, banks, automobile services providers and real estate agents, which collect and process a large amount of personal information in their daily operations, in order to protect the rights of consumers and for citizens to understand, refuse and delete the kind of personal information that is being collected, used and shared.
- Consider fully the daily management structure and data-sharing needs of MNCs, and conduct reasonable and effective in-market supervision through internal contracts and corporate commitments, to avoid dampening the enthusiasm of FIEs to invest in China, and any other negative impacts that may accelerate the withdrawal of global supply chains from China.

5. Allow Enterprises to Not Display Product Standard Numbers on Imported Apparel

Concern

Although existing laws do not clearly state whether or not imported apparel and leather products should display a product standard number, some market surveillance agencies require it for use in product inspections, which is an unnecessary burden for enterprises.

Assessment

Products manufactured abroad must be produced according to the standards or technical specifications of the place of production. As Chinese production standards or product execution standards of a voluntary nature may differ, they cannot be applied for certain products that will be imported to China. If a company applies a Chinese standard number to a product, it may end up facing penalties from the Chinese Government and entanglement from professional claimants for not fully complying with the domestic product standard; however, companies that do not label their products with a Chinese standard number may be rejected by store owners or penalised by government inspection authorities.

Many industries have realised the issue and made provisions in relevant Chinese standards or the





standard interpretations that “imported products do not need to be marked with product standard number”, such as in the following examples:

Example 1 – cosmetics: According to Article 6.6 of the *National Compulsory Standard GB 5296.3: Instruction for Use of Consumer Products – General Labelling for Cosmetics*,³⁵ “cosmetics should be marked with the national or industry standards used”. However, the *Implementation Guide for GB 5296.3* allows that “imported cosmetics do not need to be marked with a production licence number, sanitary licence number or a product standard number”.³⁶

Example 2 – food and beverage: Article 4.1.10 of *GB 7718-2011 General Labelling Rules for Pre-packaged Food*, clearly states that “pre-packaged food³⁷ manufactured and sold in China should be marked with the referred standard number and serial number of that product (excluding imported pre-packaged food)”.

Example 3 – cross-border trade: According to Article 4.1.3.1 of the joint Ministry of Commerce, National Development and Reform Commission and Ministry of Finance *Notice on Improving the Supervision on the Import of Cross-border E-commerce Retail (Document 486)*,³⁸ “products that comply with standards and technical specifications of quality, safety, health, environment and labelling of the country of origin may not comply with Chinese standards. Consumers bear their own risks.”

Recommendation

- Clarify that imported clothing and leather products do not need to be marked with Chinese product standard numbers, but should comply with the domestic mandatory national standards.

Abbreviations

CAC	Cyberspace Administration of China
EU	European Union
GPSD	General Product Safety Directive
IPR	Intellectual Property Right
MARA	Ministry of Agriculture and Rural Affairs
MNC	Multinational Corporation
NPC	National People's Congress
REACH	Registration, Evaluation, Authorisation and Restriction of Chemicals
SAMR	State Administration of Market Regulation
SC	Standing Committee
SPC	Supreme People's Court
WTO/TBT	World Trade Organization Agreement on Technical Barriers to Trade

35 *National Compulsory Standard GB 5296.3: Instruction for use of consumer products – General labelling for cosmetics*, SAMR & State Standardisation Administration, 17th June 2008, viewed 15th April 2021, <<http://www.gb688.cn/bzgk/gb/newGbInfo?hcno=86DDF327060B99B817E89EF7BD0052C2>>

36 *GB 5296.3-2008 Instructions for Use of Consumer Products: General Labelling of cosmetic products - implementation guide and selected relevant laws and regulations*, China Association of Fragrance Flavour and Cosmetic Industries, 1st June 2009, Beijing: China Standard Press.

37 *GB7718-2011 General Labelling Rules for Pre-packaged Food*, National Health Commission of the People's Republic of China, 20th April 2011, viewed 15th April 2021, <<https://sppt.cfsa.net.cn:8086/staticPages/9058ADC5-AFC3-4586-9798-D0170F6F879C.html>>

38 *Notice on Improving the Supervision on Import of Cross-border E-commerce Retail (Document 486)*, Ministry of Commerce, National Development and Reform Commission & Ministry of Finance, 1st December 2018, viewed 15th April 2021, <http://www.gov.cn/xinwen/2018-12/01/content_5345041.htm>



Healthcare Equipment Working Group

Key Recommendations

1. Strengthen the Role of Clinical Requirements and Market Forces in the Procurement of Medical Devices

1.1 Give Priority to Value-based Procurement and Improve Operational Procedures in Volume-based Procurement (VBP)

- Determine quality and clinical requirements as the main criteria for deciding VBP tenders, and do not overvalue procurement prices as the decisive factor.
- Limit VBP to genuine large-volume procurement, in general at the provincial level or above.
- Establish an inter-ministerial communication platform to ensure that VBP tendering and implementation of tendering results adhere to generally-accepted principles of VBP tenders, particularly in terms of realising procurement volume, terms of delivery and payment as agreed in the tender.

1.2 Ensure Sufficient Hospital Financing, and Scientifically Incorporate Cost Factors into the Pricing of Medical Services

- Update cost factors in diagnosis-related group (DRG) and diagnosis-intervention packet (DIP) regularly to enable medical personnel and patients to opt for innovative treatment methods.
- Ensure sufficient funding for public hospitals, increasing government subsidies for hospitals gradually and sustainably.
- Reform the payment system of medical personnel and gradually increase salaries to incentivise quality of service.

1.3 Regularly Update Healthcare Service Catalogues to Facilitate Patients' Access to Innovative Treatment Methods

- Exclude expensive medical devices—for example implants—from medical treatment fees and invoice them separately.
- Increase medical treatment prices to discourage the illegal multiple use of disposable medical devices.
- Accelerate the updating of pricing catalogues to facilitate patients' access to innovative treatment methods and state-of-the-art medical devices.

2. Continue to Advance the Development of Regulatory Science and Accelerate the Promotion of Innovation

2.1 Remove the Requirement for Country of Origin (CoO) Certification in Pre-market Approvals 🗳️ 3

- Remove the requirement for CoO certification (pre-market approval in the country of origin) as a precondition for registration and filing of imported medical devices.

2.2 Simplify Change Registration

- Deepen reforms for introducing innovative modes of supervision in order to regulate software-based medical devices.
- Streamline regulatory requirements for changing the manufacturing site from outside China to within China.





2.3 Promote the Application of Real-world Data (RWD) to Support Registration in China

- Release further implementation guidance on RWD application and data quality insurance, and summarise and release examples of real-world evidence (RWE) usage to support regulatory decision-making, and provide industry with updated information once a statistically significant number of cases have been accumulated.
- Establish a shared RWD platform or sharing mechanism to enable the RWD utility to support regulatory decision-making.
- Use public-private partnerships to promote the government leading registry system and database, with the collaboration of the industry.
- Allow RWE, as an independent source of clinical evidence, to support product registration, provided the data quality and quantity are acceptable.

3. Advance the Harmonisation of Medical Device Standards in China with International Standards 4

- Accelerate the evaluation of mandatory national standards with the goal of revising or revoking any standards that are either unreasonable or not applicable, and to modify mandatory domestic standards that do not have an equivalent International Organization for Standardization or International Electrotechnical Commission (IEC) standard into recommended standards.
- Allow into the Chinese market medical devices that have been on international markets for a long time and proved to be safe and efficacious, even if they do not fully comply with mandatory national standards.
- Implement fully the *Opinions* as soon as possible, with the goal of speeding up the processes for updating domestic standards and transforming international standards; establish domestic standard projects simultaneously with international standards; shorten the transformation cycle of international standards; and improve consistency between domestic and international standards.

4. Implement the New Foreign Investment Law and other Central Laws and Regulations to Address Discriminatory Behaviour at the Provincial Level, Especially the 'Buy China' Policy 4

- Examine existing government procurement measures to check whether they contradict the Foreign Investment Law and the Ministry of Finance's *Notice No. 38*.
- Eliminate discriminatory provincial and municipal regulations/policies and behaviour, including 'domestic brand' Class B medical equipment licences, that prevent both access to local markets, and fair and equal competition.

5. Align Different Policies and Develop a Roadmap to Guide and Support Remanufacturing/Refurbishing of Medical Equipment 2

- Align different policy-makers' remanufacturing and refurbishing policies for medical equipment, starting from the economically most relevant and already promoted by Chinese government agencies, such as medical imaging equipment, including components.
- Develop a roadmap to guide and support remanufacturing and refurbishing of medical equipment.
- Develop workable measures to implement the policy regarding medical equipment to be imported for repair, including remanufacturing and refurbishment.
- Refer to global good refurbishment practice for medical equipment to develop corresponding measures in China.



6. Promote Market Access for High-precision and Innovative In-vitro Diagnostics (IVDs)

6.1 Ensure that Innovative Diagnostic Methods are Included in Medical Services and Financing Schemes of Hospitals

- Consider the special characteristics of IVDs and the differences in methodology when formulating the amended version of the *National Medical Services Pricing Catalogue*.
- Include different diagnosis methods and technologies in provincial procurement catalogues.
- Ensure that only validated reagents are used with IVD devices.

6.2 Shorten the Time for Minor Changes to the Registrations of IVD-reagents and Grant a Transition Period after Invalidation of Registration Certificates 🌐 5

- Establish a notification channel for simple, literal, non-critical modifications, such as labelling amendments and changes to the instructions for use.
- Establish a unified procedure for domestic and imported IVD-reagents to allow for the change of manufacturing site through a notification to the responsible Medical Products Association/National Medical Products Association (NMPA).
- Accelerate the issuance of registration certificates online after internal approval has been given by the NMPA.
- Grant a grace period of six months for using the original registration certificate after approval has been granted for minor changes to registration details.

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 in developing 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 has established contact with major stakeholders both in China and in Europe. It organises regular meetings with the National Medical Products Administration (NMPA) 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 Disposable 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

The coronavirus disease 2019 (COVID-19) crisis had

¹ *Outlines of Healthy China 2030*, State Council, 25th October 2016, viewed 13th April 2021, <http://www.gov.cn/xinwen/2016-10/25/content_5124174.htm>





a huge, negative impact on the medical device market both in China and the rest of the world in 2020. Although China's healthcare sector was put under tremendous strain, it still provided unprecedented support to help the country rebound as quickly as possible. According to the Chamber's own statistics, member companies in the healthcare sector donated medical products, protective personal equipment and financial contributions totalling more than Chinese yuan (CNY) 356 million, and mobilised their worldwide procurement networks to buy urgently-required protective equipment for China in early 2020, and then Europe as the situation worsened there.

As a result of the pandemic, the Chinese Government adjusted its healthcare development policies with the aim of increasing the country's capability to tackle potential future public health crises. As in the past, the Chinese approach is two-pronged: improving basic healthcare while fostering top-end medical research and treatment. The draft *14th Five-year Plan (2021–2025) for National Economic and Social Development and the Long-Range Objectives Through 2035* (14FYP)² sets a specific target of building 500 new county-level hospitals that meet China's highest, class-III standard. Additionally, 15 regional public health centres and 20 emergency treatment centres for communicable diseases will be established. As an example of China's ambitious targets, the Ministry of Industry and Information Technology's (MIIT's) draft *Development Plan (2021–2025) for the Medical Equipment Industry* includes a proposal to develop extracorporeal membrane oxygenation (ECMO) machines, so-called artificial lungs, and other life-sustaining devices in China.³

China's ageing population and an overall increase in chronic diseases pose additional challenges to its healthcare economy. In 2020, China's overall public health expenses reached CNY 7.23 trillion, an increase of 9.8 per cent compared with 2019,⁴ which is considerably higher than China's gross domestic

product (GDP) growth of 6.1 per cent in 2019. The proportion of China's GDP spent on healthcare has increased steadily over the last two decades; in 2020, it reached 7.1 per cent, a level similar to developed markets like Singapore.

In addition to improving the quality and availability of medical services, controlling medical expenses remains a priority for the Chinese health authorities. To achieve this, measures that started as limited trial projects are being rolled out nationwide in 2021. Diagnosis-related group (DRG), a disease classification system widely used in European Union (EU) Member States, will become the main tool to calculate the average costs for disease treatment, as well as payments by the public healthcare insurance system. As an alternative to DRG, China has also developed the big data diagnosis-intervention packet (DIP), a system that automates the calculation of treatment costs, which reduces administrative overheads. The DIP will be implemented parallel to the DRG system, with hospitals selecting the one they prefer to use.

Disposable and consumable medical devices are increasingly procured through volume-based procurement (VBP). While the process of VBP tendering has become more mature and transparent, there is still a tendency for tenders to be decided mainly by price, possibly compromising quality of treatment. On 5th November 2020, the result of the first nationwide VBP procurement tender of coronary stents was published,⁵ resulting in an unsustainable average price decrease of imported devices by 95 per cent.

Regulatory Environment

Although most legislative projects were put on hold during the COVID-19 lockdowns, China continued to deepen the reform of the medical and healthcare regulatory system throughout 2020, and introduced a series of policies and measures aimed at encouraging innovation. On 9th February 2021, the State Council issued *Order No. 739*, promulgating the newly revised *Regulation on the Supervision and Administration of Medical Devices (Regulation)*.⁶ Taking effect on 1st June 2021, the *Regulation* creates a high-level legislative

2 *14th Five-year Plan (2021–2025) for National Economic and Social Development and the Long-Range Objectives Through the Year 2035*, National People's Congress, 13th March 2021, viewed 13th April 2021, <http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm>

3 *Development Plan (2021–2025) for the Medical Equipment Industry (draft for public consultation)*, MIIT, 9th February 2021, viewed 26th July 2021, <https://www.miit.gov.cn/jgsj/zbyys/gzdt/art/2021/art_3479e58a8b2c48309ec693595836aafb.html>

4 *Statistics of China's Healthcare Development 2020 (in Chinese)*, National Health Commission, 13th July 2021, viewed 14th July 2021, <<http://www.nhc.gov.cn/guihuaxxs/s10743/202107/af8a9c98453c4d9593e07895ae0493c8.shtml>>

5 *VBP of Coronary Stents, in Average the Price Decreases from CNY 10,000 to less than CNY 1,000*, Xinhua, 6th November 2020, viewed 13th April 2021, <<https://baijiahao.baidu.com/s?id=1682573973466183457&wfr=spider&for=pc>>

6 *Regulations for the Supervision and Administration of Medical Devices*, State Council, 18th March 2021, viewed 7th April 2021, <http://www.gov.cn/zhengce/content/2021-03/18/content_5593739.htm>





framework for decrees and provisions previously formulated by the NMPA; for instance, reforming the management of clinical trials, encouraging innovation in medical device research and development (R&D), and promoting the full implementation of the marketing authorisation holders (MAH) system.⁷ The amended *Regulation* took on the international communities' experiences, mainly reflected in the following aims: 1) establish a dynamic adjustment mechanism for medical device categories; 2) reform the clinical evaluation methods for medical devices; and 3) establish a unique device identification (UDI) system. The new regulation represents a breakthrough in that in-house, type-testing reports for registration submissions are now accepted, and provisions on emergency approval of medical devices have been added.

Following the amendment of the *Regulation*, several decrees and provisions will be updated. The most important ones published for public consultation are:

- *Measures for Supervision and Administration of Medical Device Production (Revised Draft for Comments)*.⁸
- *Interim Provisions on the Administrative Measures for Supervision of Medical Device Operations (Revised Draft for Comments)*.⁹
- *Administrative Measures for In-vitro Diagnostics Reagents Registration (Revised Draft for Comments)*.¹⁰
- *Administrative Measures for Medical Device Registration (Revised Draft for Comments)*.¹¹

The working group acknowledges the continuous efforts made by the Chinese authorities in 2020 and early 2021 to improve medical device review and approval processes, and encourages the Chinese Government to continue to advance the development of regulatory science and accelerate the promotion of innovation in the industry.

⁷ NMPA Notice on the Expansion of the Pilot Work of the Registrant System of Medical Devices, NMPA, 1st August 2019, viewed 7th June 2021, <http://www.gov.cn/zhengce/zhengceku/2019-11/15/content_5452302.htm>

⁸ NMPA public consultation on Measures for Supervision and Administration of Medical Device Production, NMPA, 26th March 2021, viewed 12th July 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210326100413165.html>>

⁹ NMPA public consultation on Administrative Measures for Supervision of Medical Device Operations, NMPA, 26th March 2021, viewed 12th July 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210326101246169.html>>

¹⁰ Administrative Measures for In-vitro Diagnostics Reagents Registration (Revised Draft for Comments), NMPA, 26th March 2021, viewed 12th July 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210326094620192.html>>

¹¹ NMPA public consultation on Administrative Measures for Medical Device Registration (Revised Draft for Comments), NMPA, 26th March 2021, viewed 12th July 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210326094015179.html>>

Key Recommendations

1. Strengthen the Role of Clinical Requirements and Market Forces in the Procurement of Medical Devices

1.1 Give Priority to Value-based Procurement and Improve Operational Procedures in VBP

Concern

In the absence of nationwide regulations for VBP, local criteria for selecting winning tenders tend to be based on purchasing price at the expense of product quality and clinical requirements, while the procurement of contractually-agreed volumes is not guaranteed.

Assessment

After initial trials in Anhui and Jiangsu in 2019, in the second half of 2020, procurement agencies under provincial HSAs started to call for VBP tenders for different types of CDMD. The first VBP tender at the national level was for coronary stents, and concluded in early November 2020. It resulted in an unsustainable average price decrease of more than 90 per cent for both imported and locally manufactured stents. Other VBP tenders were organised at different levels, from low-tier cities up to cross-provincial level, for which the demand of public hospitals in almost ten provinces were bundled together. In smaller towns with only one, or very few, top-class hospitals, annual demand is so limited that VBP is not justified.

The industry supports the efforts of the National Healthcare Security Administration (NHSA) to control expenses and promote the concept of 'economy of scale', justifying lower prices for higher quantities. However, several local tenders just focussed on cutting costs without considering other essential factors, for example:

- Deciding tenders on price criteria only, without sufficient consideration of clinical requirements and quality of devices and related services.
- Calling for tenders without guaranteeing a procurement volume, making it impossible for manufacturers to calculate a realistic sales price.
- Requiring a percentage price-cut as a precondition for participating in a tender, or insisting on prices lower than ever offered previously in China for a certain device, without considering procurement quantity, the





costs of transportation, servicing and maintenance, or payment conditions.

The industry acknowledges that, as procurement agencies gain more experience, tendering has become smoother, more scientific and transparent. However new challenges have arisen in implementing tender results, including the following:

- Hospitals may not in the end purchase the promised number of devices, or adhere to the agreed payment terms. Solving this issue requires the cooperation of different government departments, as tendering falls under the responsibility of the local HSA while hospital management is under the local Health Commission.
- Single cities or a small number of towns with few high-level hospitals call for VBP tenders, without being able to guarantee a large purchasing volume.
- On the basis of VBP contracts with a duration of at least one year, hospitals tend to put forward additional requirements, for example overly-long shelf-life times of stock, or keeping a large stock of rarely-used product variants. These requirements can only be met by manufacturers if they accept additional costs, which runs contrary to the VBP principle of reducing costs.

Recommendations

- Determine quality and clinical requirements as the main criteria for deciding VBP tenders, and do not overvalue procurement prices as the decisive factor.
- Limit VBP to genuine large-volume procurement, in general at the provincial level or above.
- Establish an inter-ministerial communication platform to ensure that VBP tendering and implementation of tendering results adhere to generally-accepted principles of VBP tenders, particularly in terms of realising procurement volume, terms of delivery and payment as agreed in the tender.

1.2 Ensure Sufficient Hospital Financing, and Scientifically Incorporate Cost Factors into the Pricing of Medical Services

Concern

Far-reaching reforms of hospital financing—especially new methods to calculate the amount of reimbursement by public healthcare insurance for diagnosis and treatment, such as DRG and DIP—are putting financial pressure on hospitals, which may result in reduced procurement and utilisation of high-quality medical

devices in order to save costs.

Assessment

Public hospitals in China mainly rely on three sources of income: payments through public healthcare insurance, co-payment by patients, and state subsidies, with prices for medical services controlled by provincial governments. Currently, the income of most public hospitals barely meets their expenses, mainly due to underestimation of labour costs. Reform of the payment system is accelerating in 2021, with DRG and DIP becoming the dominant forms of cost calculation. This means that the burden of cost-saving will fall on hospitals.

Recent adjustments to the price of healthcare services and a slight increase of government subsidies have alleviated the revenue gap, but public hospitals still face pressure to sell more medical services to increase their revenue, resulting in over-medication and contributing to a rapid rise of health expenses in China. Combined with lower rates of salary increases, this rise in costs is putting the public healthcare insurance fund at severe risk of deficit in the near future. To address this, the NHSA is looking to enact reforms of the payment system, in particular through the implementation of DRG and DIP for in-patients.

Implementation of DRG in European countries and other main economies started in the 1980s; however, concerns with the system are still voiced regularly by hospitals, patients and the industry. Although the DRG system can increase the efficiency of hospital management and is a mature cost calculation method, there can be negative side effects if it is not implemented well. For example, it can result in the rejection of loss-generating patients and a move towards using cheap, low-quality medical devices.

In addition, compared with other professions in China, medical personnel in China are still underpaid.¹² Gradually increasing salaries and identifying other ways to incentivise quality of care would also benefit patients.

Recommendations

- Update cost factors in DRG and DIP regularly to enable

¹² Zhuang, Pinghui, *China considers higher patient fees to fund salary boost for doctors*, South China Morning Post, 2nd May 2014, viewed 11th May 2021, <<https://www.scmp.com/news/china/article/1502551/doctors-paid-less-barbers-may-see-salaries-rise-china-mulls-increasing>>





medical personnel and patients to opt for innovative treatment methods.

- Ensure sufficient funding for public hospitals by increasing government subsidies gradually and sustainably.
- Reform the system of medical personnel payment and gradually increase salaries to incentivise quality of service.

1.3 Regularly Update Healthcare Service Catalogues to Facilitate Patients' Access to Innovative Treatment Methods

Concern

Updating healthcare-service catalogues is not a priority for many health authorities, which results in delays to patients' access to innovative treatment methods.

Assessment

The inclusion of medical treatments in a catalogue of state-approved treatment methods and assigning a price is a pre-condition for public hospitals to be able to offer a diagnosis and related treatment to patients. However, the last *National Medical Treatment Pricing Catalogue* was published in 2012, with a new version still under preparation by the NHSA. The speed of innovation in medical devices is such that many treatment methods in the 2012 pricing catalogue have already been discarded or modified, while more innovative treatment methods and medical devices have not been included.

For many treatments, single-use medical devices—such as implants—are the most significant price factor in a medical bill. Tightly-controlled treatment pricing therefore gives hospitals only one option: use relatively cheap single-use medical devices, which may lead to the quality of treatment being compromised.

At the same time, designated prices for some treatments are too low, resulting in multiple uses of disposable medical devices, which goes against the regulations of both the NMPA and the NHC.^{13&14}

¹³ Reply to Enquiry No. 1718 (No. 184 under Medical and Sports Category) of the Third Plenary Meeting of the 13th National People's Consultative Conference, NMPA, 4th August 2020, viewed 8th May 2021, <<https://www.nmpa.gov.cn/zwgk/jyta/zhxta/20200804171454155.html>>

¹⁴ The Ministry of Health Issues a Regulation that Disposable Medical Devices Shall not be used Repeatedly (in Chinese), Central People's Government of the People's Republic of China, 25th July 2006, viewed 8th May 2021, <http://www.gov.cn/jrzq/2006-07/25/content_345790.htm>

Recommendations

- Exclude expensive medical devices—for example implants—from medical treatment fees and invoice them separately.
- Increase medical treatment prices to discourage the illegal multiple use of disposable medical devices.
- Accelerate the update of pricing catalogues to facilitate patients' access to innovative treatment methods and state-of-the-art medical devices.

2. Continue to Advance the Development of Regulatory Science and Accelerate the Promotion of Innovation

2.1 Remove the Requirement for Country of Origin (CoO) Certification in Pre-market Approvals 3

Concern

Currently, most medical devices need to obtain market approval in the CoO before qualifying for registration in China, delaying market access by at least one year.

Assessment

In the amended *Regulations for the Supervision and Administration of Medical Devices*, the requirement for market approval in the CoO for innovative devices has been waived, but this does not apply to the vast majority of devices that do not have the special status of 'innovative'.¹⁵

China's Centre for Medical Device Evaluation (CMDE), under the NMPA, has accumulated ample experience in medical device evaluation. Evaluation capacity has been expanded and reviewers have become more professional, and China's regulatory environment and level of standardisation is continuously improving in general. The CMDE is therefore fully capable of conducting independent evaluations of imported medical devices without relying on their CoO certificates. Furthermore, an independent review and approval by the NMPA that does not rely on another regulator's evaluation would significantly enhance the standing of the NMPA in the global regulatory community, helping to make Chinese registration a reference standard for other countries.

¹⁵ *Regulations for the Supervision and Administration of Medical Devices*, State Council, 18th March 2021, viewed 7th April 2021, <http://www.gov.cn/zhengce/content/2021-03/18/content_5593739.htm>





Recommendation

- Remove the requirement for CoO certification as a precondition for registration and filing of imported medical devices.

2.2 Simplify Change Registration

Concern

Minor modifications to medical devices like software upgrades, or even changing the site of their manufacture, require re-registration of these products, which delays Chinese patients' access to improved product versions and restricts flexibility in the production process.

Assessment

In the last few years, the NMPA has considerably accelerated the registration process for medical devices, however there are special cases in which further improvement is expected.

Example 1: software upgrades

The traditional approach to regulating high-risk, hardware-based medical devices is not well suited for the faster iterative design, development and validation of software-based medical technologies. The traditional implementation of premarket requirements may delay patients' access to critical software updates, while regulatory experience shows that software updates pose low risks to patient health.

Some international regulatory agencies are reimagining their approach to software-based medical devices in order to foster the development of high-quality, safe and effective software-based products while assuring timely patient access. For example, a pre-certification programme that could replace the need for a premarket submission of certain products and would allow for the decreased submission of content, and/or a faster product review, would be ideal.

Example 2: transfer of medical device manufacturing

Under the current regulatory regime, the registration cycle—including type testing, clinical evaluation, technical review, approval and on-site audit—for medical device manufacturing site transfers from outside China to within

China is longer than 18 months. In comparison, the registration process of manufacturing site transfers between two sites outside of China, which does not require type testing or on-site audits, generally takes less than six months.

The transfer of medical device manufacturing from one overseas factory to another requires a modification to the registration details of the item(s) in question. Only the certification of the new manufacturing site is required, to prove that its quality system meets legal requirements. However, if the manufacturing site is transferred from outside China to within, an entirely new domestic registration is necessary.

Recommendations

- Deepen reforms for introducing innovative modes of supervision in order to regulate software-based medical devices.
- Streamline regulatory requirements for changing the manufacturing site from outside China to within China.

2.3 Promote the Application of Real-world Data (RWD) to Support Registration in China

Concern

Though China has started a small-scale trial in Bo'ao in Hainan Province, RWD are in general not accepted for registration of medical devices in China, which delays market access of medium and high-risk medical devices.

Assessment

In recent years, the use of RWD to support regulatory decision-making for medical devices has increased significantly internationally. As a pioneer of RWD use, and in order to develop a more complete understanding of Real-world Evidence (RWE) usage, the United States (US) Food and Drug Administration (FDA) recently released a set of 90 examples of RWE leveraged in support of regulatory decision-making from 2012 to 2019.¹⁶ These examples demonstrate a diversity of RWD usage, covering all registration situations in both pre- and post-market settings.

¹⁶ Examples of Real-World Evidence (RWE) Used in Medical Device Regulatory Decisions, US FDA, viewed 14th April 2021, <<https://www.fda.gov/media/146258/download>>



On 24th November 2020, the NMPA published the *Technical Guidelines for the Use of RWD in Clinical Evaluation of Medical Devices (Trial)*,¹⁷ covering RWD sources, quality evaluation principles and statistical methods. It also summarises 11 circumstances under which RWD can be used for clinical evaluation. However, as this document states that RWD is an auxiliary source of clinical data only, the requirement for traditional clinical trials is unlikely to be removed.

Recommendations

- Release further implementation guidance on RWD application and data quality insurance, and summarise and release examples of RWE usage to support regulatory decision-making, with updated information released once a significant number of cases have been accumulated.
- Establish a sharing platform or mechanism to enable the RWD utility to support regulatory decision-making.
- Allow RWE, as an independent source of clinical evidence, to support product registration, in case the provided data quality and quantity are acceptable.

3. Advance the Harmonisation of Medical Device Standards in China with International Standards 4

Concern

In China, market entry of medical devices is subject in large part to compliance with numerous mandatory national standards and industry standards, many of which are neither synchronised with international standards nor conducive to medical device innovation.

Assessment

The newly-amended *Regulation for the Supervision and Administration of Medical Devices* further clarifies the legislation level of mandatory standards for medical devices. However, certain aspects of China's overall standardisation system are still in need of improvement.

Mandatory standards make up a large portion of medical device standards overall, especially product standards. According to the NMPA, mandatory standards account for 23 per cent of all medical device standards, of which mandatory product standards make

up 72 per cent.¹⁸

According to international practice, product, process and management standards are not designated as mandatory, but rather recommended standards. The large portion of mandatory standards in China with performance requirements and testing methods that are not harmonised with international requirements has hindered the introduction of high-quality international medical devices. As a result, some high-quality, overseas products that have been marketed abroad for many years and have proved safe and effective in clinical use cannot enter the Chinese market and serve Chinese patients.

Replacing technical regulations with mandatory domestic standards, or with mandatory national versions of International Organization for Standardization (ISO) or International Electrotechnical Commission (IEC) standards, is also inconsistent with international trade rules. Eliminating technical barriers to trade and expanding the import and export of products strongly relies on carrying out exchange and cooperation in standardisation and promoting the coordination and mutual recognition of standards.

Increasing the degree of harmonisation of domestic and international (ISO and IEC) standards would increase the quality of healthcare in China. Many of China's national and industry standards have been developed from international standards, and the rate of transformation of international standards has greatly increased in recent years. However, there are still some situations where the content of the adapted standard is not completely equivalent to the original international standard, which hinders simultaneous global launches of products. Manufacturers often have to make two versions of the product, one of which is in line with international standards and the other specifically designed to meet the Chinese standards. This may either delay Chinese patients' access to innovative medical devices, as there is no guarantee that the Chinese version will be available first, or slow down the development of advanced medical devices.

The working group supports the *Opinions on Further Promoting the High-quality Development of Medical*

¹⁷ *Technical Guidelines for the Use of RWD in Clinical Evaluation of Medical Devices (Trial)*, NMPA, 24th November 2020, viewed 14th April 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20201126090030150.html>>

¹⁸ *Annual Report of China's Medical Device Standard Management 2020*, NMPA, 5th February 2021, viewed 10th May 2021, <<https://www.nmpa.gov.cn/yqlx/yqlxjgd/20210205144609101.html>>





Device Standardisation (Opinions),¹⁹ published by the Standardisation Administration of China (SAC) and the NMPA. The *Opinions* state that the revision of standards should be accelerated and a mechanism to update Chinese standards in tandem with international standards established. They also state that government agencies should simultaneously initiate standardisation at the national and international level, and improve the consistency of domestic and international standards.

Recommendations

- Accelerate the evaluation of mandatory national standards with the goal of revising or revoking any standards that are either unreasonable or not applicable, and to modify mandatory domestic standards that do not have an equivalent ISO or IEC standard into recommended standards.
- Allow into the Chinese market medical devices that have been on international markets for a long time and proved to be safe and efficacious, even if they do not fully comply with mandatory national standards.
- Implement fully the *Opinions* as soon as possible, with the goal of speeding up the processes for updating domestic standards and transforming international standards.
- Establish domestic standards projects simultaneously with international standards; and improve consistency between domestic and international standards.

4. Implement the New Foreign Investment Law and other Central Laws and Regulations to Address Discriminatory Behaviour at the Provincial Level, Especially the 'Buy China' Policy 📍 4

Concern

Although the Foreign Investment Law came into force on 1st January 2020, it has not yet been implemented effectively across China.

Assessment

The Foreign Investment Law entered into force on 1st January 2020.²⁰ Articles 9 and 16 of the law state that foreign-invested enterprises (FIEs) in China

shall enjoy access to the same preferential policies as domestic companies, and that they will receive equal treatment in government procurement activities, including with respect to products manufactured in China by FIEs. Additionally, Article 1 of the *Notice No. 38 on Promoting Fair Competition and Improving the Environment of Government Procurement (Notice No. 38)*, issued by the Ministry of Finance (MOF) on 30th July 2019, states that FIEs will receive equal treatment in government procurement activities.²¹

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 either explicitly or in practice stipulate the purchase of 'domestic brands'. Some examples of the policies adopted include the following:

- In 2020, the Health Commission of Guangdong Province published an official letter (No. 20200567) to restrict local hospitals' access to foreign medical equipment and encourage them to buy domestic branded medical equipment.²²
- In 2020, the Shanghai Municipal Charity Foundation and the Red Cross Society purchased several computed tomography (CT) devices from a local manufacturer without having an open procurement process to allow all CT manufacturers to compete.

First, the requirement to purchase 'domestic brand' medical equipment violates the principle of fair competition and equal treatment of registered companies in China. The implementation of the system of licences marked as 'domestic brand' demonstrates that products made in China by FIEs are excluded in practice, and that foreign-funded and Chinese-foreign joint ventures are subject to discriminatory treatment in the medical equipment market. Second, 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 ensuring the best clinical outcomes for patients, instead of focussing solely on the origin of the brand. The government should give priority to patients'

19 *Opinions on Further Promoting the High-quality Development of Medical Device Standardisation*, SAC & NMPA, 30th March 2021, viewed 10th May 2021, <<https://www.nmpa.gov.cn/xgk/gzwl/gzwljy/qx/20210330170905141.html>>

20 *Foreign Investment Law*, National People's Congress, 15th March 2019, viewed 14th April 2021, <<http://www.npc.gov.cn/npc/c30834/201903/121916e4943f416b8b0ea12e0714d683.shtml>>

21 *Notice on Promoting Fair Competition and Improving the Environment of Government Procurement*, MOF, 30th July 2019, viewed 14th April 2021, <http://www.gov.cn/xinwen/2019-07/30/content_5417344.htm>

22 *Letter of the Department of Finance of Guangdong Province on the Reply to the Proposal No. 20200567*, Department of Finance of Guangdong Province, 20th July 2020, viewed 14th April 2021, <http://cztd.gd.gov.cn/yjzj/zxwytatfwgk/content/post_3049428.html>



and clinical needs, and conduct evidence and value-based procurement.

Finally, following the COVID-19 outbreak, attracting investment in medical equipment manufacturing is a major priority for countries around the globe. The policies listed above severely undermine China's attractiveness as a destination for foreign investment.

Recommendations

- Examine existing government procurement measures to check whether they contradict the Foreign Investment Law and the MOF's *Notice No. 38*.
- Eliminate discriminatory provincial and municipal regulations/policies and behaviour, including 'domestic brand' Class B medical equipment licences, that prevent both access to local markets, and fair and equal competition, for FIEs.

5. Align Policies and Develop a Roadmap to Guide and Support Remanufacturing/Refurbishing of Medical Equipment 2

Concern

Insufficient policy alignment of different ministries has so far prevented remanufacturing and refurbishment of medical equipment for the Chinese market, increasing medical expenses and contradicting the national strategy to develop an environmental-friendly circular economy.

Assessment

Developing a circular economy and building a conservation-orientated society is a major strategy of the Chinese Government,²³ with the remanufacturing/refurbishment industry being an important component. By remanufacturing, the life of equipment can be prolonged, meaning that natural resources and raw materials can be saved to protect the environment. At the start of the 14FYP period, the working group would like to use the opportunity to recommend the development of a roadmap to guide and support remanufacturing in the industry, including the refurbishing of medical equipment.

As per international practices, original equipment manufacturers (OEMs) of large-scale medical imaging

equipment, such as magnetic resonance imaging or CT machines, have established mature quality control and standardised processes for equipment refurbishment. The IEC standard, *IEC 63077: 2019 Good Refurbishment Practices for Medical Imaging Equipment*, became an official international standard in 2019. It describes and defines the process of refurbishing used medical imaging equipment to a condition of safety and effectiveness comparable to when new, without significantly changing the equipment's performance, safety specification or intended use. The used medical equipment will be de-installed from hospitals by qualified personnel, transported to an OEM's facility for refurbishment, and then re-exported to any country in need of affordable, safe and effective medical equipment. At the moment, even though there is a large volume of installed medical imaging equipment in China that needs to be replaced by a new generation of products, domestic restrictions prevent global and cross-regional cooperation in such remanufacturing/refurbishing.

In recent years, the working group has observed some positive changes in policies driving the development of a circular economy in the medical equipment industry. For instance, *Order No. 7 on Amending the Administrative Measures for the Import of Electromechanical Products* was published by the Ministry of Commerce (MOFCOM) in 2018.²⁴ In Article 30 of this piece of legislation a provision has been added: "Used mechanical and electrical products that appear in the *List of Commodities Forbidden to be Imported*, and under the conditions of environmental protection and safety products, can be imported for repairing (including re-manufacturing) and re-export with the consent of the MOFCOM".

Furthermore, on 27th December 2020, the National Development and Reform Commission (NDRC) and the MOFCOM issued the *Catalogue of Industries to Encourage Foreign Investment (2020) (Foreign Investment Catalogue)*,²⁵ which encourages foreign investment in the remanufacturing of high-end medical devices, such as medical imaging equipment, and their key components. This is the first time remanufacturing of medical equipment has been included in the *Foreign*

²³ *Circular Economy Helps Transformation of Economic Development Mode and High-quality Development*, NDRC, 30th September 2019, viewed 7th April 2021, <https://www.ndrc.gov.cn/xwdt/gdzt/cl70zn/201909/t20190930_1197758.html>

²⁴ *Amending the Administrative Measures for the Import of Electromechanical Products*, MOFCOM, 10th October 2018, viewed 7th April 2021, <<http://www.mofcom.gov.cn/article/bl/c/201811/20181102804608.shtml>>

²⁵ *The Catalogue of Industries to Encourage Foreign Investment (Edition 2020)*, NDRC & MOFCOM, 27th December 2020, viewed 7th April 2021, <https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202012/t20201228_1260594_ext.html>





Investment Catalogue, and seems to signal that the door for this industry has opened.

However, some older regulations or new policies under development still act as barriers to the remanufacturing of medical equipment in China. For example, according to *Order No. 106 on the Adjustment of the Catalogue of Used Mechanical and Electrical Products Prohibited from Import*,²⁶ old medical equipment is not allowed to be imported into China. Furthermore, State Council *Order No. 739* forbids the import of used medical devices that have expired, or are considered 'invalid' or 'obsolete', without defining these terms.

On 26th March 2021, the NMPA called for comments on the draft *Administrative Measures for the Supervision of Medical Device Operations*,²⁷ which, with the same terms as *Order No. 739*, forbid the selling of 'used' imported medical devices.

The differences between these policies from different agencies cause confusion among industry players and prevent them from investing in the remanufacturing/refurbishing of medical equipment in support of China's national circular economy strategy.

Recommendations

- Align different policy-makers' remanufacturing and refurbishing policies for medical equipment, starting from the economically most relevant and already promoted by Chinese government agencies, such as medical imaging equipment, including components.
- Develop a roadmap to guide and support remanufacturing and refurbishing of medical equipment.
- Develop workable measures to implement the policy regarding medical equipment to be imported for repair, including for remanufacturing and refurbishment.
- Refer to global good refurbishment practice for medical equipment to develop corresponding measures in China.

26 *Adjustment of the Catalogue of Used Mechanical and Electrical Products Prohibited from Import*, MOFCOM & GAC, 29th December 2018, viewed 7th April 2021, <<http://www.mofcom.gov.cn/article/b/c/201812/20181202821859.shtml>>

27 *Administrative Measures for Supervision of Medical Device Operations*, NMPA, 26th March 2021, viewed 7th April 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210326101246169.html>>

6. Promote Market Access for High-precision and Innovative IVDs

6.1 Ensure that Innovative Diagnostic Methods are Included in Medical Services and Financing Schemes of Hospitals

Concern

Chinese health authorities tend not to distinguish between different methods for detecting diseases, resulting in innovative, highly-sensitive, precision detection methods being both under-funded and excluded from procurement.

Assessment

In clinical practice, IVD devices and reagents are the basis for correct diagnosis of diseases. Manufacturers are permanently developing new IVD products to increase sensitivity, specificity, stability and speed of diagnosis methods. Correct diagnosis is a precondition for efficacious treatment; whereas a wrong diagnosis may be very costly for the healthcare system. Testing for COVID-19 provides a very prominent example – a false-negative test result may not only delay treatment of one patient but also be a starting point of mass infection.

Different prices should be assigned to diagnosis methods of different sensitivity and reliability in national and provincial medical treatment pricing catalogues to avoid hospitals operating at a loss. Currently, in most cases the same price is assigned to different diagnosis methods.

A tendency in procurement to cut prices across the board may lead to the use of reagents that do not fit the designated IVD device. Because IVD devices and reagents are developed as one complete system, replacing reagents by cheap alternatives may lead to a serious deterioration in the quality/accuracy of diagnosis.

Recommendations

- Consider the special characteristics of IVDs and the differences in methodology when formulating the amended version of the *National Medical Services Pricing Catalogue*.
- Include different diagnosis methods and technologies in provincial procurement catalogues.
- Ensure that only validated reagents are used with IVD devices.





6.2 Shorten the Time for Minor Changes to the Registrations of IVD Reagents and Grant a Transition Period for Registration Certificates and Labels 5

Concern

Modifying valid registrations for IVD reagents takes an excessively long time, even for minor changes such as label updates, with an additional gap between invalidation of the old registration certificate and issuance of the new one, which endangers the supply of reagents to Chinese patients.

Assessment

In May 2021, the NMPA published an amended version of the *Provisions on IVD Registration* for public consultation,²⁸ but there is still no channel to notify the authorities of modifications to labels and instructions for use (IFU) for IVD reagents. Instead, each update requires a modification to the registration. The typical life cycle of IVD reagents from market approval in the CoO to discontinuation is four to five years; this means within one year, about 20–30 per cent of all IFUs are updated. But unlike medical devices—for which label and IFU changes can be applied for via notification—IVD label and IFU changes need approval, which is 10 times more time-consuming than notification.

In cases where the manufacturing site of imported IVD reagents is changed, the NMPA requires the filing of a time-consuming registration change, whereas domestic products only need to undergo a far simpler notification process. Modification of the registration of imported IVD reagents includes chemical tests of three consecutive batches, meaning the whole approval procedure takes about a year longer than for domestic products.

After internal approval has been given by the NMPA, it takes usually two to four weeks to issue the new registration certificate. During this period, the manufacturer is unable to produce using either the new or the old registration. As the manufacture of reagents requires a continuous flow, these gap periods seriously disrupt the process.

Recommendations

- Establish a notification channel for simple, literal, non-

critical modifications, such as labelling amendments and changes to the IFU.

- Establish a unified procedure for domestic and imported IVD reagents to allow for the change of manufacturing site through a notification to the responsible MPA.
- Accelerate the issuance of registration certificates after internal approval has been given by the NMPA.
- Grant a grace period of six months for using an invalidated registration certificate after approval has been granted for minor changes to registration details.

Abbreviations

14FYP	14 th Five-year Plan
AI	Artificial Intelligence
CDMD	Consumable and Disposable Medical Devices
CMDE	Centre for Medical Device Evaluation
CNY	Chinese Yuan
COCIR	European Coordination Committee of the Radiological, Electromedical and Healthcare
CoO	Country of Origin
CT	Computed Tomography
DIP	Diagnosis-intervention Packet
DRG	Diagnosis-related Group
ECMO	Extracorporeal Membrane Oxygenation
EU	European Union
FDA	Food and Drug Administration
FIE	Foreign-invested Enterprise
GAC	General Administration of Customs
HSA	Health Security Administration
IEC	International Electrotechnical Commission
IFU	Instructions for Use
ISO	International Organization for Standardization
IVD	In-vitro Diagnostics
MAH	Marketing Authorisation Holder
MIIT	Ministry of Industry and Information Technology
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission
NHSA	National Healthcare Security Administration
NMPA	National Medical Products Administration
OEM	Original Equipment Manufacturer
R&D	Research and Development

²⁸ *Provisions on IVD Registration, draft amended version for public consultation* (in Chinese), NMPA, 26th March 2021, viewed 9th June 2021, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210326094620192.html>>





RWD	Real-world Data
RWE	Real-world Evidence
SAC	Standardisation Administration of China
UDI	Unique Device Identification
US	United States
VBP	Volume-based Procurement





Maritime Manufacturing and Industrial Services Working Group

Key Recommendations

1. Advance the Opening-up of the Cruise Market in China and Support the Restart of Business Operations 🌐 2

- Issue a plan with a clear timeline for cruise businesses in China to restart international operations.
- Allow foreign-invested cruise operators to offer 'cruises to nowhere' departing from Chinese ports.
- Allow foreign-invested travel agencies to sell tickets directly to Chinese customers.
- Share with the working group, either annually or bi-annually, ongoing development plans for sectors deemed strategic within the Chinese cruise market, such as new technologies and geographical areas identified to become future cruise hubs, including shipyards.

2. Ease Cross-border Movement of Foreign Experts, Managers and Specially-trained Maritime Engineers / Maintenance Workers

- Ease COVID-related travel restrictions and implement a fast-track programme for foreign maritime experts, managers and specially-trained engineers, and facilitate the access of foreign marine technicians to Chinese ports.

3. Increase Opportunities for Foreign-invested Firms in the Maritime Industry to Access and Bid for Research and Development (R&D) Funds 🌐 3

- Clarify how foreign-invested firms can gain access to R&D activities in maritime manufacturing and equipment projects, and create a transparent platform that will enable them to do so.
- Ease indirect barriers for foreign-invested companies to support and become partners in R&D projects.

4. Provide a Comprehensive Roadmap Detailing how the Maritime Sector will be Included in China's 2060 Carbon Neutrality Pledge

- Provide a roadmap detailing how the maritime sector will be included in China's 2060 carbon neutrality pledge, and ensure that foreign companies can contribute with their know-how.
- Allow foreign companies to support and become partners in China's maritime R&D programmes under this roadmap, including those for domestic ships.
- Invite foreign companies to provide support to the domestic fleet in its efforts to become greener through the use of renewable fuels and by introducing safer operating procedures.

5. Expand Financing Opportunities for Foreign-invested Firms in the Maritime Industry 🌐 3

- Expand financing opportunities for foreign-invested firms.
- Remove obstacles for Chinese leasing houses that prevent them from financing foreign-invested shipyards.





- Set up a solution for Chinese banks and export credit companies to provide export guarantees for private companies, such as smaller foreign-invested shipyards.

6. Foster Fair, Competitive Conditions and a Level Playing Field in the Maritime Industry

- Enhance the transparency of domestic shipbuilding policies and supporting programmes.
- Design a bilateral roadmap to achieve fair, competitive conditions in shipbuilding, and which addresses the gaps in the global trade rules and specific maritime manufacturing areas.

Introduction to the Working Group

The Maritime Manufacturing and Industrial Services Working Group represents European companies that design, manufacture, maintain and repair ships, as well as maritime equipment manufacturers, classification societies, maritime service providers and cruise operators.¹ At the end of 2020, the working group changed its name from the Shipbuilding Working Group to the Maritime Manufacturing and Industrial Services Working Group to better encompass the various segments of the maritime industry excluding shipping.

Nations depend greatly on the sea to facilitate trade and economic development, and communities along the coast have reaped the benefits of the development of the maritime sector and its accompanying infrastructure for centuries. While the maritime sector now plays an essential role in satisfying the increasing global demand for cleaner and safer transportation systems, the green and digital transformation of maritime and offshore operations present challenges and opportunities for both European and Chinese companies in terms of supplying new innovative solutions. As ships and associated maritime equipment fall into the category of 'dual-use' technology, maritime manufacturing is defined as a strategic sector that is subject to national security and sovereignty considerations.²

Under China's 14th Five-year Plan, Chinese state-owned enterprises (SOEs), such as the China Shipbuilding Group, and Chinese shipyards are tasked with heavy spending on research and development (R&D) as part

of the drive to step up China's innovation capacity and become more self-reliant in core technologies.

Recent Developments

The COVID-19 crisis hit at a time when the global trading environment was already under considerable strain from subdued demand, low profitability, market imbalances and protectionism.³ According to the China Association of the National Shipbuilding Industry (CANSI), orders for new vessels among Chinese shipbuilders declined 8.7 per cent year-on-year in the first eleven months of 2020.⁴ European shipyards were hit much harder due to their predominant focus on high-technology and niche market segments (such as cruise and passenger ships, and ferries) which suffered a freeze on orders. In 2020, newbuilding orders at European yards declined by 64 per cent in compensated gross tonnes.⁵ Because a significant number of shipyards in the Asia Pacific region were shut down or forced to operate under strict pandemic prevention measures, China's ship repair and maintenance sector received an increased number of orders during 2020. Most of the repair orders were for regular maintenance, with ballast water system restoration and desulphurisation system restoration among the more complex requests.⁶ According to the CANSI, complete ship repairs surged seven per cent year-on-year during the first three quarters of 2020, and

3 *Trade Set to Plunge as COVID-19 Pandemic Upends Global Economy*, World Trade Organization (WTO), 8th April 2020, viewed 22nd April 2021, <https://www.wto.org/english/news_e/pres20_e/pr855_e.htm>

4 *China's Jan-Nov new vessel orders subside faster by 8.7%*, Xinde Marine News, 21st December 2020, viewed 18th March 2021, <<https://www.xindemarinews.com/en/market/2020/1221/25912.html>>

5 Source: SEA Europe based on IHS Fairplay data, paid subscription service.

6 Zhong, Nan, *Ship Repair Sector Buoyant*, China Daily, 4th February 2021, viewed 18th March 2021, <<http://www.chinadaily.com.cn/a/202102/04/WS601b398ba31024ad0baa71ff.html>>

1 Classification societies establish and maintain technical standards for various industries.

2 'Dual-use' technology and/or equipment refers to that which is suitable for both civilian and military purposes.





the yearly total rose by 47 per cent.⁷

Few long-term investments in new ships were made, and most shipping companies have not yet started the transition to fossil-free solutions. Notwithstanding the low demand for new vessels, the maritime sector remains under immense pressure to meet the International Maritime Organization's (IMO) target of reducing greenhouse gas (GHG) emissions of the total shipping industry by 50 per cent by 2050, taking the year 2008 as the baseline.⁸ China has made decarbonisation a priority, with President Xi pledging during the General Debate of the United Nations General Assembly in September 2020 that China will achieve carbon neutrality by 2060, with GHG emissions peaking before 2030.⁹

Cruise Market in Crisis

On 14th March 2020, the global cruise market was shut down due to pandemic control measures, an unprecedented move that triggered cruise companies' stocks to plunge and their revenues to plummet by almost United States dollar (USD) 20 billion.¹⁰

Because of the lack of demand over such a prolonged period, global cruise operators have had to lay-up their ships. Overall, the cruise sector has been forced to downsize, with many ship owners taking steps to reduce operating expenses, including retiring relatively young vessels. Moreover, retiring the international cruise market has had a knock-on effect on maritime manufacturing and its supply chains, as ships currently being built are depreciating in value, with some orders put on pause.¹¹ In addition, while cruise operators are not outright cancelling orders, they are withholding new orders. All of these factors impact shipbuilders' capability to manage and finance their working capital. The working group is concerned that China may lose its position as the second-largest cruise market

in the world—a position fostered by both domestic and international companies—especially if the local Shanghai cruise economy remains closed.

Maritime Manufacturing

China is aiming to optimise the structure of its maritime manufacturing sector, upgrade the technical level of ship equipment and build a maritime fleet with advanced technology and green intelligence. Liquefied natural gas (LNG) ships¹² and cruise ships are being actively developed to enhance the international competitiveness of Chinese container, crude oil, dry bulk cargo and special transport fleets.¹³ Chinese shipbuilders have been successful in attracting several newbuild ferry orders pre-COVID, with the majority of ferries being delivered by Chinese shipyards in the coming years, as illustrated in the chart opposite.¹⁴ This is consistent with formulated Chinese industrial strategies to gain leadership in high-technology maritime manufacturing segments, with orders being won through appealing price-setting. Meanwhile, in November 2020, the assembly of the first Chinese domestically-built, large, ocean-going cruise ship began. This is widely perceived as a first step for China to enter the large cruise shipbuilding business currently dominated by European shipbuilders.¹⁵

China is now one of the world's premier maritime states. Its maritime manufacturing sector has undergone tremendous growth, partly through favourable government policies and subsidies since Beijing recognised it as a strategic sector. Although subsidies were reduced from 2017 onwards, China's focus on developing self-sufficiency in the maritime industry means domestic manufacturers are still favoured, making it challenging for European suppliers to increase their market share.

Regulatory Environment

Several developments in important regulations and

⁷ Ibid.

⁸ *Reducing Greenhouse Gas Emissions from Ships*, IMO, 2018, viewed 30th March 2021, <<https://www.imo.org/en/MediaCentre/HotTopics/Pages/Reducing-greenhouse-gas-emissions-from-ships.aspx>>

⁹ *China's Pledge to Cut CO2 Emissions Boosts Global Confidence in Climate Change*, China Daily, 25th September 2020, viewed 30th March 2021, <<https://www.chinadaily.com.cn/a/202009/25/WS5f6d9edfa31024ad0ba7be3f.html>>

¹⁰ Okungbowa, Andrew Iro, *Cruise industry to lose USD 19.6 billion in revenue due to Covid-19*, New Telegraph, 28th November 2020, viewed 25th April 2021, <<https://www.newtelegraphng.com/cruise-industry-to-lose-19-6-billion-in-revenue-due-to-covid-19/>>

¹¹ Swift, Ryan, *Global cruise ship fleet lose USD4 billion in value as coronavirus pandemic idles industry, halving the number of vessels at sea*, South China Morning Post, 5th April 2020, viewed 23rd April 2021, <<https://www.scmp.com/business/companies/article/3078347/global-cruise-ship-fleets-lose-us4-billion-value-coronavirus>>

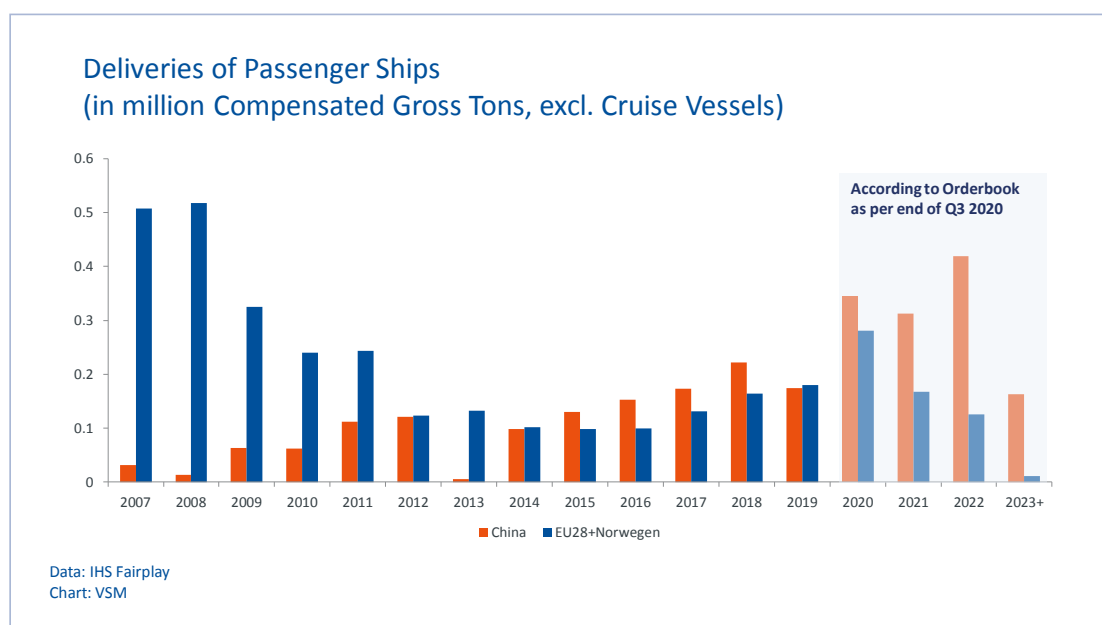
¹² An LNG carrier is a ship that is designed to transport liquefied natural gas in its chilled tanks.

¹³ *Guidelines on the Promotion of High-Quality Development of the Maritime Industry*, Ministry of Transport, 3rd February 2020, viewed 2nd April 2021, <http://xxgk.mot.gov.cn/jigou/syj/202002/t20200203_3329054.html>

¹⁴ *China's Shipbuilding Industry and Policies Affecting It*, the Organisation for Economic Co-operation and Development (OECD), 9th April 2021, viewed 3rd June 2021, <https://www.oecd-ilibrary.org/science-and-technology/report-on-china-s-shipbuilding-industry-and-policies-affecting-it_bb222c73-en?sessionId=59EIWP79nvvT6dnYVnsRMlCLip-10-240-5-165>

¹⁵ *Assembly Begins on China's First Domestically Built Large Cruise Ship*, Maritime Executive, 10th November 2020, viewed 18th March 2021, <<https://www.maritime-executive.com/article/assembly-begins-on-china-s-first-domestically-built-large-cruise-ship>>





Source: SEA Europe/VSM based on IHS Fairplay data

documents issued since the end of 2018 are worth noting:

- The State Council's *Circular No. 5 (2017)* expanded opening up to foreign investment and facilitated equity caps being lifted for high-end manufacturing, including shipbuilding.
- The *Foreign Investment Negative List (Negative List)* removed shipbuilding at the end of 2018.
- The *Action Plan for Sustainable and Healthy Development of the Offshore Engineering Equipment Manufacturing Industry (2017–2020)* was aimed at deepening reform and boosting innovation, accelerating structural adjustments within the industry and accelerating the opening-up process.
- The *White List* was abolished in April 2019.^{16&17}
- The *Action Plan to Promote the Smart Transformation of Shipyards and Shipbuilding (2019–2020)* and the *Intelligent Ship Development Action Plan (2019–2021)* set goals and actionable items through which the central government aims to upgrade the domestic shipbuilding industry in terms of added value.
- The *Guidelines on the Promotion of the High-quality Development of the Maritime Industry (2020)*

¹⁶ Shipyards included in the list were able to benefit from government funds and special bank loans. The list was first introduced in 2014.

¹⁷ *China Eliminates Shipyard 'White List'*, The Maritime Executive, 3rd April 2019, viewed 25th April 2021, <<https://www.maritime-executive.com/article/china-eliminates-shipyard-white-list>>

set a path for upgrading the technical level of ship equipment.

Despite these positive developments, the removal of the restrictions on foreign investment in the sector remains incomplete, with implementing guidelines still yet to be promulgated. Furthermore, the market opening that has taken place has not put an end to all distortive practices, such as the proliferation of subsidies, tax benefits and the preferential treatment of SOEs. In addition, with the merger of the China State Shipbuilding Corporation (CSSC) and the China Shipbuilding Industry Corporation at the end of 2019, the sector saw the creation of the China Shipbuilding Group, a state-owned industrial behemoth that holds USD 120 billion in assets.^{18&19} Moreover, although shipbuilding has been removed from the *Negative List*, the *Catalogue on Encouraging Foreign Investment (2020)* openly excludes foreign participation in ship production, thereby restricting foreign companies to the design and three-dimensional-modelling of ships and

¹⁸ *China: World's Largest Shipbuilder Established*, World Maritime News, 26th November 2019, viewed 21st April 2021, <<https://worldmaritimeweb.com/archives/286979/china-worlds-largest-shipbuilder-established/>>

¹⁹ *China's Opaque Shipyards Should Raise Red Flags for Foreign Companies*, Center for Strategic & International Studies, 26th February 2021, viewed 25th April 2021, <<https://www.csis.org/analysis/chinas-opaque-shipyards-should-raise-red-flags-foreign-companies>>



equipment.^{20&21} Marine engineering remains restricted under the *Negative List*, subject to approval measures.²²

On 30th December 2020, the European Union (EU) and China concluded in principle the bilateral Comprehensive Agreement on Investment (CAI). Under the CAI, China is making commitments on SOEs and forced technology transfers. If ratified, and commitments robustly monitored and enforced, the working group believes that European maritime manufacturing and service providers in China would benefit, and new market entrants would be encouraged as a result. However, the working group believes that the CAI is not sufficient to address the broader range of market distortions and obstacles to normal competition in shipbuilding, nor fill the fundamental gaps in international trade rules that exist in the maritime sector.²³ That would require the adoption of new disciplines and instruments specific to the sector, both at the bilateral and international levels.

Key Recommendations

1. Advance the Opening-up of the Cruise Market in China and Support the Restart of Business Operations 2

Concern

China's cruise market is only partly open to foreign-invested cruise operators, which negatively impacts the sustainability of business as restrictions continue to slow business growth, while the lack of a timeline for cruise businesses to restart international operations is causing grave financial burdens.

Assessment

Since the outbreak of the pandemic, all foreign-owned cruise ships operating in Shanghai are either docking offshore or on standby in other ports such as Singapore

and Dubai. Members estimate that the economic loss inflicted due to non-operation reached euro (EUR) 150 million combined during 2020.²⁴

There are two main revenue channels for cruises: ticket sales, which account for approximately 62 per cent of total revenue; and on-board purchases, which account for the remainder. Cruise operators have had to pay out substantial sums to passengers in refunds, compensation, and cancellation fees, while maintaining onboard services—such as air conditioning, desalination, and propulsion—to ensure their vessels remained in good shape. During 2021, cruise operators are therefore still incurring costs when not even sailing and may soon no longer be in a position to service loan repayments and address cash flow problems.²⁵

In other countries, effective communication platforms have been established between government, medical authorities and cruise operators. For instance, the EU has issued the *Interim Guidance for Restarting Cruise Ship Operations after Lifting Restrictive Measures in Response to the COVID-19 Pandemic*.²⁶ The United States (US) Government has issued a detailed roadmap for the progressive re-opening of the American cruise market, and in Japan and Singapore cruise operations are gradually resuming.²⁷ Meanwhile, the Chinese Government has yet to initiate a dialogue with industry to jointly work towards a roadmap for re-opening its international cruise market. This has left the industry in the dark as to how to prepare for business to restart.

Prior to the outbreak of the pandemic, China had overtaken Germany to become the world's second largest cruise market after the US and had seen a double-digit annual increase that would have allowed it to reach 10 million passengers by 2026. However, compared to the European and US cruise markets, the Chinese market remains partly closed to foreign-

20 *China Expands Encouraged Catalogue, Improves Foreign Investor Access*, China Briefing, 5th January 2021, viewed 25th April 2021, <<https://www.china-briefing.com/news/china-2020-fi-encouraged-catalogue-effect-january-27-2021/>>

21 *Directory of Industries to Encourage Foreign Investment (2020 Edition)*, National Development and Reform Commission, & the Ministry of Commerce, 27th December 2020, viewed 25th April 2021, <https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202012/t20201228_1260594.html>

22 *Negative List of Market Access (2020 Edition)*, China Briefing, 23rd December 2020, viewed 25th April 2021, <<https://www.china-briefing.com/news/china-2020-negative-list-market-access/#negative-list-of-market-access-edition-restricted-sector-wise-items-header>>

23 Current international trade rules under the WTO are not suitable for the shipbuilding sector. For example, existing trade remedies on "imports" of goods under WTO rules are not effectively applicable in shipbuilding, *inter alia* because ships are generally not "imported" in the common customs sense. For more details see *European Business in China Shipbuilding Position Paper 2019/2020*, p.268.

24 Information shared by working group member companies.

25 *COVID-19 Marine: Cruise Industry Impact from Coronavirus*, Clyde & Co. 10th March 2020, viewed 2nd April 2020, <<https://www.clydeco.com/insight/article/coronavirus-and-the-impact-on-the-cruise-industry>>

26 *Guidance on the Gradual and Safe Resumption of Operations of Cruise Ships in the European Union in Relation to the COVID-19 Pandemic*, European Maritime Safety Agency & the European Centre for Disease Prevention and Control, 27th July 2020, viewed 23rd March 2021, <<https://www.ecdc.europa.eu/sites/default/files/documents/COVID-19-cruise-guidance-27-07-2020.pdf>>

27 *Asian Cruises Resume from Japan and Singapore*, Maritime Executive, 5th November 2020, viewed 18th March 2021, <<https://www.maritime-executive.com/article/asian-cruises-resume-from-japan-and-singapore>>





invested operators. Rules concerning cabotage²⁸ and foreign-flagged vessels, combined with the fact that foreign-invested travel agencies are not allowed to sell cruise tickets directly to Chinese customers (they are forced to sell via Chinese tour operators instead), dragged on market growth.

Despite these barriers, foreign cruise operators were looking to increase investments in China prior to the pandemic and, with China being the first country to emerge from the crisis, the Chinese cruise market remains a high priority. In particular, if China accelerates the resumption of international services by the domestic market, it would assist cruise operators in recouping some of the losses incurred during the crisis. Furthermore, it would benefit the whole maritime value chain (both foreign-invested and domestic) in the long-term and contribute to the recovery of the global cruise sector.

In addition, the working group believes that the regular sharing of information on ongoing development plans for sectors deemed strategic within the Chinese cruise market, such as development of new technologies and geographical areas selected to become future cruise hubs, would further bolster recovery of the cruise sector in China, as it would increase business confidence and facilitate further investment.

Recommendations

- Issue a plan with a clear timeline for cruise businesses in China to restart international operations.
- Allow foreign-invested cruise operators to offer 'cruises to nowhere' departing from Chinese ports.
- Allow foreign-invested travel agencies to sell tickets directly to Chinese customers.
- Share with the working group, either annually or bi-annually, ongoing development plans for sectors deemed strategic within the Chinese cruise market, such as new technologies and geographical areas selected to become future cruise hubs, including shipyards.

²⁸ Cabotage is the right to operate sea, air or other transportation services within a particular territory. Maritime cabotage laws govern the transportation of goods and people between ports.

2. Ease Cross-border Movement of Foreign Experts, Managers and Specially-trained Maritime Engineers / Maintenance Workers

Concern

The current strict quarantine measures and visa restrictions make it difficult for foreign, specially-trained maritime experts and marine technicians to enter China to conduct specific, short-term activities related to installation, maintenance and repairs onboard ships, as well as the newbuilding of ships.

Assessment

Prior to entering China, foreign companies' employees face complex application procedures for obtaining visas to travel to China to conduct specific, short-term activities related to installation, maintenance, and repairs of equipment and ships, or newbuilding of ships. Upon arrival in China, strict quarantine requirements (up to three weeks) are imposed, and in some cases foreign experts face an additional two weeks of quarantine when travelling between provinces. Another issue is that foreign technicians entering China on a short-term basis, so-called 'flying teams', are not allowed to access ships in many Chinese ports; to date, 11 Chinese ports have completely suspended foreign technicians from entering, with one allowing foreign technicians to enter only on a case-by-case basis.^{29&30} These restrictions pose a challenge for the maritime industry and discourage foreign investment and long-term partnerships in China.

Recommendation

- Ease COVID-related travel restrictions and implement a fast-track programme for foreign maritime experts, managers and specially-trained engineers, and facilitate the access of foreign marine technicians to Chinese ports.

²⁹ By June 2021, the ports of Shanghai, Dalian, Caofeidian, Huanghua, Rizhao, Qingdao, Zhenjiang, Xiamen, Kemen and Taicang had all suspended entry for foreign technicians. The port of Yantai was allowing foreign technicians to enter on a case-by-case basis.

³⁰ *Port Operations Updates during Covid-19 June*, Oceanfavor, 2nd June 2021, viewed 9th June 2021, <<http://a.oceanfavor.com:30/en/about.asp>>





3. Increase Opportunities for Foreign-invested Firms in the Maritime Industry to Access and Bid for R&D Projects 3

Concern

Due to unclear access mechanisms, foreign-funded companies engaged in the maritime industry face indirect barriers to both obtaining R&D funds and participating in government projects.

Assessment

In 2020, three national level marine projects issued by the Ministry of Science and Technology (MOST) and the Ministry of Industry and Information Technology (MIIT) that were assigned to the CSSC would have been of interest to working group members to participate in.³¹

- *Research and Application Demonstration of Innovative Methods for Intelligent Manufacturing of Marine Equipment* – (MOST)
- *Pilot Demonstration Project of Big Data Integration Application in Shipbuilding and Offshore Engineering Equipment Industry* – (MIIT)
- *Development and Application Demonstration of the Control Platform for Ship Manufacturing Process* – (MOST)

These projects were a part of China's National Key R&D Programmes, guided by the MOST's *Interim Measures for the Management of National Key R&D Programmes* (*Guo Ke Fa Zi [2017] No. 152*) (*Measures*), updated in 2020.³² Based on the working group's investigation, there are no direct barriers preventing foreign companies from applying for R&D projects. In fact, the legal framework explicitly encourages foreign participation and foreign experts in both preparatory and implementation stages of projects.³³ But on a *de facto* level, indirect barriers exist, such as short periods allocated to prepare effective competitive proposals, the requirement for applicant companies to be registered in China with an international organisation, and for the legal representative to be a decision-maker independent from the company's global headquarters.³⁴ Moreover,

³¹ Three projects were approved by the Ministry of Science and Technology, China Ship, 5th November 2020, viewed 6th May 2021, <<http://www.cssc.com.cn/n10/n67/c18957/content.html>>

³² *Interim Measures for the Management of National Key R&D Programmes* (*Guo Ke Fa Zi [2017] No. 152*), MOST, 28th June 2020, viewed 6th May 2021, <<https://kjc.nuist.edu.cn/info/1046/3160.htm>>

³³ *Interim Measures for the Management of National Key R&D Programmes*, China Innovation Funding EU Project, 28th June 2020, viewed 6th May 2021, <http://chinainnovationfunding.eu/dt_testimonials/interim-measures-for-the-management-of-national-key-rd-programmes-2/>

³⁴ Ibid.

due to strategic considerations, tenders for maritime manufacturing and maritime equipment are sometimes labelled confidential by the Chinese Government.

Recommendations

- Clarify how foreign-invested firms can gain access to R&D activities in maritime manufacturing and equipment projects and create a transparent platform that will enable them to do so.
- Ease indirect barriers for foreign-invested companies to support and become partners in R&D projects.

4. Provide a Comprehensive Roadmap Detailing how the Maritime Sector will be Included in China's 2060 Carbon Neutrality Pledge

Concern

To deliver on the IMO's target of reducing GHG emissions from shipping by 50 per cent by 2050, economically-competitive, zero-emission vessels must be operating on a global scale by 2030, which will be impossible without China stepping up its efforts to implement effective policies and inviting foreign companies to the table.

Assessment

The Chinese leadership has pledged ambitious goals to achieve peak emissions by 2030, and carbon neutrality by 2060. This will entail China having to make profound changes in all areas, including decarbonising its maritime sector. Ammonia, hydrogen, biofuels and electrification are some of the many renewable fuels currently being trialled as alternative fuel sources, but with the average life of a commercial vessel being 20 years, many shipowners are reluctant to place new orders because they do not know which technology will prevail. The use of some of these alternative fuels is also very challenging, meaning that developing this new technology is not an easy task.

Foreign companies are already aggressively pursuing decarbonisation strategies and are eager to contribute towards the goal of decarbonising China's maritime industry. Therefore, opening the market further to allow increased foreign investment would not only accelerate the decarbonisation process overall, by boosting industry knowledge on decarbonisation methods, but would also introduce competitive pressure that would





push local Chinese companies to enhance their own low-carbon technologies. The working group therefore recommends that foreign companies be invited to provide support to the domestic fleet in becoming greener by using renewable fuels and introducing safer operating procedures.

Recommendations

- Provide a roadmap detailing how the maritime sector will be included in China's 2060 carbon neutrality pledge and ensure that foreign companies can contribute with their know-how.
- Allow foreign companies to support and become partners in China's maritime R&D programmes under this roadmap, including those for domestic ships.
- Invite foreign companies to provide support to the domestic fleet in their efforts to become greener through the use of renewable fuels and by introducing safer operating procedures.

5. Expand Financing Opportunities for Foreign-invested Firms in the Maritime Industry

Concern

Foreign-invested companies engaged in China's maritime industry face restrictions accessing financing, which gives an unfair advantage to domestic players and limits foreign-invested companies' overall market access.

Assessment

Shipyards in China use three financing methods: loan financing, ship leasing and internal financing. In general, the Chinese tools supporting the shipbuilding industry are made for big companies, most of them SOEs that can count on easy and less-costly financing methods. Since these SOEs also benefit from subsidies and grants, they can price their ships well below production cost.

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.

In most shipbuilding contracts, the primary source of funding for the shipyard lies in the pre-delivery instalments paid by the buyer (usually four pre-delivery

instalments and one final upon delivery). Until the shipyard delivers the ship/boat, the buyer's deposit and stage payments made during construction are at risk. For this reason, the shipyard needs to provide security to the buyer. Therefore, the bank of the buyer will ask the shipyard to provide a guarantee on those risky instalments (for example deck laying and engine delivery). The most common type of security is a refund guarantee issued by a shipyard's bank that is acceptable to the buyer (and the buyer's financing bank), so that the buyer can seek a refund directly from the shipyard's bank if the shipyard defaults or becomes insolvent. One funding possibility for the shipyard is to apply for a bank guarantee with their local bank, but Chinese banks only provide bank guarantees against cash deposits. This means the shipyard needs to block off a certain amount of financing on its account throughout the bank guarantee provided for the period of construction. The amounts involved are usually large and the construction period may take more than two years, making this an unviable option.

Another common financing tool in the industry is to get support from an export credit company. However Chinese export credit companies, such as Sinosure, only support very large companies, meaning foreign-invested shipyards will not be considered.

Ship leasing is the most common form of financing in China, but Chinese leasing houses tend to favour domestic companies when selecting a project partner. Furthermore, since 2017, Chinese leasing houses have reportedly been asked by the MIIT not to finance newbuilding projects at foreign-owned shipyards.^{35&36} There is no explicit law or prescription for Chinese leasing houses to adhere to such demands, and given that they are supervised by the China Banking and Insurance Regulatory Commission, it is unclear whether this MIIT request is even valid.³⁷ However, the working group has seen no indication that this practice has changed, and members report that they still face indirect barriers to obtaining financing.

35 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.

36 Shen, Cichen, *No More Finance for Foreign-yard Newbuilds*, *China's Leasing Houses Told*, *Lloyd's List*, 19th October 2017, viewed 2nd April 2021, <<https://lloydslist.maritimeintelligence.informa.com/LL111954/Nomore-finance-forforeignyard-newbuilds-Chinas-leasing-houses-told>>

37 *China's Shipbuilding Industry and Policies Affecting It*, OECD, 9th April 2021, viewed 3rd June 2021, <https://www.oecd-ilibrary.org/science-and-technology/report-on-china-s-shipbuilding-industry-and-policies-affecting-it_bb222c73-en;jseessionid=59EIWP79nnvT6dnYVnsRMlcl.ip-10-240-5-165>





Using internal financing is thus the only viable option for small and foreign-invested shipyards in China. However, because it takes years to build a ship, and decisions must 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 and shipyards must boost their profitability to finance themselves internally.

This presents a financing problem for foreign-invested companies—which tend to be smaller private companies or foreign SOEs operating on a smaller scale in a joint venture with a Chinese partner—during the period of ship construction. To compete with Chinese SOEs and to maintain market share, they must lower their prices, which in turn lowers their profitability and their ability to finance internally. Apart from advocating for similar treatment between domestic and foreign-invested companies, the working group would like to see an upgrade of Chinese financial tools (such as the export guarantee) for smaller, private foreign companies.

Recommendations

- Expand financing opportunities for foreign-invested firms.
- Remove obstacles for Chinese leasing houses that prevent them from financing private enterprises, including foreign-invested shipyards.
- Set up a solution for Chinese banks and export credit companies to provide export guarantees for smaller foreign-invested shipyards.

6. Foster Fair Competition and a Level Playing Field in the Maritime Industry 3

Concern

Government interventions and trade-distortions may jeopardise the recovery of the global shipbuilding sector.

Assessment

Removing obstacles to fair competition in shipbuilding remains a pressing priority for European industry

players. A transparent and fair market environment is a pre-requisite to achieving mutually beneficial, bilateral cooperation and long-lasting partnerships between the EU and China in the maritime manufacturing sector. The current sentiment among European shipbuilding companies is that the Chinese state continues to play a strong role in the allocation of resources, by extending various forms of (potentially) market-distorting measures to its domestic shipbuilding players, such as grants, capital injections through debt-for-equity swaps and preferential access to finance.³⁸ According to recent studies, combined state support to Chinese firms in the shipping and shipbuilding industry totalled roughly USD 132 billion between 2010 and 2018. This includes financing from state banks (USD 127 billion) and direct subsidies (USD 5 billion).^{39,40&41} Being the global shipbuilding leader in terms of market share, it is essential that China plays a leading role in promoting a level playing field, both domestically and globally.

Recommendations

- Enhance the transparency of domestic shipbuilding policies and supporting programmes.
- Design a bilateral roadmap to achieve fair, competitive conditions in shipbuilding, and which addresses the gaps in the global trade rules and specific maritime manufacturing areas.

³⁸ These trade-distorting government interventions should not be confused with financial support in the context of global emergencies, such as the COVID-19 crisis. At such times, support is on the contrary beneficial for industries, if it is targeted, limited in time and proportional.

³⁹ *Hidden Harbors: China's State-backed Shipping Industry*, Center for Strategic and International Studies (CSIS), 8th July 2020, viewed 6th April 2021, <<https://www.csis.org/analysis/hidden-harbors-chinas-state-backed-shipping-industry>>

⁴⁰ Barwick, P.J., Kalouptisidi, M. and Bin Zahur, N., *China's Industrial Policy: An Empirical Evaluation*, National Bureau of Economic Research, July 2019, revised September 2019, viewed 6th April 2021, <<https://www.nber.org/papers/w26075>>

⁴¹ *China's Shipbuilding Industry and Policies Affecting It*, the Organisation for Economic Co-operation and Development (OECD), 9th April 2021, viewed 3rd June 2021, <https://www.oecd-ilibrary.org/science-and-technology/report-on-china-s-shipbuilding-industry-and-policies-affecting-it_bb222c73-en;jsessionid=59EIWP79nnvT6dnYVnsRMlcl.ip-10-240-5-165>





Abbreviations

CAI	Comprehensive Agreement on Investment
CANSI	China Association of the National Shipbuilding Industry
CNY	Chinese Yuan
COVID-19	Coronavirus Disease 2019
EU	European Union
EUR	Euro
GHG	Greenhouse Gas
IMO	International Maritime Organisation
LNG	Liquid Natural Gas
MIIT	Ministry of Infrastructure and Information Technology
MOST	Ministry of Science and Technology
R&D	Research and Development
SOE	State-owned Enterprise
US	United States
USD	United States Dollar
WTO	World Trade Organization



Petrochemicals, Chemicals and Refining Working Group

Key Recommendations

1 Sustainability and Green Chemistry

1.1 Promote Sustainability through Effective Communication, Best Practice Sharing and Innovation on Safety and Environmental Management

- Strengthen cooperation between the government and international businesses and encourage the central authorities to involve these companies as key stakeholders, for example in planning the Petrochemicals, Chemicals and Refining industry's incremental incorporation into the Emissions Trading System.
- Establish regular, formal communication channels and cooperation mechanisms to include foreign enterprises and industrial associations in the legislation drafting and revision process, provide sufficient time for discussion at each level, and opportunities for review after implementation.
- Conduct regulatory training for authorities at every level (town, provincial and national) to align interpretations and enforcement, and provide appendices with standard answers to frequently-asked questions and a central platform for relevant parties to raise questions.
- Support the creation of platforms (for example, a local forum) to share and leverage Responsible Care principles, promote best practices and innovation in green development, and improve collaboration between domestic and international businesses.
- Avoid 'one-size-fits-all' solutions when enforcing compliance in recognition of the different levels of maturity of operational practices in the industry.
- Use a policy of 'guide' not 'ban' for chemical industry management and enhance policy support on logistics facilities for chemicals production and sales to realise materials' sustainability throughout its lifecycle.
- Clarify the distinction in standards between mandatory requirements and good practices and provide regulatory flexibility for industry evolution and new technologies.
- Encourage scientific and risk-based approaches to formulating safety and environmental policies for chemical enterprises' operations, such as leveraging requirements for energy consumption and environmental protection instead of simply the highest possible emission standard.
- Ensure that laws and regulations are clearly written to avoid different interpretations by authorities and inconsistent law enforcement.

1.2 Improve Policies for Promotion of the Circular Economy Within the Chemical Industry

- Foster value chain cooperation as well as regulatory, financial and tax support to promote the implementation of circular economy principles, e.g. re-use of chemical waste as a raw material and energy co-generation.
- Encourage resource sharing and collaboration within chemical parks.
- Facilitate cross-provincial waste transportation in order to optimise waste treatment with energy or material recovery.
- Simplify the permit allocation process for projects with a favourable impact on the circular economy, particularly for small-scale sites and chemicals parks, and offer the possibility of case-by-case exemptions.
- Provide policy incentives for the use of renewable energy (i.e. wind, solar, hydraulic) and non-fossil



- feedstock (i.e. bio, CO₂, waste plastics) in the production of chemicals.
- Grant tax incentives that promote plastic recycling processes and improve urban waste infrastructure.
- Speed up the construction of a green standard system for recycled plastics.
- Provide policy and financial incentives in order to upgrade local plastic waste recycling systems, encourage eco-design that enables high recycling efficiency and rates, and accelerate both mechanical and chemical recycling of plastic waste.
- Promote public education on the high potential of recycled plastics to dispel impressions that they are inherently low-quality materials.

2 Investment and Manufacturing Costs

2.1 Guarantee Fair and Reasonable Treatment by Local Authorities with Respect to Relocations and Temporary Closures of Enterprises and Chemical Parks 🌐 5

- Ensure that any criteria provided and actions undertaken to have businesses relocate or temporarily close are based on law and regulations, are transparent and are published well in advance.
- Use a 'case-by-case' approach to address suggestions for plant relocations, with significant lead-time and lenient timelines to avoid disrupting chemical supply chains.
- Reach mutual agreement with companies on relocation timelines and fair compensation to decrease their associated costs.
- For large-scale state events, avoid disruptions to chemical supply chains as part of central planning.

2.2 Facilitate the Diversity and Competitiveness of the Oil and Gas Sectors

a) Continue Deregulation of Retail Fuel Market 🌐 3

- Fully remove oil product price ceilings to deliver a competitive retail market in China, and establish a clear time schedule for market deregulation

b) Deregulate the Liquefied Petroleum Gas (LPG) Market on a National Level 🌐 2

- Fully deregulate cylinder LPG prices for domestic use in Shanghai, Xinjiang, Hainan and Hunan, the last provinces for which local governments set the retail price.

2.3 Simplify the Regulatory Process to Support New Market and Technology Innovation in Fine Chemical Manufacturing

- Simplify the permit allocation process for minor recipe changes within the same product category to promote quick market responses and encourage innovation.
- Simplify the permit allocation process for plant debottlenecking projects that aim to increase production capacity and optimise the workflow without changing the main production process or increasing emissions.

3 Chemicals Management

3.1 Develop a Well-argued and Practical Legislation Framework for Chemical Risk Management



- Remove local barriers to hazardous chemicals (HC) transportation and enhance capacity building for HC transportation, import and export.
- Establish procedures to seek input from industry when either developing general risk assessment guidance or assessing any specific substances.
- Advance the development of Risk Management Option Analysis guidance to make sure key stakeholders are involved and all factors (for example, exposure scenarios, socio-economic



analyses, alternative availability) are considered in the decision-making process for chemicals prioritisation and risk management measures selection.

- Adjust the requirements for extending confidential business information protection rights under *Order 12*, and clarify the procedure and timeline for Inventory of Existing Chemical Substances in China entry of substances registered under *Order 7*.
- Reduce unnecessary duplicate testing by narrowing eco-toxicology test requirements and accepting test results from foreign institutions.
- Exempt low volume notification for new chemicals and HC registration for research purposes from notification requirements.
- Simplify and improve the registration system for HC and new chemicals.
- Reduce minimum data requirements of new chemical notification to reduce costs.
- Ensure alignment between chemicals management approaches and strategic sectors like the green economy to ensure substances that enable green innovation are managed proportionately based on socio-economic considerations.

Introduction to the Working Group

The Petrochemicals, Chemicals and Refining (PCR) Working Group represents the leading European companies in the petroleum and chemical industry in China, many of which are Fortune Global 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 chemical industry and the effects from various locally enacted regulations.

Recent Developments

The Petrochemicals, Chemicals and Refining Working Group has maintained an ongoing strategic dialogue with the Chinese Government and relevant institutions, including high-level meetings with 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, the Ministry of Industry and Information Technology, the National Development and Reform Commission, the National Health Commission (NHC), the European Chemicals Agency and senior European Commission officials. The working group greatly appreciates the constructive exchanges that have taken place between European stakeholders 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 also has a close relationship with several chemical industry associations, including the Association of International Chemical Manufacturers (AICM) and the China Petroleum and Chemical Industry Federation (CPCIF), which share the aim of facilitating the Chinese manufacturing industry in becoming more sustainable and innovative.

Sustainability and Green Chemistry

China has continuously strengthened its regulations for environmental protection, recently announcing that its carbon emissions would peak by 2030 and carbon neutrality reached by 2060. Realising these ambitious targets will require a green transformation amongst industries and significant drops in pollutants and emissions intensity. The national Emissions Trading System (ETS) was launched on 1st February 2021 under the jurisdiction of the MEE after nearly a decade of planning.¹ The ETS currently only covers the power generation industry, but will eventually integrate other industries such as cement, steel, aluminium, chemicals and petrochemicals.²

1 Administrative Measures for *Carbon Emissions Trading (Trial)*, MEE, 5th January 2021, viewed 1st March 2021, <http://www.mee.gov.cn/xxgk/2018/xxgk/xxgk02/202101/t20210105_816131.html>

2 Slater, Huw, Shu, Wang and De Boer, Dimitri, *China's National Carbon Market is About to Launch, China Dialogue*, 29th January 2021, viewed 1st March 2021, <<https://chinadialogue.net/en/climate/chinas-national-carbon-market-is-about-to-launch/>>





The central government has also finalised the legal framework of the national pollutant discharge permit system, with the *Regulations on Management of Pollutant Discharge Permits*, which were released in January 2021 and went into effect on 1st March 2021.³ The system supervises emissions by requiring manufacturers to apply for permits before discharging pollutants, in order to closely monitor emission levels.

The development of a circular economy is necessary for the chemical industry to become sustainable. On 22nd February 2021, the State Council issued a document laying out a coordinated overall policy for circular economy development that includes the creation of a formal scrap-recycling system and a focus on Extended Producer Responsibility.⁴ The working group welcomes this high-level, nationwide focus on circular economy and looks forward to more detailed implementation measures.

On 7th April 2021, the MEE published the *Guiding Opinions on Strengthening the Positive List Management of Ecological Environment Supervision and Law Enforcement and Promoting Differentiated Law Enforcement and Supervision*.⁵ The working group is pleased to see the central authorities have adopted its suggestion to avoid 'one-size-fits-all' solutions when enforcing compliance, considering the different levels of maturity of operational practices in the chemical industry. The working group hopes the policy will be implemented properly.

Investment and Manufacturing Costs

The Yancheng factory explosion in March 2019 in Jiangsu Province intensified a nationwide focus on plant

safety and relocation,⁶ which has been accompanied by provincial-level plans to shut down non-compliant companies. Although the working group welcomes the increased emphasis on safety, excessive shutdown measures may also disrupt compliant chemical supply chains.

The Yangtze River Protection Law was finalised in December 2020 and entered into force in March 2021.⁷ The law prohibits the construction or expansion of chemical parks and projects within one kilometre of the river, with no nuance for projects intended to upgrade plants' safety and ecological protection. Several working group members report that local authorities ordered them to shut down within unreasonably short timeframes. In addition, many companies receive conflicting information from different government departments and encounter difficulties in establishing direct negotiation channels with the relevant authorities.

Chemicals Management

The working group welcomes the MEE's finalisation of the *Measures for Environmental Management Registration of New Chemical Substances (Order 12)*,⁸ which went into effect at the beginning of 2021. Although the new legislation eases new substance reporting requirements compared to its predecessor *Order 7*,⁹ the lack of reporting exemptions for low-quantity chemicals used in research will likely hamper innovation capacity and add to manufacturers' administrative burdens. The MEM's draft Hazardous Chemicals Safety Law¹⁰ similarly creates a standardised legislative framework for hazardous chemical (HC) management, but inconsistent enforcement of other chemical-related regulations by local authorities has already raised concern among manufacturers.

3 *Order No. 736 of the State Council of the People's Republic of China*, State Council, 29th January 2021, viewed 1st March 2021, <http://www.gov.cn/zhengce/content/2021-01/29/content_5583525.htm>

4 The Extended Producer Responsibility is a very important concept. It is also called product stewardship in chemical industry. It means a producer should think about the health, environmental and safety impact along the life cycle of a product. When a company designs a product, it should think about what the product will bring to the earth when it becomes a waste. This is a very important concept especially to those industry which will be exposed to final consumers such as automobile, mobile and cosmetics industries. For example, all electronics product should meet Restriction of Hazardous Substances (RoHS) requirement so it can be recycled. *Guiding Opinions of the State Council on Accelerating the Establishment and Improvement of a Green and Low-Carbon Circular Development Economic System*, State Council, 22nd February 2021, viewed 1st March 2021, <http://www.gov.cn/zhengce/content/2021-02/22/content_5588274.htm>

5 *Guiding Opinions on Strengthening the Positive List Management of Ecological Environment Supervision and Law Enforcement and Promoting Differentiated Law Enforcement and Supervision*, MEE, 7th April 2021, viewed 21st May 2021, <http://www.mee.gov.cn/xxgk/xxgk05/202104/t20210423_830095.html>

6 *State Council Security Committee: Comprehensively Carry out Centralised Investigation and Rectification of Dangerous Chemicals Safety Hazards*, State Council, 25th March 2019, viewed 1st March 2021, <http://www.gov.cn/xinwen/2019-03/25/content_5376596.htm>

7 *Yangtze River Protection Law of the People's Republic of China*, National People's Congress, 26th December 2020, viewed 1st March 2021, <<http://www.npc.gov.cn/npc/c30834/202012/1626d0bc5284485588222995e712c434.shtml>>

8 *Measures for Environmental Management Registration of New Chemical Substances (Order 12)*, MEE, 29th April 2020, viewed 1st March 2021, <http://www.mee.gov.cn/xxgk/xxgk02/202005/t20200507_777913.html>

9 *Measures for Environmental Management of New Chemical Substances (Order 7)*, MEE, 19th January 2010, viewed 1st March 2021, <http://www.gov.cn/gongbao/content/2010/content_1671246.htm>

10 *People's Republic of China Hazardous Chemicals Safety Law (Draft for Comments)*, MEM, 2nd October 2020, viewed 1st March 2021, <https://www.mem.gov.cn/gk/tzgg/tz/202010/t20201002_368140.shtml>



1. Sustainability and Green Chemistry

1.1 Promote Sustainability through Effective Communication, Best Practice Sharing and Innovation on Safety and Environmental Management

Concern

Recent government policies reinforced negative views concerning the chemical industry in China and ignored its significant contributions to promoting the responsible, green and innovative economy necessary to realise China's 2030/2060 carbon goals.

Assessment

The chemical industry is a key stakeholder in the development of an urgently needed, clear and comprehensive strategy on creating a sustainable green economy, and in helping China reach its ambitious goals of achieving peak carbon by 2030 and carbon neutrality by 2060.

The launch of the national ETS is an important step towards decarbonisation in China. With the ETS poised to deeply transform the power generation industry and any industries it covers in the future, the working group urges the MEE and corresponding provincial authorities to maintain communication with chemical industry stakeholders, as their operations will be included in or impacted by the scheme. The working group also believes that when the ETS is expanded, it should be implemented on a product-by-product basis rather than industry-wide all at once, in order to ensure necessary lead time and opportunities for stakeholder engagement in the process.

Another challenge that companies experienced during the initial phase of the Shanghai pilot ETS was that participants received emission credits based on their 'historical emissions', meaning that those with larger volumes of emissions received more credits for free. The ETS should incentivise the adoption of advanced technologies rather than creating disadvantages for companies that already lead in energy efficiency and emissions reduction. The working group urges the national ETS to allocate emission credits based on industry benchmarks and sector goals (as agreed upon by industry and government).

China already has 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 the authorities, especially following the 2015 Tianjin

Port explosion.¹¹ Since then, national and regional governments have become extremely sensitive towards chemical safety issues.¹² Their concern is legitimate, as the many chemical enterprises in China vary greatly in their scope of stakeholders, activities and operating conditions, and every misstep can damage the overall reputation of the industry. International chemical companies and large state-owned enterprises usually implement comprehensive and sound policies based on Environmental Health and Safety (EHS) Assistant systems. In addition, international firms deploy Responsible Care practices,¹³ an initiative developed by the International Council of Chemical Associations (ICCA), which China joined in 2014.

Many accidents in the industry 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 EHS matters are not recognised by the Chinese authorities, who still insist on a 'one-size-fits-all' approach to the chemical industry, such as bans affecting compliant and non-compliant companies alike.¹⁴ To avoid these problems, a formal channel of communication and cooperation between chemical companies and government officials is necessary to promote the implementation of responsible and sustainable practices, and improve preventative measures. This collaboration should include chemical parks or associations such as the AICM or CPCIF. Practical steps like providing English-language versions of policies and more opportunities for comments and discussion could also facilitate communication.

Furthermore, vaguely-written regulations may lead to experts, professionals and various levels of authorities having different interpretations of laws and regulations, and thereby result in major inconsistencies in enforcement that affect business operations. For example, if a

11 Hernandez, Javier C., *Tianjin Explosions Were Result of Mismanagement, China Finds*, The New York Times, 5th February 2016, viewed 1st March 2021, <<https://www.nytimes.com/2016/02/06/world/asia/tianjin-explosions-were-result-of-mismanagement-china-finds.html>>

12 State Council Security Committee: *Comprehensively Carry out Centralised Investigation and Rectification of Dangerous Chemicals Safety Hazards*, State Council, 25th March 2019, viewed 1st March 2021, <http://www.gov.cn/xinwen/2019-03/25/content_5376596.htm>

13 According to the ICCA, "Responsible Care is a voluntary commitment by the global chemical industry to drive continuous improvement and achieve excellence in environmental, health and safety and security performance": *Responsible Care*, ICCA, viewed 1st March 2021, <<https://www.icca-chem.org/responsible-care/>>

14 AICM Points Out Barriers to Responsible Care in China, Chemical Watch, 28th July 2016, viewed 1st March 2021, <<https://chemicalwatch.com/48853/aicm-points-out-barriers-to-responsible-care-in-china>>



new regulation is not clear enough, local government departments may stop issuing permits until they receive more specific guidelines from a higher department. Interpretation should therefore be clarified and aligned among local and central authorities before new regulations go into force.

Although the authorities have ambitious plans for greening the economy, promoting innovation and increasing digitisation, the appropriate mechanisms for facilitating cooperation between companies and institutions are often lacking. These initiatives also may not distinguish between mandatory requirements and good practices. The standard for volatile organic compounds (VOC), for example, requires manufacturers to remove 90 per cent of VOCs even if emissions are already limited. This comes at a high cost in terms of both investment and energy efficiency. Such uncertainty is neither conducive to industry evolution nor to the development of new technologies. Focussing on overall energy consumption and environmental protection would be more conducive to greening operations than an arbitrary emissions standard. The government should also establish sound and practical communication platforms that encourage industries to reduce their environmental impact and fully utilise existing resources in an innovative manner, for example, in hazardous waste management.

Recommendations

- Strengthen cooperation between the government and international businesses and encourage the central authorities to involve these companies as key stakeholders, for example, in planning the PCR industry's incremental incorporation into the ETS.
- Establish regular, formal communication channels and cooperation mechanisms to include foreign enterprises and industrial associations in the legislation drafting and revision process and provide sufficient time for discussion at each level.
- Conduct regulatory training for authorities at all levels (town, provincial and national) to align interpretations and enforcement, and provide appendices with standard answers to frequently asked questions and a central platform for relevant parties to raise issues.
- Support the creation of platforms (for example, a local forum) to share and leverage Responsible Care principles, promote best practices and innovation in green development, and improve collaboration between domestic and international businesses.

- Avoid 'one-size-fits-all' solutions when enforcing compliance in recognition of the different levels of maturity of operational practices in the industry.
- Use a policy of 'guide' not 'ban' for chemical industry management and enhance policy support on logistics facilities for chemicals production and sales to realise materials' sustainability throughout their lifecycle.
- Clarify the distinction between mandatory requirements and good practices and provide regulatory flexibility for industry evolution and new technologies.
- Encourage scientific and risk-based approaches to formulating safety and environmental policies for chemical enterprises' operations, such as leveraging requirements for energy consumption and environmental protection instead of simply the highest possible emission standard.
- Ensure that laws and regulations are clearly written to avoid different interpretations by authorities and inconsistent law enforcement.

1.2 Improve Policies for Promotion of the Circular Economy Within the Chemical Industry 2

Concern

China needs stronger institutional management and flexible enforcement to promote circular innovation within the chemical industry and establish a complete plastic waste disposal system.

Assessment

Around half of global carbon dioxide (CO₂) emissions come from the extraction and processing of materials that underpin a 'take-make-dispose' economy.¹⁵ In contrast, a circular economy aims to close industrial loops by turning outputs from one manufacturer, including waste, into inputs for another. Since 2005, China has recognised the circular economy as a way to deal with the economic and environmental risks of heavy resource exploitation, and in 2008 enacted the Circular Economy Promotion Law.¹⁶ In July 2018, China and the European Union (EU) signed a joint Memorandum of Understanding on Circular Economy Cooperation, to mutually realise the economic and environmental potential of a transition to a

¹⁵ *Circular Economy and Material Value Chains*, World Economic Forum, n.d., viewed 1st March 2021, <<https://www.weforum.org/projects/circular-economy/>>

¹⁶ *Several Opinions of the State Council on Accelerating the Development of a Circular Economy*, State Council, 2005, viewed 1st March 2021, <http://www.gov.cn/zwgk/2005-09/08/content_30305.htm>



circular economy and implement best-practice-sharing.¹⁷

The circular economy is an emerging model and thus still faces economic challenges, including the need for huge investment in research and development, the building of a circular value chain, and market and public education to foster acceptance of new methods such as the use of recycled materials, which many view as low-quality. The State Council circular issued in February 2021 is a huge step forward, outlining an overall system for circular economy development.¹⁸ This document must be followed up with a clearly defined mid- and long-term legislation framework, including targets and roadmaps, as well as the involvement of Chinese and European companies to bring more innovation and draw upon the EU's circular economy framework.

As chemicals are essential for many industries, chemical manufacturers are key players in the midstream of many supply chains.¹⁹ The chemical industry is eager to minimise the environmental footprint of its activities. Foreign chemical companies operating in China have a strong focus on sustainability throughout a product's whole life cycle, rather than just during its market life,²⁰ as well as on developing new products that are recyclable by design at the end of their lifespan. Chemical parks can facilitate circular ecosystems in manufacturing, as participating enterprises can share resources within a closed loop.

Another way to apply circular economy principles to plastics manufacturing is to make use of the waste generated by production processes, for example, the use of cogeneration for energy supply optimisation, i.e. other industries or companies using co-products as material, or the transformation of waste into recognised valuable materials. At the beginning of the value chain, renewable energies can be used to manufacture plastics, which would thereby improve the energy efficiency of a product's value chain. Regarding products' end-of-life, chemical manufacturers are developing innovative

methods such as chemical recycling to turn plastic waste into feedstock for creating new products without using virgin fossil resources.²¹

In China, incomplete physical and policy infrastructures pose a barrier to the mass adoption of chemical recycling of waste plastics, which is generally sourced from the 'dry waste' category as per urban waste classification. However, it is often difficult to separate waste plastics that are of sufficient high quality to be used as raw materials from other dry waste. Advancements in urban domestic waste infrastructure are therefore necessary to improve recycling processes. The working group also recommends facilitating cross-provincial disposal system in order to combine capacity and facilities for all types of waste.

Meanwhile, authorities and industry can collaborate to create green standards for the whole plastic recycling supply chain. Tax incentives such as exemptions on consumption tax, full value-added tax refunds and renewal of preferential tax treatment (for example, the catalogues of preferential corporate income tax treatments for specialised equipment in the areas of environmental protection, water conservation or energy usage reduction, and production safety²²) could likewise offset the costs of the high-quality equipment and technology necessary for chemical recycling.²³

In general, authorities should ensure that regulations and standards do not constrain sustainable operations, but rather their applicability to specific cases or overall environmental footprint is considered. For example, *GB 18484 Pollution Control Standard for Hazardous Wastes Incineration* requires online monitoring for all incineration projects even if no dangerous pollutants are emitted.²⁴ Overly detailed requirements like this ignore a project's overall environmental footprint. Simplifying the permit allocation process for projects with favourable impacts on the circular economy, and applying a flexible approach based on the specific situation instead of one-size-fits-all enforcement, would encourage plants and chemical

17 *China-EU agreement paves way for global adoption of circular economy*, Ellen MacArthur Foundation, 16th July 2018, viewed 1st March 2021, <<https://www.ellenmacarthurfoundation.org/news/china-eu-agreement-paves-way-for-global-adoption-of-circular-economy>>

18 *State Council's Guiding Opinions on the Establishment of a Sustainable Economic System*, State Council, 22nd February 2021, viewed 1st June 2021, <http://www.gov.cn/zhengce/content/2021-02/22/content_5588274.htm>

19 2019 *AICM Sustainable Development Report*, AICM, 4th June 2019, viewed 1st March 2021, <<http://aicm.cn/upload/files/20190604/1559634731364010712.pdf>>

20 *AICM Sustainability Journal: Sustainable Cases and Practices (The Second Edition)*, AICM, 7th September 2020, viewed 1st June 2021, <<http://aicm.cn/download/newsletter>>

21 *Chemical Recycling of Plastic Waste*, BASF, n.d., viewed 1st March 2021, <<https://www.basf.com/global/en/who-we-are/sustainability/we-drive-sustainable-solutions/circular-economy/mass-balance-approach/chemcycling.html>>

22 *A Summary of China's Corporate Income Tax Incentives*, Jones Day, July 2008, viewed 29th March 2021, <<https://www.jonesday.com/en/insights/2008/07/a-summary-of-chinas-corporate-income-tax-incentives>>

23 For more information, please see the *Finance and Taxation Working Group Position Paper 2021/2022* on p. 274.

24 *Pollution Control Standard for Hazardous Wastes Incineration*, MEE, 1st January 2002, viewed 22nd March 2021, <<http://www.mee.gov.cn/image20010518/1533.pdf>>



parks to carry out innovative pilot projects.

Recommendations

- Foster value chain cooperation as well as regulatory, financial and tax support to promote the implementation of circular economy principles, such as re-use of chemical waste as a raw material and energy co-generation.
- Encourage resource-sharing and collaboration within chemical parks.
- Facilitate cross-provincial waste transportation in order to optimise waste treatment with energy or material recovery.
- Simplify the permit allocation process for projects with a favourable impact on the circular economy, particularly for small-scale sites and chemicals parks, and offer the possibility of case-by-case exemptions.
- Provide policy incentives for the use of renewable energy (i.e. wind, solar, hydraulic) and non-fossil feedstock (such as bio, CO₂, waste plastics) in the production of chemicals.
- Grant tax incentives that promote waste plastic recycling processes and improve urban waste infrastructure.
- Speed up the construction of a green standard system for recycled plastics.
- Provide policy and financial incentives in order to upgrade local plastic waste recycling systems, encourage eco-design that enables high recycling efficiency and rates, and accelerate both mechanical and chemical recycling of plastic waste.
- Promote public education on the high potential of recycled plastics to dispel impressions that they are inherently low-quality materials.

2. Investment and Manufacturing Costs

2.1 Guarantee Fair and Reasonable Treatment by Local Authorities with Respect to Relocations and Temporary Closures of Enterprises and Chemical Parks

Concern

Despite progress in national legislation to ensure that the shutdown or relocation of chemical facilities does not unfairly target companies that comply with EHS regulations, implementation—particularly on the local level—has yet to reassure compliant companies of consistent and fair treatment.

Assessment

Since the March 2019 explosion in Jiangsu's Xiangshui Chemical Industrial Park, many chemical producers have been forced to shut down in Jiangsu and Shandong provinces.²⁵ These unexpected shutdowns can cause large ripples that disrupt raw material supply chains. In other cases, temporary closures for large-scale state events lead to concerns over production and supply chain disturbances and, in some cases, may pose serious safety and ecological risks.

With the increasing intensity of environmental inspections and associated law enforcement, some petrochemical joint venture plants have been receiving more frequent requests from the authorities for reductions in production, or even shutdowns, for reasons including summer ozone control, autumn-winter transition (Blue Sky Programme)²⁶ air quality control, or major events nearby.²⁷

The working group fully understands the pressure over safety and environmental risks; however, this kind of sudden-stop, one-size-fits-all enforcement focusses on quotas rather than performance,²⁸ which can damage the chemical supply chain and have negative industrial repercussions. Closure or relocation initiatives should involve continuous communication between authorities and enterprises and employ a 'one enterprise, one policy' customised approach. For example, enforcement of the Yangtze River Protection Law has led local governments to demand the closure of plants and chemical parks within one kilometre of the river, despite the relevant article only prohibiting the construction or expansion of plants. The time allowed for relocation is also unrealistic in terms of the requirements involved in moving entire operations and workforces. Furthermore, these decisions are made via formal letters issued by provincial safety and environmental offices that advise municipal governments on which plants should be closed or relocated. Enterprises are unable to communicate directly with these offices and therefore

25 Wei, Cang, *2 Eastern Provinces Clamp Down on Chemical Plants*, China Daily, 9th May 2019, viewed 1st March 2021, <<http://www.chinadaily.com.cn/a/201905/09/WS5cd37fb3a3104842260baa77.html>>

26 Hu, Yongqi, *Three-year Action Plan Aims for Blue Skies*, China Daily, 19th June 2018, viewed 1st March 2021, <<http://www.chinadaily.com.cn/a/201806/19/WS5b287383a310010f8f59d939.html>>

27 Zhou, Viola, *Beijing Under Pressure to Deliver Blue Sky for Party Congress as Smog Arrives Early*, South China Morning Post, 4th September 2017, viewed 1st March 2021, <<https://www.scmp.com/news/china/society/article/2109652/beijing-under-pressure-deliver-blue-sky-party-congress-smog>>

28 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 1st March 2021, <<http://aicm.cn/download/newsletter>>



rely on information from local industry and information bureaux, which take the advice of the offices as orders rather than suggestions, even if there is no evidence that the operations cause environmental hazards. International businesses requested to relocate should be treated equally as local companies. More importantly, the international business wants to receive clear information and relocation criteria, be able to discuss relocation timelines with local authorities to minimise the associated costs, and receive fair compensation after relocation.

Recommendations

- Ensure that any criteria provided and actions undertaken to have businesses relocate or temporarily close are based on law and regulations, are transparent and are published well in advance.
- Use a 'case-by-case' approach to address suggestions for plant relocations, with significant lead-time and lenient timelines to avoid disrupting chemical supply chains.
- Reach mutual agreement with companies on relocation timelines and fair compensation to decrease their associated costs.
- For large-scale state events, avoid disruptions to chemical supply chains as part of central planning.

2.2 Facilitate the Diversity and Competitiveness of the Oil and Gas Sectors

a) Continue Deregulation of Retail Fuel Market

Concern

Despite 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

China's oil market prices are currently regulated through a system of price caps by the central government and only tenuously linked to international oil prices.²⁹ There have been several positive signals in recent years that suggest the government intends to deregulate the retail fuel sector. For instance, the *Several Opinions on Deepening Oil and Gas Sector Reform (Opinions)*,

²⁹ China Sets Floor for Retail Fuel Pricing, State Council, 13th January 2016, viewed 1st March 2021, <http://english.gov.cn/news/top_news/2016/01/13/content_281475271410529.htm>

released by the State Council in May 2017,³⁰ advocated a central role for the market in guiding oil prices. However, the actions encouraged by the *Opinions* have not been forthcoming.³¹

Deregulating oil prices and removing price ceilings would deliver a competitive retail market in China, with several key benefits, such as supporting China's commitment to continue its economic reform. A fully functioning retail fuel market would also boost service and product quality by offering consumers greater choices between high- and low-quality fuel.³² 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.³³

Recommendation

- Fully remove oil product price ceilings to deliver a competitive retail market in China, and establish a clear time schedule for market deregulation.

b) Deregulate the Liquefied Petroleum Gas (LPG) Market on a National Level

Concern

Despite deregulation of the LPG market across most of the country, LPG for domestic use is still regulated in several provinces, preventing market competition and giving retailers little room to make profit.

Assessment

Government regulation in the LPG market prevents market competition. The biggest proportion of LPG usage goes toward heating and cooking at the household level, yet while industrial and commercial LPG is fully deregulated, Shanghai, Xinjiang, Hainan and Hunan still regulate cylinder LPG prices for household use. For example, for standard cylinders of 14.5 kilograms (kg), the Shanghai Government sets the maximum retail price as the local refineries' price plus Chinese yuan (CNY) 25

³⁰ Six Aspects of the 'Opinions on Deepening the Reform of the Oil and Gas System', China Law Info, 22nd May 2017, viewed 1st March 2021, <<http://www.chinalawinfo.com/News/NewsFullText.aspx?NewsId=85728>>

³¹ Lelyveld, Michael, *China's Oil Industry Reform Falls Short*, Radio Free Asia, 12th June 2017, viewed 1st March 2021, <https://www.rfa.org/english/commentaries/energy_watch/chinas-oil-industry-reform-falls-short-06122017105651.html>

³² China Gasoline Retailing Development Trends Report 2019, Deloitte, May 2019, viewed 1st March 2021, <<https://www2.deloitte.com/content/dam/Deloitte/cn/Documents/energy-resources/deloitte-cn-er-china-gasoline-retailing-development-trends-report-en-190527.pdf>>

³³ Zheng, Xin, *BP to Invest More in Outlets*, China Daily, 13th August 2018, viewed 1st March 2021, <<http://www.chinadaily.com.cn/a/201808/13/WS5b70dfc3a310add14f385598.html>>





to cover labour, cylinder, production and transportation costs, as well as depreciation, safety management fees, sales and management costs, and tax, among other external expenses.³⁴ Although changes in the maximum retail price are announced periodically, the CNY 25 price differential has not been adjusted for five years. As a result, cylinder LPG prices are much lower than in the rest of the country, where the price is based on market competition; for example, in March 2021, Shanghai's price per cylinder was CNY 84,³⁵ compared to CNY 125 in Hangzhou, CNY 114 in Jiaying, and CNY 105 in Huzhou.³⁶ This regulation prevents LPG retail companies from making profit in the four provinces.

Recommendation

- Fully deregulate cylinder LPG prices for domestic use in Shanghai, Xinjiang, Hainan and Hunan, the last provinces for which local governments set the retail price.

2.3 Simplify the Regulatory Process to Support New Market and Technology Innovation in Fine Chemical Manufacturing

Concern

Strict permit allocation requirements for increasing production capacity or making minor changes to product recipes hinder fine chemical manufacturers from quickly adapting to market conditions.

Assessment

The permit allocation process for fine chemicals manufacturing is very stringent, and includes requirements for safety assessments, environmental impact assessments, occupational health assessments and capital expenditure thresholds. To adapt to market changes, downstream fine chemical manufacturers sometimes need to adjust recipes or technologies. If these adjustments involve raw materials that are not on the plant's list of registered chemicals, the new materials

must undergo an entirely new permit allocation process, even if they are replacing an ingredient with similar properties and do not bring any additional operational risk or pollution.

The same constraint is true for production increases. Permit allocation processes stipulate maximum production capacities, therefore, in order to increase manufacturing capacity—for instance, when debottlenecking³⁷ is required—manufacturers must relaunch the permit process which usually takes six months to one year. Creating a simplified permit allocation process for minor replacements of fine chemical ingredients or slight capacity increases would reduce administrative burdens and allow manufacturers to respond more competitively to market advancements.

Recommendations

- Simplify the permit allocation process for minor recipe changes within the same product category to promote quick responses to shifting market demand and encourage innovation.
- Simplify the permit allocation process for site debottlenecking projects that aim to increase production capacity and optimise the workflow without changing the main production process or increasing emissions.

3. Chemicals Management

3.1 Develop a Well-argued and Practical Legislation Framework for Chemical Risk Management

Concern

Although the legislative framework for chemical management has become more streamlined, specific legislation for classification and labelling of new chemicals, priority chemicals and HC fail to capture the principle of proportionality for risk assessment and management.

Assessment

Regulators attach great importance to preventing HC accidents. The MEM released the Law on the Safety of Hazardous Chemicals for public comment in November 2020. In 2015, the MEM adopted the *Catalogue of*

34 Notice of the Shanghai Municipal Development and Reform Commission on Further Strengthening the Management of the Price of Bottled Liquefied Petroleum Gas for Civilians (Order No. 3), Shanghai Development and Reform Commission (DRC), 9th May 2017, viewed 1st March 2021, <http://pkulaw.cn/fulltext_form.aspx?Gid=18052366&Db=lar>

35 Notice of Shanghai Municipal Development and Reform Commission on Adjusting the Maximum Retail Price of Cylinder LPG for Civil Use, Shanghai DRC, 9th March 2021, viewed 9th March 2021, <<https://fgw.sh.gov.cn/jgl/20210309/6fef223b745c49adb82c6168b4fcca94.html>>

36 Civil Liquefied Petroleum Gas in Zhejiang Province (2021-03-02), Zhejiang Provincial Development and Reform Commission, 5th March 2021, viewed 15th March 2021, <http://fzggw.zj.gov.cn/art/2021/3/5/art_1228966734_58924950.html>

37 Debottlenecking is the process of getting more production out of existing plants and equipment by improving processes or revamping equipment. In many industries, adding production capacity with new equipment or factories is a major investment that has a significant impact on an organisation's finances. As a result, debottlenecking is often a mission critical activity, particularly when production approaches capacity: *What is Debottlenecking?*, Simplicable, 7th February 2015, viewed 2nd June 2021, <<https://simplicable.com/new/debottlenecking>>



Hazardous Chemicals to manage 2,828 chemicals with significant toxic, explosive, corrosive and/or flammable properties.³⁸ The State Council's *Regulation on Safety Management of Hazardous Chemicals* has been in place since 2002,³⁹ and updated in 2011.⁴⁰ While the working group welcomes strengthened management of HCs, overcautious management has increased the compliance burden for the whole value chain. For instance, nickel sulphate is an essential component of lithium-ion batteries and therefore crucial to China's transition to green mobility.⁴¹ Although nickel sulphate is a non-explosive HC, under Chinese legislation, all HCs have the same transportation and storage requirements. As a result, European exporters and their local import partners end up suffering unnecessary compliance costs.

The working group also notes inconsistencies in local interpretations of HC legislation. Following the 2015 Tianjin accident, only a few harbours, including Shanghai's Waigaoqiao and Yangshan ports, have allowed HC imports and exports. Although HC legislation has long prohibited certain substances from transport through 'inland waterways', sea transportation of HCs directly to/from domestic ports to/from destinations abroad was generally excluded. On 18th February 2021, less than two weeks before the Yangtze River Delta Law entered into force, however, the Shanghai authorities released the local interpretation of the Law, which included "imported/exported" chemicals in the scope of banned chemicals.⁴² This means certain chemicals can no longer be imported/exported through the Waigaoqiao port. Although companies can still use Yangshan port for HC transportation, the new interpretation has severely restrained the operations of HC importers and exporters. Therefore, the working group recommends that the Shanghai Government remove "import/export" from the ban scope to ensure that local interpretation is

in line with the general practice and business operations can continue through the two ports.

In January 2019, the MEE released its draft *Regulation on Environmental Risk Assessment and Control of Chemicals*,⁴³ the first Chinese chemical management legislation to encompass both new and existing chemicals. The draft mandates annual reporting obligations, several lists of substances for differentiated management, multiple control options, and requirements for adequate information disclosure to stakeholders. This disclosure includes lists of chemicals for priority assessment and control, as well as toxic and harmful contaminants of air, water and soil.

The development of the above 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 in order to promote science-based enforcement that avoids the stigmatisation of certain elements. The working group welcomes the MEE and the NHC's joint release of the *Framework Guidance for the Technical Approaches of Chemical Risk Assessment*,⁴⁴ which adopts science-based approaches and recognises the specificities of some substances, like metals. The EU's Risk Management Option Analysis (RMOA) could likewise serve as an example of appropriate risk management by which chemicals listed for priority assessment are not automatically subjected to priority control without additional analysis and a process for public consultation. The working group encourages the MEE to work with chemical industry stakeholders to develop RMOA guidance for effective chemical prioritisation and selection of risk management measures.

The MEE's *Order 12* went into effect on 1st January 2021, replacing the *Order 7* legislative framework.⁴⁵ Unlike in early drafts, the final version of *Order 12* does not exempt reporting new chemical substances

38 *Catalogue of Hazardous Chemicals*, Chemical Inspection and Regulation Service, 9th March 2015, viewed 1st March 2021, <http://www.cirs-reach.com/pdf/Catalog_of_Hazardous_Chemical_2015_CN.pdf>

39 *Hazardous Chemicals Safety Management Regulations*, State Council, 26th January 2002, viewed 1st March 2021, <http://www.gov.cn/gongbao/content/2002/content_61929.htm>

40 *Hazardous Chemicals Safety Management Regulations (Order No. 591 of the State Council)*, State Council, 2nd March 2011, viewed 15th April 2019, <http://www.gov.cn/jflfg/2011-03/11/content_1822902.htm>

41 *How Electric Vehicles are Driving the Nickel Sulphate Market*, Wood Mackenzie, 8th June 2020, viewed 15th March 2021, <<https://www.woodmac.com/news/opinion/how-electric-vehicles-are-driving-the-nickel-sulphate-market/>>

42 *Notice of the Shanghai Maritime Safety Administration on Implementing the "Yangtze River Protection Law" to Prohibit the Transportation of Highly Toxic Chemicals and Other Cargoes in the Shanghai Section of the Yangtze River*, Shanghai Maritime Safety Administration, 18th February 2021, viewed 25th April 2021, <<https://www.sh.msa.gov.cn/wgfw/77516.jhtml>>

43 *Notice of Public Consultation on the Regulations on Risk Assessment Chemical (Draft for Comments)*, MEE, 8th January 2019, viewed 1st March 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/201901/t20190111_689258.html>

44 *Notice regarding the issuance of the "Framework Guidelines for Technical Methods of Environmental Risk Assessment of Chemical Substances (Trial)"*, NHC, 16th September 2019, viewed 1st March 2021, <<http://www.nhc.gov.cn/jkj/s5878/201909/t52216d8dc7d434d84c54038acab6ce2.shtml>>

45 *Announcement on the Issuance of the "Guidelines for the Environmental Management Registration of New Chemical Substances" and Related Supporting Forms and Filling Instructions*, MEE, 16th November 2020, viewed 1st March 2021, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk01/202011/t20201119_808843.html>



under 0.1 metric tonnes per year for research purposes that undergo reasonable risk assessment. Reporting substances of such small volume will add to the administrative burden of chemical enterprises. For example, manufacturers often provide reagents in dosages of several milligrams, or even micrograms, to thousands of downstream users. It is not feasible to track management of these substances after registration. Moreover, the environmental exposure risk of such small amounts of new chemical substances used for laboratory research is extremely low.

Limited quantity exemption for new chemicals that undergo reasonable risk-assessment would encourage innovation and reduce the administrative burden on both enterprises and inspection bodies. Moreover, the draft Hazardous Chemicals Safety Law already includes regulations on low-volume exemptions, signalling the willingness of authorities to waive science- or risk-based requirements. The working group hopes that a detailed, specific exemption scheme for the risk assessment of HCs will be included in the final version of the law.

The working group also encourages the MEE to reduce unnecessary duplicate testing on new chemical substances and the resulting financial burden on manufacturers. *Order 12* requires that new chemical substances undergo five eco-toxicology tests on local species, and does not accept data from foreign institutions. Either reducing the number of mandatory eco-toxicology testing or accepting eco-toxicology data from studies performed in other jurisdictions would reduce costs for manufacturers.

Order 12 also limits the period for protection of confidential business information (CBI) to five years after the registration date, at which point information will be submitted to the *Inventory of Existing Chemical Substances in China* (IECSC). However, it is still unclear what will happen to substances registered under *Order 7* but not yet entered into the IECSC. Applications for extension of the CBI period will be denied if the information has appeared in “advertisement/promotional materials, publicly published materials, publicly accessible patent/research materials, database, internet and other publicly available materials or media,”⁴⁶ yet this provision is not

conducive to technology innovation and compliance registration. If a product has been registered in a foreign jurisdiction, the relevant information will be published in that jurisdiction’s database, making it ineligible for an extension of CBI protection, even if it is a new substance in China. Authorities should therefore consider allowing enterprises to use generic names when entering products into the IECSC in order to protect CBI.

The MEE has developed an online registration system for new chemical substances. Working group members hope that the online platform can be improved in order to make the registration process smoother, more efficient and more user-friendly. For example, the system currently does not allow enterprises to set up sub-accounts, which puts them at risk of exposing chemical information if using different consultants for different projects.

The online system for HC registration, which is run by the MEM’s National Registration Centre for Chemicals, should similarly be simplified. Some of the information required, such as in regard to storage, transportation, usage and emergency measures, already exists in the products’ safety data sheets. Authorities should avoid the need to duplicate information in order to reduce administrative burdens.

As a principle, the working group suggests that chemicals management align with green ambitions. There is a relationship between the risk management measures applied to substances and the ability of innovative sectors like the green economy to fully utilise the materials. A socio-economic analysis should be carried out to ensure that chemicals management does not unduly inhibit the green economy.

Recommendations

- Remove local barriers to hazardous chemicals transportation and enhance capacity building for hazardous chemicals transportation, import and export.
- Establish procedures to seek input from industry players when either developing general risk assessment guidance or assessing any specific substances.
- Advance the development of RMOA guidance to make sure key stakeholders are involved and all factors (for example, exposure scenarios, socio-economic

⁴⁶ *Guidelines for Environmental Management Registration of New Chemical Substances*, MEE, 17th November 2020, viewed 2nd June 2021, <<http://www.mee.gov.cn/xxgk/xxgk01/202011/W020201119648157169625.pdf>>



analyses, alternative availability) are considered in the decision-making process for chemicals prioritisation and risk management measures selection.

- Adjust the requirements for extending CBI protection rights under *Order 12*, and clarify the procedure and timeline for IECSC entry of substances already registered under *Order 7*.
- Reduce unnecessary duplicate testing by narrowing eco-toxicology test requirements and accepting test results from foreign institutions.
- Exempt low volumes of new chemicals and HC registration for research purposes from notification requirements.
- Simplify and improve the registration system for HC and new chemicals.
- Reduce minimum data requirements of new chemical notification to reduce costs.
- Ensure alignment between chemicals management approaches and strategic sectors like the green economy to ensure substances that enable green innovation are managed proportionately based on socio-economic considerations.

PCR
RMOA
VOC

Petrochemicals, Chemicals and Refining
Risk Management Option Analysis
Volatile Organic Compounds

Abbreviations

AICM	Association of International Chemical Manufacturer
CBI	Confidential Business Information
CIT	Corporate Income Tax
CNY	Chinese Yuan
CO ₂	Carbon Dioxide
CPCIF	China Petroleum and Chemical Industry Federation
DRC	Development and Reform Commission
EHS	Environmental, Health and Safety
ETS	Emissions Trading System
EU	European Union
HC	Hazardous Chemicals
ICCA	International Council of Chemical Associations
IECSC	Inventory of Existing Chemical Substances in China
IOC	International Oil Company
Kg	Kilogram
LPG	Liquefied Petroleum Gas
MEE	Ministry of Ecology and Environment
MEM	Ministry of Emergency Management
NHC	National Health Commission



Pharmaceutical Working Group

Key Recommendations

1. Further Advance Regulatory Harmonisation and Convergence with International Standards 🕒 2

- Strongly support the National Medical Products Administration (NMPA) in its efforts to join the PIC/S as a formal member and to provide best practice on overseas Good Manufacturing Practice audits and inspections.
- Provide enough time for manufacturers and all parties involved in the supply chain to ensure a smooth transition to international standards, starting from imported/exported drugs.
- Continue cooperation with health authorities of different countries and set up a three-party collaboration mechanism among regulators, academia and industry to pilot emerging policies and develop new international guidelines.

2. Coordinate Different Measures for Intellectual Property (IP) Protection and Ensure Their Adequate Implementation 🕒 5

- Immediately implement the six-year regulatory data protection (RDP) rule under the existing *Regulations for Implementing the Drug Administration Law*, and accelerate further improvement of the legal revision and detailed rules.
- Set up a clear timetable to launch implementation rules for RDP.
- Set up an effective patent term extension (PTE) mechanism that will be of benefit to multinational originator companies.
- Set up an effective patent linkage mechanism to balance the interests of originator companies and generics companies.
- Give the pharmaceutical industry more room to participate in the policy-making process and contribute to the formulation and successful implementation of IP protection laws and regulations, particularly relating to patent linkage and PTE.

3. Continuously Improve Rare Disease Policy to Ensure Patients' Access to Medicines 🕒 2

- Establish a central office responsible for rare diseases management to develop a national framework policy as well as clear and achievable goals for rare disease treatment.
- Set up a cross-ministerial coordination mechanism responsible for promoting the expansion of and regularly updating the *National Rare Disease Drug List*, tracking provincial rare disease drug lists, and providing a foundation for corresponding market access and reimbursement policy measures.
- Improve the availability of rare disease drugs through a specific, clear and fair evaluation system that ensures the clinical needs of patients are met.
- Encourage local authorities to evaluate and include more high-value rare disease drugs on provincial reimbursement drug lists and provide best practices for national rare disease drug security solutions in order to improve patients' access to treatment for rare diseases, especially ultra-rare diseases.
- Encourage local authorities to pilot innovative fund-raising models for rare disease patients at



provincial, municipal or county level.

- Integrate different social resources in the funding of rare disease drugs with participation of government, industrial associations and patient groups—including commercial insurance and charity funds—and combine with basic medical insurance to build a multi-layer insurance net for rare and ultra-rare disease patients.

4. Maintain Regular Listing in the National Reimbursement Drugs List (NRDL) Dynamic Updates to Promote the Medical Insurance System Reform and Introduce a Value-based Evaluation Mechanism for Innovative Drug Inclusion 🗣️ 2

- Build a transparent, evidence-based reimbursement negotiation procedure for innovative drugs to allow companies to apply for reimbursement, and set clear criteria distinguishing regular candidate selections from negotiation candidate selections.
- Allow all approved drugs to enter the candidate selection pool in the NRDL adjustment mechanism before specified NRDL update kick-off dates.
- Explore innovative payment methods, such as price-volume contract, or payment by performance.
- Establish regular communication channels with the industry throughout the regular process to allow pharmaceutical companies to address consulting experts' questions with supplemental evidence and requests for further evaluation.
- Maintain regular listing in the NRDL dynamic updates mechanism to reduce administrative costs for the government, and guide the pricing of pharmaceuticals within a reasonable range.
- Promote value-based negotiation listing in NRDL dynamic updates mechanism and allow premium price for innovative drugs, based on health economic evaluation and insurance big-data analysis, to guide and motivate industry development.
- Automatically grant a one-year extension to the two-year price negotiation contract term, provided that no new indication and generic drugs are to be launched within the year, and that the first two-year sales figures fulfil the requirements of the medical insurance fund's budget impact calculation.
- Strengthen IP protection, especially for drugs in patent validity disputes, which are still under protection of compound patent and should not be included in the NRDL.

5. 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 🗣️ 3

- Halt the biomedicine VBP conducted at provincial level, considering the high risks of treatment replacement for patients.
- Invest the funds saved through centralised drug procurement and the NRDL adjustment in the admission of innovative drugs, especially those urgently needed in clinical practice.
- Further optimise the NRDL structure and increase efficiency of using the medical insurance fund to achieve a balance between generic and original brand drugs.
- Set reasonable price competition rules and avoid awarding bids quoting extremely low prices, to increase companies' motivations to innovate and continuously improve drug quality through global price surveys and cost surveys combined with expert calculations.
- Clarify rules for substituting disqualified drugs, stringently assess the quality of the selected drugs and formulate measures to closely monitor their usage, in order to protect patients.
- Prioritise previous VBP winners for contract extension, and assess their willingness to extend





contract before organising another round of VBP.

- Develop and improve evaluation indicators to provide a comprehensive assessment of the effectiveness of the VBP and fully respect the opinions of doctors and patients based on the actual situation of clinical treatment practice.

6. Harmonise the Vaccine Policy Environment with International Standards to Improve Access to Innovative Vaccines for the Chinese Population

- Increase the availability of innovative vaccines and immunisation to the Chinese population through harmonising the regulatory environment with international standards, including but not limited to the requirements for international multi-centre clinic trial blood samples, technical guidance and pharmacopeia.
- Promote the reform of China's procurement criteria and process to include all NMPA-approved vaccines, imported and locally manufactured, for its National Immunisation Programme to enable access for more innovative vaccines and build a more sufficient and sustainable supply to address public health needs.
- Promote vaccination strategy in respiratory diseases, such as influenza, to avoid dual infection with COVID-19, and expand influenza immunisation programmes in Chinese provinces and cities.

Introduction to the Working Group

The Pharmaceutical Working Group represents 35 international pharmaceutical manufacturing companies operating in China. 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 authorities. In particular, the working group has established a sound communication channel with the Chinese medical authorities and regulators. It 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

Despite the outbreak of the coronavirus disease 2019 (COVID-19), China continued to deepen the reform of its medical and healthcare system in 2020, introducing

a series of policies and measures to encourage cost control integration and innovation. The new *Administrative Measures for Drug Registration* stipulate four channels for accelerating new drug registration: breakthrough therapeutic drugs; conditional approval; priority review and approval; and special approval procedures.¹ Meanwhile, the Chinese healthcare industry has further ambitions to be at the forefront of biopharmaceutical and digital innovation, as highlighted in the 14th Five-year Plan, to further benefit Chinese patients. The working group is impressed by the achievements of the Chinese authorities and the healthcare industry in dealing with the unprecedented public health emergency brought by COVID-19 and containing the spread of the virus in China. In order for China to achieve its goals of further improving public health and preventing future healthcare crises, the working group is committed to cooperating with the authorities and supporting the development of regulations to strengthen medicinal product supply chains, and improve Chinese patients' access to innovative products.

Several important regulations and public consultations

¹ *Administrative Measures for Drug Registration*, State Administration for Market Regulation (SAMR), 30th March 2020, viewed 6th April 2021, <http://gkml.samr.gov.cn/nsjg/fgs/202003/t20200330_313670.html>





relating to the pharmaceutical industry have been published since the second half of 2020, including:

- On 2nd July 2020, the National Medical Products Administration (NMPA) called for public consultation on the *Regulations on Administration of Drug Inspection*.²
- On 3rd August 2020, the NMPA released the *Interim Provisions on the Administration of Domestic Agents of Overseas Market Authorisation Holder (MAH) (Trial)* for public consultation.³
- On 11th September 2020, the NMPA and the China National Intellectual Property Administration (CNIPA) called for public consultation on the *Implementation Measures for the Early Settlement Mechanism for Drug Patent Disputes (Trial)*.⁴
- On 16th September 2020, the National Healthcare Security Administration (NHSA) issued the *Notice on Accelerating the Implementation of the Pharmaceutical Price and Tendering and Procurement Credit Evaluation System*.⁵
- On 30th September 2020, the NMPA published the *Administrative Measures for the Filing of Pharmaceutical Representatives (Trial)*.⁶
- On 13th October 2020, the State Administration for Market Regulation (SAMR) called for public consultation on the *Anti-monopoly Guideline for the Active Pharmaceutical Ingredients Field*.⁷
- On 18th October 2020, the National People's Congress (NPC) Standing Committee (SC) passed the fourth *Amendment of the Patent Law*.⁸
- On 28th January 2021, the State Council published the *Opinions on Promoting the Normalisation and*

Institutionalisation of Centralised and Volume-based Procurement of Drugs.⁹

The Pharmaceutical Working Group acknowledges the continuous efforts made by the Chinese authorities in the past year to improve drug review and approval processes. The working group encourages the Chinese Government to further accelerate the listing of innovative drugs during and after the COVID-19 crisis, and to continue improving access to innovative drugs for the whole population.

Key Recommendations

1. Further Advance Regulatory Harmonisation and Convergence with International Standards

Concern

The lack of harmonisation and convergence with international standards in China's overseas good manufacturing practices (GMP) audits and inspections, and of drug and vaccine traceability standards, remain top concerns of the industry.

Assessment

After China joined the International Council for Harmonisation of Technical Requirements for Pharmaceuticals for Human Use (ICH) Management Committee in 2017, the NMPA released a roadmap specifying the timelines for implementing ICH guidelines. This included making it mandatory to submit adverse events reported from clinical trials according to the ICH E2B (R3) standard for electronic data transmission. Pharmaceutical companies have been required to submit reported serious adverse events in an interim system since May 2018, and post-approval reports will be submitted via a system to be developed by July 2022.¹⁰ The draft of the *E2B (R3) Implementation Guide* customised for China (describing differences with *E2B (R3) Core Elements*) was released for public comment in May 2019 and finalised in November that same year, demonstrating that China is

2 *Call for Public Consultation on the Regulations on Administration of Drug Inspection*, NMPA, 2nd July 2020, viewed 6th April 2021, <<https://www.nmpa.gov.cn/directory/web/nmpa/xxgk/zqyj/zqjyyp/20200702151401143.html>>

3 *Call for Public Consultation on the Interim Provisions on the Administration of Domestic Agents of Overseas MAH (Trial)*, NMPA, 3rd August 2020, viewed 6th April 2021, <<https://www.nmpa.gov.cn/directory/web/nmpa/zhuanli/ypqxgg/ggzhqyj/20200803190645124.html>>

4 *Call for Public Consultation on the Implementation Measures for the Early Settlement Mechanism for Drug Patent Disputes (Trial)*, NMPA, 11th September 2020, viewed 6th April 2021, <<https://www.nmpa.gov.cn/directory/web/nmpa/xxgk/ggtg/qtggtg/20200911175627186.html>>

5 *Notice on Accelerating the Implementation of the Pharmaceutical Price and Tendering and Procurement Credit Evaluation System*, NHSA, 16th September 2020, viewed 6th April 2021, <http://www.nhsa.gov.cn/art/2020/9/16/art_37_3580.html>

6 *The Administrative Measures for the Filing of Pharmaceutical Representatives (Trial)*, NMPA, 30th September 2020, viewed 6th April 2021, <<https://www.nmpa.gov.cn/directory/web/nmpa/xxgk/ggtg/qtggtg/20200930163955170.html>>

7 *Call for Public Consultation on the Anti-monopoly Guideline for the Active Pharmaceutical Ingredients Field*, SAMR, 13th October 2020, viewed 6th April 2021, <http://www.samr.gov.cn/hd/zjdc/202010/t20201013_322278.html>

8 *NPCSC Decision on the Amendment of the Patent Law*, CNIPA, 18th October 2020, viewed 6th April 2021, <https://www.cnipa.gov.cn/art/2020/10/18/art_2197_153643.html>

9 *The State Council's Opinions on Promoting the Normalisation and Institutionalisation of Centralised and Volume-based Procurement of Drugs*, NMPA, 28th January 2021, viewed 6th April 2021, <<https://www.nmpa.gov.cn/xxgk/fgwj/qita/20210205140707156.html>>

10 *Chinese Food and Drug Authority (CFDA) Announcement on the ICH Level II Guideline*, China-Japan Pharmaceutical Information, 29th January 2018, viewed 3rd April 2021, <<http://www.cjpi.org.cn/zryyxxw/yaop/cfdatz/webinfo/2018/01/1515087120886527.htm>>





actively fulfilling its ICH commitments.^{11&12} The working group believes, this implementation of ICH guidelines in drug innovation and registration will ultimately benefit China by speeding up reviews and approvals, and strengthening the life-cycle management of drugs.

The NMPA has planned to expand overseas GMP inspections in the near future. While the industry recognises the NMPA's continuous efforts to ensure drug quality, failure to adopt internationally recognised standards in its overseas GMP audits and inspections is a major concern for the industry, as it may disadvantage European pharmaceutical companies, and ultimately limit patients' and doctors' access to high quality drugs.

The NMPA is planning to join the Pharmaceutical Inspection Cooperation Scheme (PIC/S), whose mission is to lead the international development, implementation and maintenance of harmonised GMP standards and quality systems of inspectorates in the field of medicinal products.¹³ As of June 2021, PIC/S has 54 members, including leading regulatory agencies such as the Belgian Federal Agency of Medicines and Health Products, the French National Agency for Medicines and Health Products Safety, the German Federal Ministry of Health, the United States Food and Drug Administration, the Australian Therapeutic Goods Administration, the British Medicines and Healthcare Products Regulatory Agency, and the Japanese Pharmaceuticals and Medical Devices Agency.¹⁴ By joining the PIC/S, China will have opportunities to participate in the development and harmonisation of international GMP guidelines; network and share information with other regulatory inspectors; and receive PIC/S Rapid Alert and Recall System notifications regarding quality defects of batches of medicinal products.¹⁵ Therefore, the working group fully supports the NMPA's intention to join the PIC/S.

In the wake of the outbreak of COVID-19, many new

digital technologies have been widely used to combat the pandemic; for example, digital tools that enable decentralised clinical trials, and real-world evidence (RWE) that acts as an extra control tool to enrich innovative clinical trials. The working group is pleased to see that China's Center for Drug Evaluation (CDE) set up two guidelines on RWE that are based on three-party collaboration among regulators, academia and industry. Moreover, China's and the health authorities of other countries are cooperating and collaborating on potential actions. Both of these approaches will contribute to piloting emerging policies and develop international harmonised new guidelines for tools such as RWE and advanced digital therapies.

Recommendations

- Strongly support the NMPA in its efforts to join the PIC/S as a formal member and to provide best practice on overseas GMP audits and inspections.
- Provide enough time for manufacturers and all parties involved in the supply chain to ensure a smooth transition to international standards, starting from imported/exported drugs.
- Continue cooperation with health authorities of different countries and set up a three-party collaboration mechanism among regulators, academia and industry to pilot emerging policies and develop new international guidelines.

2. Coordinate Different Measures for Intellectual Property (IP) Protection and Ensure Their Adequate Implementation



Concern

Although the pharmaceutical industry is encouraged by recent policy initiatives to improve IP protection, such as the new Patent Law,¹⁶ implementation rules may lead to inadequate patent protection or enforcement, and effective regulatory data protection (RDP) remains unenforced.

Assessment

China has actively encouraged basic research, drug discovery and clinical development in the life science industry. China is at a critical stage of development, as it is not only a generics producer but is also achieving

11 Notice on Public Consultation on the Post-Market Individual Case Safety Reports (ICSRs) E2B (R3) Implementation Guide (Draft for Comment), China Center for Food and Drug International Exchange, 31st May 2019, 3rd April 2021, <<http://www.ccpie.org/cn/yjxx/yphzp/webinfo/2019/05/1560671808241787.htm>>

12 Notice on Publishing the Post-Market Individual Case Safety Reports (ICSRs) E2B (R3) Implementation Guide, NMPA Centre for Drug Reevaluation, 22nd November 2019, viewed 3rd April 2021, <http://www.cdr-adr.org.cn/drug_1/ICHzd_1/ICH_E2B/201911/t20191122_46834.html>

13 Mission, Vision and Values, PIC/S website, viewed 10th April 2021, <<https://www.picscheme.org/en/mission-vision-and-values>>

14 Introduction of PIC/S, PIC/S website, viewed 10th April 2021, <<https://www.picscheme.org>>

15 Benefits, PIC/S website, viewed 10th April 2021, <<https://www.picscheme.org/en/benefits>>

16 Patent Law, NPC, 19th November 2020, viewed 23rd April 2021, <<http://www.npc.gov.cn/npc/c30834/202011/82354d98e70947c09dbc5e4eeb78bdf3.shtml>>





significant progress in pharmaceutical innovation. Since 2015, the former China Food and Drug Administration (CFDA) (now the NMPA) has issued a series of policies and regulations that optimise the review and approval procedures for new pharmaceutical products. 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 of an innovation-driven pharmaceutical industry.

As part of its accession to the World Trade Organization (WTO), China committed to provide RDP. However, while China's *Regulations for Implementing the Drug Administration Law* anticipate a six-year period of protection for test data of products containing a new chemical ingredient, in practice there is no mechanism in China to prevent the unfair commercial use of safety and efficacy data generated by innovative pharmaceutical companies. In the past few years, the Chinese Government has published several policies to strengthen drug IP protection. The working group is encouraged by the recent policies and the proposed amendments to the Patent Law to foster innovation and strengthen IP protection. The working group believes that establishing a multilevel protection mechanism, which encompasses patents and RDP, will help China become a medical power and a major pharmaceutical innovator.

However, despite these encouraging legal and policy developments, drug innovators have been deeply concerned about the continuous approvals of generic drugs by the NMPA before the expiration of the respective compound patents, and the lack of timely legal remedies for patent holders. Over 10 generic drugs have been approved by the NMPA since 2019 even though the originators' patents were still in force. Some of the approved generics attempted business-related activities, such as listing in provinces, participation in centralised procurement and inclusion as candidates for the National Reimbursement Drug List (NRDL). These activities cause originator companies great unease. At time of writing, namely May to June 2021, the patent linkage and patent term extension (PTE) rules to be included in the fourth revision of the Patent Law were not yet published. In addition, the draft implementation rules regarding the scope of and procedure for patent linkage and the PTE are very concerning to the working group, as members are

uncertain whether multinational originator companies can benefit from these policies. The working group recommends the draft implementation rules be clarified and refined, and an effective patent linkage system that balances the interest of all parties be established. It also strongly recommends setting up a clear timetable regarding the RDP.

In the process of forming a multi-level protection mechanism, the working group would also like to see greater opportunities for providing feedback and contributing to the formulation and successful implementation of IP protection rules and regulations.

Recommendations

- Immediately implement the six-year RDP rule under the existing *Regulations for Implementing the Drug Administration Law*, and accelerate further improvement of the legal revision and detailed rules.
- Set up a clear timetable to launch implementation rules for RDP.
- Set up an effective PTE mechanism that will be of benefit to multinational originator companies.
- Set up an effective patent linkage mechanism to balance the interests of originator companies and generics companies.
- Give the pharmaceutical industry more room to participate in the policy-making process and contribute to the formulation and successful implementation of IP protection laws and regulations, particularly relating to patent linkage and PTE.

3. Continuously Improve Rare Disease Policy to Ensure Patients' Access to Medicines 1

Concern

Patients with rare diseases in China still have limited access to care due to inadequate funding and drug availability.

Assessment

To increase patient access to innovative drugs, in 2018, the NMPA CDE published the *First Batch of Overseas New Drugs Urgently Needed in Clinical Settings*, which includes 40 drugs.¹⁷ In 2019, a second list with an additional 26 drugs was released, which includes 17

¹⁷ Notice on the Publication of the First Batch of Overseas New Drugs Urgently Needed in Clinical Settings, CDE, 1st November 2018, viewed 10th April 2021, <<http://www.cde.org.cn/news.do?method=largeInfo&id=c059310700b4b383>>





rare disease drugs.¹⁸ Inclusion on these lists resulted in 15 out of the 66 drugs—of which four were rare disease drugs—receiving regulatory approval in less than 10 months. In addition, the *Drug Registration Administrative Measures* made innovative and rare disease drugs eligible for priority review and approval, effective since 1st July 2020.¹⁹ While such policies have improved rare disease drug availability, patients still encounter significant gaps in hospitals' rare disease diagnosis capabilities and, most importantly, affordability of treatment.

The *National Rare Disease List*—which includes 121 rare diseases—has not been updated or expanded since first issued by the National Health Commission (NHC) in 2018.²⁰ This limits the formation of other regulations relating to the capacity-building of rare disease diagnosis and treatment, recognition and reimbursement of rare disease drugs, and tax reduction on such drugs. In addition, while some high-value rare disease drugs were included in the NRDL assessment, none were given reimbursement status.

To allow greater access to treatment for rare diseases patients, the working group suggests the *National Rare Disease List* and the *Batch of Overseas New Drugs Urgently Needed in Clinical Settings* be expanded to include more diseases and additional innovative drugs. To do so, the regulators will need to clarify the criteria for selection for both lists, taking industry feedback into account.

On 28th December 2020, the NHC released the updated version of the NRDL, to which 119 new drugs were added and 29 removed. Among the 119 newly included drugs, seven are rare disease drugs.²¹

A further very encouraging sign is that patients from several provinces in China are now benefitting from the inclusion of several high-value rare disease medicines on provincial reimbursement drug lists. The working

group encourages more provinces to pilot the high-value orphan drug reimbursement scheme to improve the affordability of rare disease therapies for Chinese patients. This is a positive move to improve the affordability of rare disease treatments, and new drugs shall continuously be added to the reimbursement list. However, the current reimbursement policy only covers 70 to 80 per cent of the drug expenses across China, and most patients still cannot afford treatment, especially high-value rare disease drugs. This translates into high levels of out-of-pocket expenditure for rare disease patients. To further alleviate the burden on patients, the funding of rare disease drugs will not only need to leverage basic medical insurance (BMI), but also additional resources, such as commercial insurance and charity funds.

Lastly, as rare disease-related matters are managed by different ministries, the working group recommends setting up a cross-ministerial coordination mechanism responsible for regularly updating the rare disease drug list, and providing a foundation for corresponding market access and reimbursement policy measures.

Recommendations

- Establish a central office responsible for rare diseases management to develop a national framework policy as well as clear and achievable goals for rare disease treatment.
- Set up a cross-ministerial coordination mechanism responsible for promoting the expansion of and regularly updating the *National Rare Disease Drug List*, tracking provincial rare disease drug lists, and providing a foundation for corresponding market access and reimbursement policy measures.
- Improve the availability of rare disease drugs through a specific, clear and fair evaluation system that ensures the clinical needs of patients are met.
- Encourage local authorities to evaluate and include more high-value rare disease drugs on provincial reimbursement drug lists and provide best practices for national rare disease drug security solutions in order to improve patients' access to treatment for rare diseases, especially ultra-rare diseases.
- Encourage local authorities to pilot innovative fund-raising models for rare disease patients at provincial, municipal or county level.
- Integrate different social resources in the funding of rare disease drugs with participation of government, industrial associations and patient group—including

18 *Notice on the Publication of the Second Batch of Overseas New Drugs Urgently Needed in Clinical Settings*, CDE, 29th May 2019, viewed 10th April 2021, <<http://www.cde.org.cn/news.do?method=largeInfo&id=8ed064bd7e51fe68>>

19 *Administrative Measures of Drug Registration*, SAMR, 30th March 2020, viewed 3rd April 2021, <http://gkml.samr.gov.cn/nsjg/fgs/202003/t20200330_313670.html>

20 *Notice on the Publication of the First National Rare Disease List*, NHC, 8th June 2018, viewed 13th April 2021, <<http://www.nhc.gov.cn/zygj/s7659/201806/393a9a37f39c4b458d6e830f40a4bb99.shtml>>

21 *New Version of the NRDL Officially Implemented and Seven New Rare Diseases Included*, Xinhua, 3rd March 2021, viewed 8th May 2021, <http://www.xinhuanet.com/fortune/2021-03/03/c_1127160060.htm>



commercial insurance and charity funds—and combine with BMI to build a multi-layer insurance net for rare and ultra-rare disease patients.

4. Maintain Regular Listing in the NRDL Dynamic Updates to Promote the Medical Insurance System Reform and Introduce a Value-based Evaluation Mechanism for Innovative Drug Inclusion 2

Concern

Price control has become the core of China's drug pricing mechanism, including NRDL negotiation and drug procurement, which negatively impacts innovation.

Assessment

On 5th March 2020, the State Council unveiled the *Opinions on Deepening the Medical Insurance System Reform*.²² The objective of the reform is to establish by 2030 a medical security system that is centred on BMI and is underpinned by medical aid. The *Opinions* call for improvement of the medical treatment insurance mechanism, establishment of financing methods, monitoring of medical insurance payment and funds, and promotion of supply-side reform of medical services.

The working group is pleased by the Chinese Government's efforts to improve patient access to innovative, safe and affordable treatment and believes that the State Council's commitment to further open up the medical insurance system will alleviate the financial burden on patients at a faster pace.

However, while drugs that previously failed to be added to the NRDL can now reapply in following years, there is no mechanism allowing all approved drugs to enter the candidate selection pool before specified NRDL update kick-off dates, and no clear criteria distinguishing regular candidate selections from negotiation candidate selections.²³

The working group recommends building a clear,

evidence-based reimbursement negotiation procedure for innovative drugs. Likewise, establishing regular communication channels with the industry would be of much benefit to the annual dynamic updates of the NRDL, as it would allow the industry to address with supplementary evidence any questions from NHSA experts that arise or to carry out further evaluations.

Moreover, the working group recommends granting a one-year extension to the two-year price negotiation contract term, on condition that no new indication or generic drugs are to be launched within the year, and that the sales from the first two years fulfil the requirements of the medical insurance fund's budget impact calculation.

At present, price is still the main factor for success in drug procurement and the NRDL negotiations. In procurement and bidding, the difference between the value and quality of drugs, and the drug manufacturer's capability to accommodate the resulting demand if selected, should be taken into account. Scientific drug evaluation requires supporting data evidence to adequately measure the value a drug can generate for patients, healthcare systems and society. Therefore, policies such as centralised drug procurement and access to the NRDL negotiations should be based on the results of such value assessments, and innovative drugs should get premium prices, which will in turn stimulate innovation.

Taking oncology drugs as an example, the smooth renewal of the drug negotiated after expiration of the agreement is crucial in terms of medication continuity for the oncology patient group. In addition, the process and method of renewal will affect the industry's expectations on the return from innovative drugs. The NHSA has explored more simplified assessment process and renewal methods, including recommendations such as publicising the conditions and rules for the adjustment of payment standards, enhancing transparency and creating guidelines for smooth renewals.

The exclusivity of patent drugs should be fully taken into account in health insurance access policies to maintain fairness and prevent patent infringement. Since the end of 2018, a number of generic drugs have obtained marketing approval from the NMPA while the original brand drugs are still within patent term. Some generic drugs with marketing approval then appeared in the

²² *Opinions on Deepening Medical Insurance System Reform*, State Council, 5th March 2020, viewed 10th April 2021, <http://www.gov.cn/zhengce/2020-03/05/content_5487407.htm>

²³ Negotiation access refers to exclusive patent drugs with high clinical value, but of high price or great influence on the medical fund. For these patent drugs to be included in the NRDL, they must pass an expert evaluation, and form a national unified payment standard negotiated by experts and enterprises. Regular access refers to non-exclusive drugs that are directly included in the NRDL.





NRDL; several even passed the formality examination stage to become 'new generic drugs'. This has a direct and significant impact on patented drugs market access to hospitals, while also tacitly allowing and even encouraging patent infringement. The working group suggests that, while the pharmaceutical industry awaits the implementation of the new Patent Law, drug patents should be protected during the medical insurance negotiation. Generic drugs should not be listed in the NRDL while the original drug's patent term is still valid, in order to fully reflect market exclusivity. Moreover, generic products of patented drugs should not be listed in provincial procurement networks or included in the volume-based procurement (VBP) list before the final judicial decision on patent infringement takes effect.

From 1st March 2021, the 2020 NRDL went into effect on a national level. The working group suggests the following:

- Further accelerate the implementation of the 2020 NRDL by opening channels to hospitals, ensuring the use of negotiated drugs is not affected by proportion or total amount controls.
- Formulate targeted payment policies, such as the inclusion of drugs in outpatient payment system, setting an appropriate payment ratio and capping line to improve patients' coverage.
- Further encourage the designation of pharmacies to deal with special drugs under medical insurance, so that patients can benefit from the policy as soon as possible.

Lastly, more innovative payment methods should be considered, and as the financial burden on public medical insurance funds continues to grow, the working group further promotes 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 promoting 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 drug and medical treatment that are within the government policy's scope of self-payment. The system should allow patients to reimburse their personal BMI accounts

by purchasing commercial insurance, thus securing patients' right to choose different medicines. This would facilitate treatment access and increase affordability for patients, in particular rare and ultra-rare diseases patients, who often face the highest out-of-pocket costs.

Recommendations

- Build a transparent, evidence-based reimbursement negotiation procedure for innovative drugs to allow companies to apply for reimbursement, and set clear criteria distinguishing regular candidate selections from negotiation candidate selections.
- Allow all approved drugs to enter the candidate selection pool in the NRDL adjustment mechanism before specified NRDL update kick-off dates.
- Explore innovative payment methods, such as price-volume contract, or payment by performance.
- Establish regular communication channels with the industry throughout the regular process to allow pharmaceutical companies to address consulting experts' questions with supplemental evidence and requests for further evaluation.
- Maintain regular listing in the NRDL dynamic updates mechanism to reduce administrative costs for the government, and guide the pricing of pharmaceuticals within a reasonable range.
- Promote value-based negotiation listing in NRDL dynamic updates mechanism and allow premium price for innovative drugs, based on health economic evaluation and insurance big-data analysis, to guide and motivate industry development.
- Automatically grant a one-year extension to the two-year price negotiation contract term, provided that no new indication and generic drugs are to be launched within the year, and that the first two-year sales figures fulfil the requirements of the medical insurance fund's budget impact calculation.
- Strengthen IP protection, especially the drugs in patent validity dispute which are still under protection of compound patent should not be included in the NRDL.

5. 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, problems in drug selection, procurement and quality supervision have impacted both patients' and doctors' access to drugs, and taken a strong toll on market competition.

Assessment

On 25th February 2020, the State Council issued *Opinions on Deepening the Reform of the Healthcare Security System (Opinions)*, aiming to further reduce the burden of medical expenses on Chinese patients.²⁴ According to the *Opinions*, a mature healthcare security system will be established by 2025 with the completion of the key reform tasks in medical insurance payment, medical insurance fund supervision and medical service supply. The industry hence expects the first phase of VBP to be finalised by 2025, and more VBPs to be carried out afterwards.

On 28th January 2021, the State Council published the *Opinions on Promoting the Normalisation and Institutionalisation of Centralised and Volume-based Procurement of Drugs*, emphasising the full use of the strategic purchasing role of medical insurance funds.²⁵ Through adopting a series of policy measures, coordination mechanisms and working mechanisms, the policy aims to normalise and institutionalise the promotion of centralised drug purchases, and improve the pricing mechanism to ultimately benefit the general public.

According to Chinese state media, the VBP reform saved over Chinese yuan (CNY) 100 billion by the end of 2020.²⁶ The working group fully supports the government's goal of reducing patients' financial burdens. However, the working group also notes that the share of patented innovative drugs used in VBP is still low in comparison to the international market, and that many regional VBPs involve generic drugs that have not passed the Generic Quality Consistency Evaluation (GQCE). The procured drugs are intended for use in the treatment of digestive tract diseases, diabetes, hypertension, anti-infection, cardiovascular

disease and other conditions. As a result of official negotiations, price limiting by the government and competing with other market players, some regions chose the lowest priced drugs without considering the clinical effect and without a clear and scientific price competition mechanism. A mature and scientific-effectiveness evaluation system on VBP is also lacking.

With regards to biologic medicines, such VBP and other 'forced-switch' policies carried out without GQCE and other supporting measures could put patients at even greater risk, due to the high complexity of biologics and the diseases they treat.

In addition, in cases where a tender-winning drug in the first round of VBP was subsequently disqualified due to quality issues, the rules for substituting disqualified drugs remain unclear. Therefore, the working group recommends that the relevant government authorities stringently assess the quality of the selected drugs and formulate measures for subsequent monitoring in order to protect patients during VBP. Otherwise, there will be no mechanism available to grant contract extension for previously qualified VBP winners, which constitutes good clinical practice.

Recommendations

- Halt the biomedicine VBP conducted at provincial level, considering the high risks of treatment replacement for patients.
- Invest the funds saved through centralised drug procurement and the NDRL adjustment in the admission of innovative drugs, especially those urgently needed in clinical practice.
- Further optimise the NRDL structure and increase efficiency of using the medical insurance fund to achieve a balance between generic and original brand drugs.
- Set reasonable price competition rules and avoid awarding bids quoting extremely low prices, to increase companies' motivations to innovate and continuously improve drug quality through global price surveys and cost surveys combined with expert calculations.
- Clarify rules for substituting disqualified drugs, stringently assess the quality of the selected drugs and formulate measures to closely monitor their usage, in order to protect patients.
- Prioritise previous VBP winners for contract extension, and assess their willingness to extend contract

²⁴ *State Council's Opinions on Deepening the Reform of Healthcare Security System*, State Council, 5th March 2020, viewed 10th April 2020, <http://www.gov.cn/zhengce/2020-03/05/content_5487407.htm>

²⁵ *The State Council's Opinions on Promoting the Normalization and Institutionalization of Centralized and Volume-based Procurement of Drugs*, NMPA, 28th January 2021, viewed 6th April 2021, <<https://www.nmpa.gov.cn/xxgk/fgwj/qita/20210205140707156.html>>

²⁶ *The Cost Saving of VBP of Drugs Exceeds CNY 100 Billion*, State Council, 29th January 2021, viewed 8th May, 2021, <http://www.gov.cn/zhengce/2021-01/29/content_5583664.htm>





before organising another round of VBP.

- Develop and improve evaluation indicators to provide a comprehensive assessment of the effectiveness of the VBP and fully respect the opinions of doctors and patients based on the actual situation of clinical treatment practice.

6. Harmonise the Vaccine Policy Environment with International Standards to Improve Access to Innovative Vaccines for the Chinese Population

Concern

The current vaccine policy environment in China is not harmonised with international standards (such as registration process, Chinese Pharmacopoeia (ChP)), and opportunities for dynamic adjustment access to the National Immunisation Programme (NIP) is lacking.

Assessment

'Prevention first' serves as one of the core strategies of national Healthy China initiatives. With COVID-19 having become a global health concern, the Chinese Government has prioritised reforming the national disease control system and strengthening vaccine R&D capabilities. These priorities were also highlighted in the 14th Five-year Plan and long-ranging goals for 2035 and during the 2021 sessions of the NPC and the Chinese People's Political Consultative Conference.

On 13th May 2021, China announced the establishment of the National Disease Prevention and Control Bureau. Although the overall structure and detailed roles and responsibilities of the Bureau have not been clarified, its establishment shows that disease prevention and control has been placed high on the national political agenda. In addition, the authorities have announced relevant new legislation that will aim to reinforce pandemic prevention and response capabilities, and enhance technology innovation capacity. These include the Public Health Emergency Response Law listed in the NPCSC 2021 Legislative Work Plan²⁷ and the Infectious Disease Prevention and Control Law currently under revision by the NHC.²⁸

27 2021 Legislative Work Plan of the NPCSC, NPC, 21st April 2021, viewed 8th May 2021, <<http://www.npc.gov.cn/npc/c30834/202104/1968af4c85c246069ef3e8ab36f58d0c.shtml>>

28 Notice on Public Consultation on the Infectious Diseases Prevention and Control (Revised Draft for Comments), NHC, 2nd October 2020, viewed 8th May 2021, <<http://www.nhc.gov.cn/wjw/yjzj/202010/330ecbd72c3940408c3e5a49e8651343.shtml>>

While the working group welcomes these development, it expects to see further regulatory changes to foster the growth of the domestic vaccine industry. China has actively participated in global initiatives in fighting COVID-19, especially in contributing to COVID-19 vaccine development and supply. In this context, the harmonisation of China's vaccine regulatory framework with international standards will not only help Chinese people get quicker access to more innovative vaccines, but also support the expansion of China-manufactured vaccines into global markets. Chinese authorities have made efforts to speed up the registration and approval process for vaccines. However, the length of the process remains challenging, and affects the simultaneous global development of vaccines. The working group also expects that China will develop detailed implementation guidelines for the Public Health Emergency Response Law and the Infectious Disease Prevention and Control Law, in particular regarding requirements on international multi-centre trial (IMCT) blood samples, technical guidance and pharmacopoeia, among others.

In addition, procurement of NIP vaccines is open to domestically produced products only. Imported vaccines that are safe, urgently-needed and affordable should be included in the NIPs – thereby improving access and sustainable supply of innovative vaccines.

Due to differences between the ChP and international standards, imported biological products—including vaccines, monoclonal antibodies or insulin—are subject to additional testing or requirements. The working group suggests including experts from foreign-invested pharmaceutical manufacturers to participate in the ChP committee, which would help bring more innovative vaccines to China, as well as to expand Chinese products abroad.

Lastly, in the context of COVID-19, the prevention and control of other respiratory diseases is also key for health authorities globally. Promoting vaccination against other respiratory diseases, such as influenza, and expanding immunisation programmes to more Chinese provinces and cities will help avoid dual infection with COVID-19.

Recommendations

- Increase the availability of innovative vaccines and immunisation to the Chinese population through





harmonising the regulatory environment with international standards, including but not limited to the requirements for IMCT blood samples, technical guidance and pharmacopeia.

- Promote the reform of 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.
- Promote vaccination strategy in respiratory diseases, such as influenza, to avoid dual infection with COVID-19, and expand influenza immunisation programmes in Chinese provinces and cities.

Abbreviations

BMI	Basic Medical Insurance
CDE	Centre for Drug Evaluation
CFDA	China Food and Drug Administration
ChP	Chinese Pharmacopeia
CNIPA	China National Intellectual Property Administration
COVID-19	Coronavirus Disease 2019
GMP	Good Manufacturing Practices
GQCE	Generic Quality Consistency Evaluation
ICH	International Conference on Harmonization of Technical Requirements for Registration of Pharmaceuticals for Human Use
IMCT	International Multi-centres Clinic Trial
IP	Intellectual Property
MAH	Market Authorisation Holder
NHC	National Health Commission
NHSA	National Healthcare Security Administration
NIP	National Immunisation Programme
NMPA	National Medical Products Administration
NPC	National People's Congress
NRDL	National Reimbursement Drug List
PIC/S	Pharmaceutical Inspection Cooperation Scheme
PTE	Patent Term Extension
R&D	Research and Development
RDP	Regulatory Data Protection
RWE	Real-world Evidence
SAMR	State Administration for Market Regulation
VBP	Volume-based Procurement
WTO	World Trade Organization





Rail Working Group

Key Recommendations

1. Continue to Expand Market Access and Strengthen Fair Competition in the Rail Industry

- Recognise that foreign-invested enterprises' (FIEs') and joint ventures' (JVs') technologies meet "autonomous and controllable" requirements, in line with the Foreign Investment Law's intent to treat all company entity equally:
 - Ensure full participation of FIEs and JVs in new construction and after-sales service projects in China's 'large rail' and 'urban rail' markets.
 - Encourage innovation of different market entities to continuously improve product quality, service, technology and safety in the rail industry.
 - Ensure fair competition with domestic enterprises.
- Remove barriers in the field of bidding, and treat all market entities fairly.

2. Increase the Participation of FIEs and Utilise their Advantages in National Initiatives Such as 'New Infrastructure' and the Belt and Road Initiative (BRI) in Order to Boost the Economy

- Establish a dialogue mechanism to take into account the views of FIEs in China when formulating national initiatives such as 'new infrastructure' and the BRI, and when implementing plans.
- Provide more support on innovation and research and development for FIEs.

3. Promote the Adoption and Absorption of FIEs' Advanced Technologies in the Rail Industry in Order to Help the Formulation of Domestic Standards and Technical Specifications, and Improve the Participation of FIEs in and Transparency of the Formulation Process

- Provide equal access to all companies legally registered in China to participate in the standardisation activities of relevant technical committees or working groups, and give them the right to vote.
- Encourage the adoption of advanced technologies in Chinese standards and their convergence with international standards.
- Accelerate the modernisation level of the rail standards system, to make it fair, reasonable, inclusive and transparent, and make the extensive participation of stakeholders in the standards-setting process an important evaluation indicator.
- Regulate the standardisation activities of social organisations, and recognise standards of social organisations as national standards or industry standards before applying them to the product certification system.

4. Improve the Rail Industry Supply Chain through Improved Protection of Intellectual Property Rights (IPR)

- Protect IPR in order to encourage increased investment in the rail industry and to foster the participation of small and medium-sized enterprises in the supply chain.



Introduction to the Working Group

The Rail Working Group consists of manufacturers of vehicles, infrastructure, signal, traction and braking systems, as well as service providers, in the rail industry. The working group represents the common interests of the European rail industry, focusing on issues such as market access and fair competition, participation in national and third-country infrastructure projects and standardisation activities.

Recent Developments

China's rail industry has grown rapidly in the last few years. According to the Ministry of Transport (MOT), during the 13th Five-year Plan period, from 2016 to 2020, China's total operating railway network reached 146,000 kilometres (km), covering 99 per cent of cities with a population of more than 200,000 people. The total length of high-speed rail is about 38,000 km, ranking first in the world and covering 95 per cent of China's cities with a population of one million or above.¹ As of the end of 2020, urban rail operates in 45 cities across China, with an operating length of 7,978.18 km.² This includes subways, which, at 6,302.79 km, accounts for 79 per cent of the total length. Compared with developed countries, China's rail industry still has a lot of room for development.

The Chinese Government attaches great importance to the development of its rail industry, and has issued a series of national guiding policies and documents supporting the construction of 'new infrastructure' to develop "a country with a strong transportation network".³ On 11th March 2021, the National People's Congress (NPC) adopted the *14th Five-year Plan for National Economic and Social Development of the People's Republic of China and the Outline of Long-Term Goals for 2035* (14FYP),⁴ which, among other things, states China's intention to "speed up the construction of a country with a strong transportation

network, by building a modern and comprehensive transportation system, and promoting the integrated development of various modes of transportation, and improving the network effect and operational efficiency". The 14FYP includes the planning of 'strategic backbone' channels,⁵ high-speed railway, ordinary railway, urban agglomeration and urban rail transportation.

At the Fifth Plenary Session of the 19th Central Committee of the Communist Party of China (CPC) in October 2020, President Xi Jinping emphasised the need to "coordinate the advancement of infrastructure construction and accelerate China's construction towards a transportation powerhouse". In August 2020, the China Railway Corporation released the *Outline of Advanced Railway Planning Towards Becoming a Transport Powerhouse in the New Era*, which described the two main goals for 2035 and 2050:⁶

- building a strong and modernised transportation system that is internationally advanced by 2035; and
- becoming an important player in global railway development and an important participant in the formulation of the global railway standards by 2050.

In addition to supporting the rapid development of the rail industry, the Chinese Government has also issued related requirements for state-owned enterprises (SOEs), as part of the implementation of its three-year reform plan for the public sector. One of the stated goals is for SOEs to further strengthen overseas outreach and cross-border acquisitions, with a focus on the integration and development of enterprises.⁷ With these supportive policies, the working group believes foreign-invested enterprises (FIEs) and SOEs will be able to achieve better cooperate and create win-win situations for the rail industry.

The working group is very optimistic about the potential

1 State Council Information Office Holds a Press Conference on the Development Achievements of the 13th Five-Year Plan, MOT, 22nd October 2020, viewed 2nd November 2020, <<http://www.mot.gov.cn/2020wangshangzhibo/shisanwufzcj/>>

2 Association Express: Overview of Urban Rail Transit Routes in Mainland China in 2020, China Association of Metros, 4th January 2021, viewed 9th April 2021, <<https://www.camet.org.cn/mzzx/7422>>

3 The CPC Central Committee and the State Council Issued the Programme of Building National Strength in Transportation, Central People's Government of the People's Republic of China (PRC), 19th September 2019, viewed 30th October 2020, <http://www.gov.cn/zhengce/2019-09/19/content_5431432.htm>

4 14th Five-year Plan for National Economic and Social Development of the People's Republic of China and the Outline of Long-Term Goals for 2035, Central People's Government of the PRC, 13th March 2021, viewed 13th April 2021, <http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm>

5 China's strategic backbone channels include: exit and entry channels of Xinjiang and Tibet, central and western region channels, river and coastal channels, 14FYP and the Outline of Long Term Goals for 2035 Proposed to Speed up the Construction of a Country with a Strong Transportation Network and Improving the Network Effect and Operational Efficiency, MOT, 8th March 2021, viewed 19th May 2021, <https://www.mot.gov.cn/jiaotongyaowen/202103/t20210308_3529817.html>

6 Outline of Advanced Railway Planning Towards Becoming a Transport Powerhouse in the New Era, China Railway Corporation, 13th August 2020, viewed 30th October 2020, <http://www.china-railway.com.cn/xwzx/rdzt/ghgy/mtbd/202008/t20200813_107702.html>

7 The Three-year Reform of State-owned Enterprises Focusing on Scientific and Technological Innovation Has Been Launched, Central People's Government of the PRC, 12th March 2021, viewed 8th April 2021, <http://www.gov.cn/xinwen/2021-03/12/content_5592630.htm>





of China's rail industry. The working group believes that SOEs and Chinese government authorities should cooperate with FIEs in a more open manner, and that the successful development of the industry will depend upon the support of international advanced technology and the full participation of FIEs.

Key Recommendations

1. Continue to Expand Market Access and Strengthen Fair Competition in the Rail Industry

Concerns

Wholly foreign-owned enterprises (WFOEs) and joint ventures (JVs) controlled by foreign investors are at a disadvantage to domestic enterprises under the requirement for "autonomous and controllable" technology in the Chinese rail industry.

Assessment

Market access restrictions are still a major problem for FIEs wanting to enter China's rail industry. The *European Business in China Business Confidence Survey 2021* (BCS) published by the European Chamber found that 45 per cent of respondents missed out on business opportunities due to market access restrictions, a figure that has stayed much the same for the past six years.⁸ In addition, in recent years, the concept for technology in China to be "autonomous and controllable" has been mentioned frequently in important industry documents. In November 2017, the National Development and Reform Commission (NDRC) issued the *Three-Year Action Plan on Enhancing Core Competitiveness in the Manufacturing Sector (2018–2020)*, which says it is necessary to "develop products that are internationally advanced and that have independent intellectual property rights" to realise the "industrialisation of key rail equipment technologies".⁹ One of the development goals stipulated in the *Outline of Advanced Railway Planning Towards Becoming a Transport Powerhouse in the New Era (Outline)*, issued by the China Railway Corporation on 12th August 2020, is to "develop advanced and

independent technology through innovation"; that is, to "improve the independent innovation capacity and the level of industry chain modernisation of railways, improve the science and technology innovation systems of railways, and ensure that the key core technology and equipment is autonomous and controllable, advanced, suitable, safe and efficient."¹⁰ Furthermore, the Central Economic Work Conference, held in Beijing from 16th to 18th December 2020, identified the government's priorities for 2021, with "enhancing the autonomous and controllable ability of industrial and supply chains" being the second item on the list.¹¹

The working group fully understands China's determination to enhance the security of industrial and supply chains, particularly in an increasingly complex global environment, and FIEs are willing to support this policy by utilising their own technological advantages and localisation strategies. However, the process of formulating and implementing specific policies in the rail industry often follows a 'one-size-fits-all' approach, which excludes FIEs and JVs controlled by foreign investors on the grounds of upholding the "autonomous and controllable" policy. This puts FIEs at a distinct disadvantage, whereby they are unable to compete fairly with domestic enterprises. This happens particularly frequently in new construction and after-sales projects for railways, urban rail and subways. For example, when participating in the bidding of rail projects, in a 100-point scoring system, WFOEs and JVs controlled by foreign investors often receive zero points in the category of 'localisation', and only JVs controlled by a Chinese entity can receive one point. The working group believes that this is contrary to the legislative spirit of the Foreign Investment Law, which "encourage[s] further open[ing] up, actively promote[s] foreign investment, and protect[s] the legal rights and interests of foreign investment."¹² At the same time, it prevents WFOEs and JVs controlled by foreign investors from better integrating into the China's 'dual circulation' strategy.

¹⁰ *Outline of Advanced Railway Planning Towards Becoming a Transport Powerhouse in the New Era*, China Railway Corporation, 12th August 2020, viewed 11th April 2021, <http://www.china-railway.com.cn/xwzx/rdzt/ghgy/gqyw/202008/t20200812_107636.html>

¹¹ *Central Economic Work Conference Held in Beijing, Xi Jinping and Li Keqiang Made Important Speeches, Li Zhanshu, Wang Yang, Wang Huning, Zhao Leji and Han Zheng Attended the Meeting*, Xinhuanet, 18th December 2020, viewed 11th April 2021, <http://www.xinhuanet.com/politics/leaders/2020-12/18/c_1126879325.htm>

¹² *Foreign Investment Law*, NPC of the PRC, 15th March 2019, viewed 30th April 2021, <http://www.npc.gov.cn/zgrdw/npc/xinwen/2019-03/15/content_2083532.htm>

⁸ *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, <<https://www.europeanchamber.com.cn/cms/page/en/publications-business-confidence-survey/368>>

⁹ *Notice by the National Development and Reform Commission on the Three-Year Action Plan on Enhancing Core Competitiveness in the Manufacturing Sector (2018–2020)*, Central People's Government of the PRC, 29th November 2017, viewed 30th October 2020, <http://www.gov.cn/xinwen/2017-11/29/content_5243125.htm>





FIEs and JVs have both made important contributions to China's economy for many years through their technological advantages, innovation, international vision and localisation of operations. At the Joint Meeting for Members of the Economic Community of the Chinese People's Political Consultative Conference (CPPCC) during the 2021 Two Sessions, Premier Li Keqiang emphasised that while "the safety and stability of industrial and supply chains need to be ensured in the process of opening up", it would "not be a closed-door process" and that there is a "need to utilise the both international and domestic markets as well as resources."¹³ The working group supports this sentiment. With China having deeply integrated into the global economy, it is not possible to increase domestic demand without the coordination and support of international industrial and supply chains, which requires cooperation and competition with FIEs.

The working group noted the NDRC's September 2020 release of the *Notice of Further Regulating the Examination of the Business Qualifications of Enterprises in the Process of Bid Invitation and Bidding (Notice)*, which refers to "removing all kinds of hidden barriers and unreasonable thresholds in the field of bidding and tendering, maintaining the business environment of fair competition in bidding and tendering", and "fair treatment for all kinds of market players".¹⁴ The working group hopes that the contents of the *Notice* will be thoroughly implemented.

Recommendations

- Recognise that FIEs' and JVs' technologies meet "autonomous and controllable" requirements, in line with the Foreign Investment Law's intent to treat all company entities equally:
 - Ensure full participation of FIEs and JVs in new construction and after-sales service projects in China's 'large rail' and 'urban rail' markets.
 - Encourage innovation of different market entities to continuously improve product quality, service, technology and safety in the rail industry.
 - Ensure fair competition with domestic enterprises.

¹³ Li Keqiang: *Guarantee the Security and Stability of Industrial Chain Supply Chain in Opening Up*, State Council, 7th March 2021, viewed 11th April 2021, <http://www.gov.cn/xinwen/2021-03/07/content_5591040.htm>

¹⁴ *Notice by the General Office of the National Development and Reform Commission and the General Office of the State Administration for Market Regulation of Further Regulating the Examination of the Business Qualifications of Enterprises in the Process of Bid Invitation and Bidding*, NDRC, 22nd September 2020, viewed 30th March 2021, <https://www.ndrc.gov.cn/xxgk/zcfb/tz/202009/t20200928_1239758_ext.html>

- Remove barriers in the field of bidding, and treat all market entities fairly.

2. Increase the Participation of FIEs and Utilise their Advantages in National Initiatives Such as 'New Infrastructure' and the Belt and Road Initiative (BRI) in Order to Boost the Economy

Concerns

In the rail industry, China's national initiatives are significant for rail product manufacturers, yet the level of foreign participation is currently relatively low and the advantages of FIEs are not fully utilised or acknowledged.

Assessment

Since its announcement, the BRI has introduced new opportunities across the Eurasian continent. It provides more regional opportunities for multinational enterprises to invest and develop in China, and also has the potential to enhance the scope of and opportunities for cooperation between FIEs and Chinese enterprises, which is conducive to the formation of complementary advantages and increasing economic benefits. However, there is currently a distinct lack of involvement of European players in the BRI.¹⁵ The working group believes that allowing more European companies to participate in the BRI and other national strategies will help to raise the quality and feasibility of rail projects, through increased competition and the introduction of world-class technologies and services. Many European companies are very advanced in upgrading rail products and generating innovations. They also have inherent advantages in running cross-cultural operations and a solid track record of implementing complex infrastructure projects in other countries. The working group believes that, if provided equal treatment and equal access to research and development (R&D) funding of the domestic companies, European companies can further accelerate the development of China's rail industry, in line with the government's long-term sustainability goals.

Recommendations

- Establish a dialogue mechanism to take into account

¹⁵ *The Road Less Travelled: European Involvement in China's Belt and Road Initiative*, European Union Chamber of Commerce in China, 16th January 2020, <http://european-chamber.com.cn/en/publications-archive/762/The_Road_Less_Travelled_European_Involvement_in_China_s_Belt_and_Road_Initiative>





the views of FIEs in China when formulating national initiatives such as 'new infrastructure' and the BRI, and when implementing plans.

- Provide more support on innovation and R&D for FIEs.

3. Promote the Adoption and Absorption of FIEs' Advanced Technologies in the Rail Industry in Order to Help the Formulation of Domestic Standards and Technical Specifications, and Improve the Participation of FIEs in and Transparency of the Formulation Process

Concern

FIEs in the rail industry generally do not have the same opportunities to participate in the formulation of standards and regulations in the same way that local enterprises do, and they also have very limited opportunities to put forward opinions and suggestions, which may create market entry barriers and result in unfair competition.

Assessment

FIEs in the rail industry are usually unable to participate equally in the formulation of standards and the rights to make regulations as local enterprises, and also encounter difficulties in providing input into the decision-making process. Moreover, as a result of standardisation reform in China, social organisations have been endowed with the legal status to formulate standards for themselves. The working group has noticed that such standards are often applied in mandatory product certification.

In addition, in recent years, large domestic SOEs have been pressuring external suppliers to adopt their internal standards. Due to the lack of stakeholders in the industry chain to participate in their internal standards formulation process, the behind-the-curve nature, and low applicability and universality, of the resulting standards are common problems. This has affected the application of advanced technologies in the Chinese market to some extent, and it has become a significant hidden barrier to FIEs trying to enter the market.

The *Opinions of the Ministry of Transport on Several Issues Concerning Promoting the Modernisation of the Transport Governance System and Governance Capability*, released on 24th October 2020, state that,

"improving the standard system in transportation sector, strengthening effective supply of standards in key areas, and making use of the guiding role of standardisation" are essential for boosting the modernisation of the transport administration system.¹⁶ The Rail Working Group firmly believes that European companies operating in China have valuable contributions to make in terms of the advancement, applicability and convergence of international standards in the domestic transport industry. The working group therefore recommends that FIEs be allowed equal participation in China's standardisation activities, as enshrined in the Foreign Investment Law, the Standardisation Law and the currently frozen Comprehensive Agreement on Investment. The working group further suggests that the fairness, rationality, openness and transparency, as well as extensive participation by all stakeholders, in the standard-setting process be taken as important indicators for improving the modernisation of the standards system for the rail industry.

Recommendations

- Provide equal access to all companies legally registered in China to participate in the standardisation activities of relevant technical committees or working groups, and give them the right to vote.
- Encourage the adoption of advanced technologies in Chinese standards, and their convergence with international standards.
- Accelerate the modernisation level of the rail standards system, to make it fair, reasonable, inclusive and transparent, and make the extensive participation of stakeholders in the standards-setting process an important evaluation indicator.
- Regulate the standardisation activities of social organisations, and recognise standards of social organisations as national standards or industry standards before applying them to the product certification system.

4. Improve the Rail Industry Supply Chain through Improved Protection of Intellectual Property Rights (IPR)

Concern

Poor enforcement of IPR protection discourages

¹⁶ *Opinions of the Ministry of Transport on Several Issues Concerning Promoting the Modernisation of the Transport Governance System and Governance Capability*, MOT, 24th October 2020, viewed 30th October 2020, <http://xxgk.mot.gov.cn/2020/jigou/zcyjs/202010/t20201024_3479808.html>





technological innovation in the rail industry, especially by specialised small and medium-sized enterprises (SMEs).

Assessment

Respondents to the BCS 2021 reported improvements in China's written laws regarding IPR protection; however, European companies still see the level of IPR enforcement as lacking.¹⁷ As a result, many are reluctant to bring their latest technology to China, which has the potential to affect project execution and partnerships between foreign and Chinese companies.

In the rail industry, SMEs that are part of the supply chain can drive innovation and technological progress for the industrial supply chain. These SMEs have the flexibility and specialised expertise to actively promote innovation and provide necessary products and services for larger rail companies. Specialised companies are normally active in multiple industries, which helps them to introduce best practices and cutting-edge technologies from other industries.

To ensure the healthy development of the rail industry, China needs to secure the participation of SMEs. Meanwhile, IPR is the foundation of SMEs, so they require sufficient IPR protection. Therefore, China will need to continue to improve its IPR enforcement regime.

Recommendation

- Protect IPR in order to encourage increased investment in the rail industry and to foster the participation of SMEs in the supply chain.

Abbreviations

14FYP	14 th Five-year Plan
BCS	Business Confidence Survey
BRI	Belt and Road Initiative
CPC	Communist Party of China
CPPCC	Chinese People's Political Consultative Conference
FIE	Foreign-invested Enterprise
IPR	Intellectual Property Rights
JV	Joint Venture
MOT	Ministry of Transportation
NDRC	National Development and Reform Commission
NPC	National People's Congress
R&D	Research and Development
SME	Small and Medium-sized Enterprise
SOE	State-owned Enterprise
WFOE	Wholly foreign-owned Enterprise

¹⁷ *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, <<https://www.europeanchamber.com.cn/cms/page/en/publications-business-confidence-survey/368>>





European Chamber
中国欧盟商会

Section Four

Services

4



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
- Information and Communication Technology
 - Cybersecurity
- Logistics
 - International Liner Shipping

Despite negative growth in the first quarter of 2020, resulting from the COVID-19 pandemic and subsequent lock-down measures, China's economy rebounded strongly, ultimately recording positive 2020 gross domestic product growth of 2.3 per cent.¹ This contrasted with the expectations held by European businesses in China at the beginning of 2020. According to a joint survey by the European and German chambers in China, conducted from 18th to 21st February 2020, nearly half of the 577 respondents forecasted a double-digit drop in revenue for the first half of 2020, and a quarter expected to see a drop of over 20 per cent.² Contrary to this pessimistic outlook, European companies in China found themselves performing well overall, as production came back online far quicker than had been initially anticipated. Although year-on-year revenue shifts were the worst in a decade, 42 per cent of respondents to the European Chamber's *Business Confidence Survey 2021* actually reported revenue increases in 2020.³

However, compared with their well-performing peers in goods and/or manufacturing, European companies in services—a sector traditionally saddled with more onerous market access barriers and other operating restrictions—suffered far more as a result of the pandemic.⁴

The aviation and aerospace sector, for example, already faced the long-term challenge of congested airspace, which leads to additional costs, longer flying times and increased environmental damage.⁵ These challenges were compounded by the COVID-related restrictions imposed in 2020, which first saw international travel completely stopped, before subsequently being permitted in an extremely limited manner due to pandemic control measures. In late March 2020, the Civil Aviation Administration of China (CAAC) introduced the 'five-one' policy for international inbound flights, with each foreign airline only being allowed to maintain one route to China with no more than one weekly flight.⁶ Even though China's domestic passenger traffic level was able to recover to 90 per cent of

¹ *Statistical Communiqué of the People's Republic of China on the 2020 National Economic and Social Development*, National Bureau of Statistics of China (NBSC), 28th February 2021, viewed 1st July 2021, <http://www.stats.gov.cn/english/PressRelease/202102/t20210228_1814177.html>

² *COVID-19 SEVERELY IMPACTING BUSINESS: TRADE ASSOCIATIONS CALL FOR PROPORTIONATE MEASURES TO GET REAL ECONOMY BACK ON TRACK*, European Union Chamber of Commerce in China, 27th February 2021, viewed 1st July 2021, <<https://www.europeanchamber.com.cn/en/press-releases/3161>>

³ *European Chamber Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 8th June 2021, <[https://europeanchamber.oss-cn-beijing.aliyuncs.com/upload/documents/documents/BCS_EN_final\[917\].pdf#>](https://europeanchamber.oss-cn-beijing.aliyuncs.com/upload/documents/documents/BCS_EN_final[917].pdf#>)

⁴ Ibid.

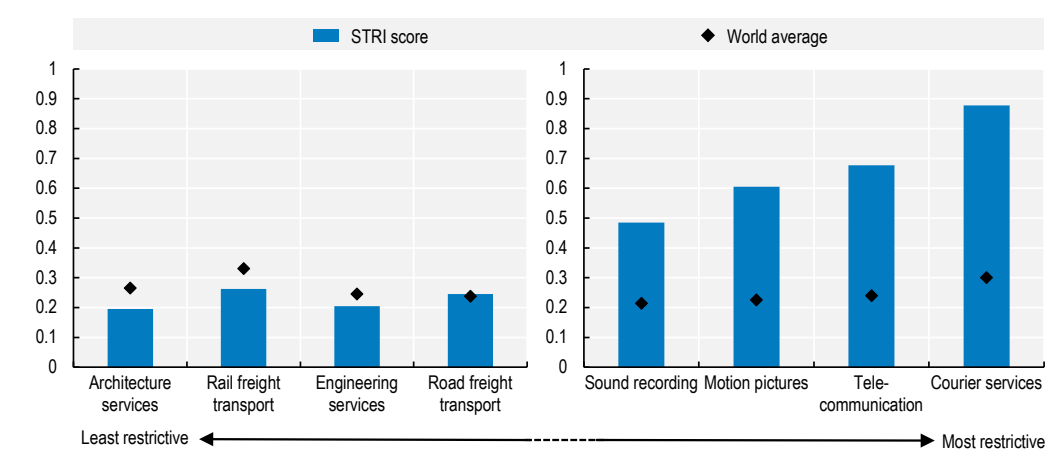
⁵ For more information, please refer to the *Aviation and Aerospace Working Group Position Paper 2021/2022* on p.303.

⁶ *Airlines Reduce Services Out of China after Intl Flight Cuts Ordered by CAAC*, China Aviation Daily, 28th March 2021, viewed 1st July 2021, <<http://www.chinaaviationdaily.com/news/77/77725.html>>

pre-COVID-19 levels as the pandemic was brought under control in China, recovery of cross-border air travel continued to be hampered due to recurring waves of outbreaks, which led to more stringent travel restrictions and a refusal to recognise both measures introduced by other countries aimed at restarting cross-border travel and vaccination programmes.⁷

Civil engineering and construction is another sector that was heavily impacted, as their opportunities for doing business in China—already limited to mostly consulting and sub-contracting—became even scarcer, as the kind of high-end projects they typically work on dried up. This sector also continues to face severe market access barriers that have been in place for many years. According to the 2020 Organisation for Economic Cooperation and Development's (OECD's) *Services Trade Restrictiveness Index (STRI)* on China, architecture services and engineering services remain among the sectors with the lowest score relative to the average STRI across all countries.⁸ Although foreign construction companies have been permitted to establish wholly foreign-owned construction enterprises in China for more than 15 years, and limitations on the performance of wholly foreign-owned projects were abolished through the Foreign Investment Law, in most cases European construction service providers (CSPs) are not allowed to bid for third-parties contracts in Chinese Government projects. As a result, European CSPs gain no due recognition for the value they add, cannot control the quality of the final project design, and their business opportunities in China remain extremely limited.⁹

Sectoral breakdown – The least and most restricted sectors in China



Note: Selection was made based on how far the sectors' score were from the world average score, as a percentage difference
i.e. $(STRI_{country, sector} - STRI_{world average, sector}) / STRI_{world average, sector}$

Source: OECD Services Trade Restrictiveness Index (STRI): China 2020

Certain segments in the logistics industry also suffered a significant downturn in 2020. According to the Ministry of Transport (MOT), the completed freight volume from January to April 2020 was 11.66 billion tonnes, a decrease of 13.7 per cent year-on-year.¹⁰ While business for domestic logistics

⁷ For more information, please refer to the *Aviation and Aerospace Working Group Position Paper 2021/2022* on p.303.

⁸ *OECD Services Trade Restrictiveness Index (STRI): China 2020*, OECD, January 2021, viewed 1st July 2021, <<https://www.oecd.org/trade/topics/services-trade/documents/oecd-stri-country-note-CHN.pdf>>

⁹ For more information, please refer to the *Construction Working Group Position Paper 2021/2022* on p.311.

¹⁰ *Economic Operation of Transportation in April*, MOT, 27th May 2020, viewed 1st July 2021, <http://xxgk.mot.gov.cn/jigou/zhghs/202005/t20200527_3383950.html>



service providers gradually recovered as daily life returned to normal, heavy restrictions on European businesses in China are still in place. For example, the long-term ban on international cargo relay by foreign shippers remains, something the International Liner Shipping Sub-working Group has been advocating for removal for the past 21 years. Currently, international shipping liners choose to tranship containers outside of China rather than using a domestic feeder service, which increases their costs. If foreign shipping services were permitted to carry out international relay between Chinese ports the impact on domestic companies' market share would only be marginal. Yet it would bring huge benefits for Chinese ports and hubs while adding a competitive advantage to the Chinese economy overall. The working group continues to seek a resolution to this issue.¹¹

As digitalisation looks set to underpin China's economic growth in the coming decades, the challenges facing European companies in the information and communication technology (ICT) industry unfortunately look set to increase, as China seeks to increase self-reliance in related technologies under the banner of 'national security'. Although European ICT companies have played an important role in supplying infrastructure, devices, services and applications to and in China, they have, by and large, been excluded from new opportunities in the market. Market access barriers, such as foreign shareholding restrictions on value-added telecommunication services (VATS) in the *2020 Negative List for Foreign Investment*, have led to a loss of business opportunities for European ICT companies in China. In addition to such direct restrictions, invisible barriers such as limited access to standardisation bodies and industrial policies that favour domestic companies further exacerbate this situation.¹² One of the largest challenges is the burdensome and vaguely-defined requirements for data localisation, data security and cybersecurity. Significantly, this results in additional costs and challenges for *all* European companies doing business in China, not just those in ICT.¹³ Maintaining these barriers comes at a cost to China as well, as they deter European companies from bringing edge-cutting expertise to China, which prevents Chinese consumers from accessing high-quality services and China's digital economy from benefitting from the most advanced technologies.

11 For more information, please refer to the *International Liner Shipping Sub-working Group 2021/2022 Paper* on p.362.

12 For more information, please refer to the *Information and Communication Technology Working Group 2021/2022 Paper* on p.327.

13 For more information, please refer to the *Cybersecurity Sub-Working Group 2021/2022 Paper* on p.340.



Aviation and Aerospace Working Group

Key Recommendations

1. Facilitate Full Resumption of Air Transportation and the Mobility of People between China and the European Union (EU)

- Consult with the European Commission, EU Member States, the EU Aviation Safety Agency (EASA) and international bodies such as the International Civil Aviation Organization and the International Air Transport Association (IATA) to create an agreed system for mutual recognition of health information, and promote the use of digital health certificates.
- Resume as early as possible consultations between China and EU Member States to ensure the restoration of bilateral air traffic entitlements as granted by Air Service Agreements.
- Facilitate a gradual and orderly resumption of international traffic, and publish in advance a roadmap of border opening under different circumstances that will be consistent nationwide.
- Commit to applying international practices, as defined by the IATA, on slot allocation at airports to ensure fast recovery of air traffic flows.

2. Update the Civil Aviation Regulatory Framework to Bring it in Line with the Special Measures on Foreign Investment (Negative List 2020) and any Relevant International, Regional or Bilateral Agreements Signed with China

- Promote EU-China technology collaboration in the aviation industry through cooperation on relevant rules and regulations, including but not limited to airworthiness, airline operations, airport management and aviation information technology.
- Enhance dialogue and communications between the EASA and the Civil Aviation Administration of China to ensure the smooth implementation of the Bilateral Aviation Safety Agreement and the Technical Implementation Procedures.
- Improve the consultation process to allow industry stakeholders to contribute their expertise and experience to the improvement of industry governance.

3. Increase the Efficiency of Airspace Utilisation in China 5

- Enhance the utilisation of new technologies as well as data interoperability in the aviation sector to ease airspace congestion and improve efficiency in the short term.
- Utilise EU expertise to implement a nation- and system-wide information management-based data communication platform with a centralised pool of data.
- Apply this data-driven approach to derive new applications and operational concepts covering airspace design, flow management and interoperable flight management between flight information regions.
- Improve aircraft arrival capacity at major airports by implementing distance-based and time-based separation.
- Study as early as possible the integration of air traffic management and unmanned aircraft system traffic management to ensure fast and safe development of the unmanned aircraft system market in China.
- Enhance exchanges with EU authorities and industry to enable harmonisation of unmanned aerial vehicle standards and regulations.



- Continue to pilot programmes in selected cities/regions and expand to new areas in order to carry out the opening of China's low-altitude airspace for the general aviation market.

4. Accelerate the Implementation of Sustainable Initiatives in China and Europe by Creating Research, Legal, Standards and Investment Cooperation Frameworks 2

- Create a trusted and long-term communication channel between the EU and China to negotiate the emissions' targets within the framework of, but not limited to, the Carbon Offsetting and Reduction Scheme for International Aviation.
- Leverage existing and past cooperation frameworks, such as Horizon Europe, to implement concrete projects on sustainable aviation technology.
- Develop a regulatory framework for aircraft lifecycle analysis and management.
- Relaunch projects on alternative fuel industrialisation by creating concrete-use cases.
- Create specific dialogues aimed at developing a certification strategy to ensure improved efficiency of aircraft in the future, including electrification or autonomy.

Introduction to the Working Group

The Aviation and Aerospace Working Group includes passenger and freight air carriers and manufacturers of 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. The working group speaks with a unified and inclusive voice to increase both the quantity and quality of political-level dialogue and industry advocacy.

The Aviation and Aerospace Working Group aims to monitor reforms in the areas of general aviation (GA), state-owned enterprises (SOEs) and third-party evaluators. The working group is also concerned about administrative measures relating to the control of international air shipping rights, fostering the creation of standards with regard to electronic air freight, supporting domestic aviation manufacturing, accelerating airworthiness approval procedures and opening airline approval procedures, among others.

During the past year, although the coronavirus 2019 (COVID-19) pandemic had a devastating impact on the aviation and aerospace industries, the working group still carried out a number of important advocacy

activities. These included discussions with the authorities to try and address the main concerns related to the resumption of flights; the waiver of slot rights in China and Europe; Industry 4.0 and the intelligent aviation industry; post-crisis industrial development; smart aviation; air cargo business; airworthiness certification; implementation of the European Union (EU)-China Bilateral Aviation Safety Agreement (BASA) and Technical Implementation Procedures (TIP), the conclusion of EU-China Comprehensive Agreement on Investment (CAI) (currently frozen by the European Parliament)¹ and mutual recognition of vaccinations, among others.

The working group has maintained a sound relationship with key stakeholders, including the Civil Aviation Administration of China (CAAC), the Ministry of Industrial Information and Technology (MIIT), Civil Aviation University of China, the International Air Transport Association (IATA), the International Civil Aviation Organization (ICAO), the China Quality Certification Centre, the Chinese Aeronautical Establishment, the China Aeronautical Research and Development Centre, the European Union Aviation Safety Agency (EASA), the

¹ *European Chamber Stance on the European Parliament Freezing of the CAI Ratification Process*, European Union Chamber of Commerce in China, 28th May 2021, viewed 6th July 2021, <https://www.europeanchamber.com.cn/en/press-releases/3342/european_chamber_stance_on_the_european_parliament_freezing_of_the_cai_ratification_process>



EU Directorate General for Transportation (DG MOVE), and the embassies of EU Member States in China. The working group has also maintained a smooth communication with other Chinese entities like the China-Europe Association for Technical and Economic Cooperation Constitution, and industrial actors like the Aviation Industry Corporation of China, the Commercial Aircraft Corporation of China (COMAC) and a number of Chinese airlines, among others.

In 2021, the working group has continued to work on strengthening communication and partnerships with Chinese and European stakeholders, in the interest of enhancing EU-China aviation cooperation and facilitating European business in China. Main activities are focussed on the 14th Five-year Plan (14FYP) in the areas of civil aviation and transportation, unmanned aerial vehicle (UAV) technology and market development in China and Europe, the implementation of EU-China bilateral agreements (the BASA and the TIP), and sustainable development and emissions reduction.

Recent Developments

At the end of 2020, China's domestic passenger traffic level had recovered to 90 per cent of pre-COVID-19 levels.² However, the global recovery remained very weak due to recurring waves of the pandemic, strict travel restrictions, and a lack of recognition of both measures aimed at restarting cross-border travel and vaccination programmes. It is forecast that global air travel may return to 2019 levels by 2024,³ but this depends to a large extent on the implementation of effective vaccine programmes and their global recognition.

The development of aviation intelligence and information technologies is accelerating. China has certain advantages in the manufacture of feeder liners,⁴ general aviation (GA) aircraft and helicopters, and is one of a few countries capable of assembling

large aircrafts.⁵ However, China needs to make further reforms in its aviation industry, while also improving its legal system and strengthening international cooperation, both to break through the bottlenecks of administrative inefficiencies and boost innovation.

According to the white paper *Sustainable Development of Transport in China*, published by the State Council in December 2020, China will continue to implement the United Nations 2030 Agenda for Sustainable Development and promote the development of green transportation and green aviation.⁶ China has also stated its intention to reform its overall governance system and strengthen innovation in order to achieve its ambitious energy conservation and carbon reduction targets.

Key Recommendations

1. Facilitate Full Resumption of Air Transportation and the Mobility of People between China and the European Union (EU)

Concern

Although resumption of air transportation between the EU and China is key to economic recovery and the strengthening of bilateral economic ties, China's borders remain closed to work permit holders and other business travellers, while air traffic entitlements have not been fully restored, which is seriously harming the operations of European carriers.

Assessment

At the end of 2019, COVID-19 broke out in China and subsequently spread worldwide. Following the decrease in demand for air travel due to travel restrictions, the aviation industry suffered historic losses. Chinese authorities launched aid measures to assist the industry, such as subsidies for airlines that continued to fly, reductions of or exemptions from airport fees, increases in infrastructure investment related to emergency needs, the resumption of work and restoring safety.⁷

² *China's civil aviation flights equal to 90% of pre-COVID-19 levels*, People's Daily, 10th September 2020, viewed 24th May 2021, <<http://en.people.cn/n3/2020/0910/c90000-9758807.html>>

³ *Recovery Delayed as International Travel Remains Locked Down*, IATA, 28th July 2020, viewed 24th May 2021, <<https://www.iata.org/en/pressroom/pr/2020-07-28-02/>>

⁴ "Feeder liners fly to and from medium-sized and small airports in various provinces, covering shorter distances and carrying less passengers than trunk liners." *China Promotes Feeder Liner to Prop Up Civil Aviation*, china.org.cn, 12th January 2006, Viewed 21st May 2021, <<http://www.china.org.cn/english/travel/154961.htm>>

⁵ *Advice of deepening reform of Civil Aviation*, CAAC, 1st March 2021, viewed 21st May 2021, <http://www.caac.gov.cn/XWZX/MHYW/202103/t20210301_206631.html>

⁶ *Full Text: Sustainable Development of Transport in China*, State Council, 22nd December 2020, viewed 21st May 2021, <<http://www.scio.gov.cn/zfbps/32832/Document/1695320/1695320.htm>>

⁷ *Notice on Policies to Actively Respond to COVID-19*, CAAC, 9th March 2020, viewed 21st May 2021, <http://www.caac.gov.cn/XXGK/XXGK/TZTG/202003/t20200309_201361.html>





However, foreign airlines did not completely benefit from all of these financial incentives due to travel bans on international passengers and non-operation of flights.

In order to prevent and control COVID-19 cases being imported from abroad through passenger air travel, the CAAC issued the 'five-one' policy and the *Notice of Adjustments to International Passenger Flights* in March and June 2020 respectively, which specify that "one weekly passenger flight operated by a foreign airline to China from an EU Member State is permitted".^{8&9}

During the summer of 2020, the 'five-one' policy was partially softened, allowing foreign airlines to apply for more than one flight per week. However, in certain cities, such as in Beijing, foreign flights were not allowed to land directly, provoking complaints of unfair treatment.

In addition, the 'circuit-breaker' policy penalised airlines that carried COVID-19-positive passengers into China,¹⁰ even though airlines themselves were already complying with the requirement to utilise the health code issued and verified by Chinese embassies. The working group suggests that relevant government departments consider whether airlines should ultimately be held responsible for COVID-19-positive cases arriving in China.

Regrettably, these limitations are still in place in 2021, and bilateral air traffic entitlements have not yet been restored. These unfair arrangements seriously harm the operations of European carriers, and need to be rectified in 2021 in order to ensure a level playing field in the industry.

Air travel is the only viable transportation option for strengthening business and people-to-people exchanges between the EU and China. A lack of smooth flight connections causes market access barriers and high communication costs. Many other jurisdictions are

already reopening their airspace and borders based on a roadmap of mutual recognition of health information or other specific agreements. Therefore, in order to facilitate trade and exchanges with EU Member States, travel restrictions—including the suspension of work permits or the imposition of visa restrictions—that hinder the resumption of airlines' normal, scheduled routes between the EU and China, need to be eased by the Chinese authorities.

Recommendations

- Consult with the European Commission, EU Member States, the EASA and international bodies such as the ICAO and the IATA to create an agreed system for mutual recognition of health information, and promote the use of digital health certificates.
- Resume as early as possible consultations between China and EU Member States to ensure the restoration of bilateral air traffic entitlements as granted by Air Service Agreements.
- Facilitate a gradual and orderly resumption of international traffic, and publish in advance a roadmap of border-opening under different circumstances that will be consistent nationwide.
- Commit to applying international practices, as suggested by the IATA, on slot allocation at airports to ensure fast recovery of air traffic flows.

2. Update the Civil Aviation Regulatory Framework to Bring it in Line with the Special Measures on Foreign Investment (Negative List 2020) and any Relevant International, Regional or Bilateral Agreements Signed with China

Concern

Numerous EU-China initiatives have been introduced that cover aviation investment and airworthiness, but few have delivered significant results due to implementation issues and a lack of support.

Assessment

China represents the world's largest aviation market and the largest pool of international tourists, while Europe remains a top global travel destination and a major market for Chinese airlines. On this basis, among others, China and Europe have become significant trading partners and have established strong economic ties and collaboration in many areas. That being said,

⁸ *Notice on Further Reducing International Passenger Flights during the Epidemic Prevention and Control Period*, CAAC, 26th March 2020, viewed 23rd May 2021, <<http://www.caac.gov.cn/XXGK/XXGK/TZTG/202003/P020200326766958017420.pdf>>

⁹ *Notice on Adjustment of International Flights*, CAAC, 4th June 2020, viewed 21st May 2021, <http://www.caac.gov.cn/XXGK/XXGK/TZTG/202006/t20200604_202928.html>

¹⁰ "The circuit breaker will be triggered when five passengers travelling by one route operated by an airline test positive." *CAAC Adjusts Rules on International Passenger Flights Introduces Incentives and Circuit Breaker*, Ministry of Foreign Affairs, 5th June 2020, viewed 21st May 2021, <https://www.fmprc.gov.cn/mfa_eng/topics_665678/kjgzbdyyq/t1786310.shtml>





exchanges on the formulation of regulations and industry consultation in general need to be enhanced and elevated.

On 23rd June 2020, the updated *Special Measures on Foreign Investment (Negative List 2020)*,¹¹ was jointly published by the Ministry of Commerce (MOFCOM) and the National Development and Reform Commission (NDRC). The updated version removed the restrictions on foreign investment in air traffic control. Following this, the Ministry of Transportation (MOT), the MOFCOM and the NDRC jointly announced the abolishment of the *Regulation on Foreign Investment in China Civil Aviation and its Six Supplemental Regulations*,¹² meaning that foreign investment will have access to the industry unless on a negative list. The CAAC likewise abolished the *Project Proposal and Feasibility Study to Foreign Investment below the Investment Quota in China Civil Aviation*.¹³ However, the working group notes that some incumbent regulations are not consistent with the *Negative List 2020*, including but not limited to the *Interim Permit Management Measures of Using and Entering the Foreign Computer Tickets Reservation System by the Sales Agency Appointed by Foreign Airline Carriers in China* (CCAR315).^{14&15} These regulations need to be repealed or replaced.

As industry has been predicated on the development of global standards, the resumption of international travel will depend on how the EU and China are able to agree on common approaches. The working group believes that a broad and cross-functional 'task force' approach could be effective, through which EU and Chinese authorities would work together, with all relevant authorities represented, towards mutually agreed targets. This would bridge current gaps and facilitate a comprehensive picture of joint activities to

instil sustainable growth of travel between and within China and the EU.

The EU-China BASA and TIP, signed in September 2020, upgraded bilateral airworthiness cooperation. The BASA/TIP set a structure to improve the efficiency of airworthiness cross-validation based on mutual trust. To date, however, only a few programmes have been delivered within the context of the BASA/TIP. Those issues, such as fuel additives, can impact the progress of all cross-validation programmes in a post-BASA/TIP era industry. The working group deems that a lack of working procedures to execute the BASA/TIP has raised significant challenges to its initial implementation. Continuous and effective communication between the CAAC and the EASA will help to achieve the results that the BASA/TIP are intended to deliver.

Recommendations

- Promote EU-China technology collaboration in the aviation industry through cooperation on relevant rules/regulations including but not limited to airworthiness, airline operations, airport management and aviation information technology.
- Enhance dialogue and communications between the EASA and the CAAC to ensure the smooth implementation of the BASA and the TIP.
- Improve the consultation process to allow industry stakeholders to contribute their expertise and experience to benefit industry governance.

3. Increase the Efficiency of Airspace Utilisation in China

Concern

Congested airspace in China, caused by both limited air routes and a lack of data exchange/communication, in conjunction with inefficient air traffic management (ATM), leads to additional costs, longer flying times and increased environmental damage for air carriers, while restricted access to low-altitude airspace further hinders the development of the industry.

Assessment

China has been investing heavily in the expansion of its air traffic control (ATC) system in order to support the rapid growth in air travel. To allow airports to reach their full capacities, many construction and expansion projects are being carried out at an accelerated pace

11 *Special Measures on Foreign Investment (2020 Negative List)*, NDRC and MOFCOM, 23rd June 2020, viewed 23rd May 2021, <http://qhs.china-gdftz.gov.cn/zwgk/sczrl/content/post_7831497.html>

12 *Abolishment of the Regulation on Foreign Investment and its Supplemental Regulations*, CAAC, 27th January 2021, viewed 21st May 2021, <http://www.gov.cn/xinwen/2021-01/27/content_5583076.htm>

13 *Notice on Abolishment of Project Proposal and Feasibility Study on foreign Investment below investment quota in China Civil Aviation*, CAAC, 16th October 2020, viewed 23rd May 2021, <http://www.caac.gov.cn/XXGK/XXGK/TZTG/202011/t20201102_205083.html>

14 *Notice on Abolishment of the Regulations on Foreign Investment in Civil Aviation and its Supplementary Provisions*, CAAC, 30th December 2020, viewed 21st May 2021, <http://www.caac.gov.cn/XXGK/XXGK/MHGZ/202101/t20210126_206183.html>

15 *Interim Permit Management Measures of Using and Entering the Foreign Computer Tickets Reservation System by the Sales Agency Appointed by Foreign Airline Carriers in China*, CAAC, 28th March 2016, viewed 21st May 2021, <http://www.caac.gov.cn/XXGK/XXGK/MHGZ/201605/t20160530_37632.html>



throughout the country.

As a consequence, different types of systems are being implemented, making it increasingly challenging to achieve seamless interoperability and data exchange between systems from different suppliers. This has been compounded by an inability to centralise ATM data or utilise concepts such as big data. This represents a significant missed opportunity to study ways to improve the efficiency of air traffic flows in China and increase the capacity of airport resources, as well as to better utilise airspace.

If dataflow is the bloodstream of ATM systems, then having an interoperable data exchange and information management platform would form a critical vein, linking every system and sub-system within the ATM ecosystems. Having such well-connected infrastructure would unlock huge potential in operational concepts to improve airspace congestion. For instance, better air traffic flow management coordination can be achieved; landing and take-off sequences can be dynamically exchanged between airports and transmitted across different system platforms; airplane separation can be safely reduced to increase airspace capacity; and coordination between heterogeneous ATC systems can be more seamless, thereby reducing the workload of air traffic controllers.

The COVID-19 pandemic has given rise to an additional demand on ATC systems, leading to an increasing need for flexible airspace management concepts and tools. For instance, during the onset of the pandemic outbreak in Wuhan, the Guangzhou Air Traffic Management Bureau (ATMB) activated a contingency plan to take over ATC of Wuhan airspace, in case controllers were unable to function due to the lockdown. On this occasion, sectors needed to be efficiently reallocated to the Guangzhou Area Control Centre and Approach controllers.

The 14FYP has included regional projects, such as the Greater Bay Area, which calls for harmonisation of airspace across the five regions of Guangzhou, Shenzhen, Zhuhai, Hong Kong and Macau. These regional projects require a re-planning of the airspace that spans across different government administrations. It demands an efficient airspace management concept, smooth coordination as well as effective operational procedures. It also calls for flow management tools to

be able to optimise the airspace efficiency and runway capacities of the different airports.

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 the industries of the two sides and encourage the adoption of common standards and the sharing of best practices.

In the meantime, to improve controllers' career planning, professional development and training, the Aviation and Aerospace Working Group suggests implementing a partnership at working-group level between the safe air travel organisation the European Organisation for the Safety of Air Navigation (EUROCONTROL) and Chinese ATMBs. Integration of civil/military and international/domestic airspace and routing will also help increase the punctuality of flights, create room for future growth in aircraft movements and reduce carbon emissions by letting airlines choose the most effective routes in Chinese airspace.

Another issue that requires improvements to China's ATM is the abrupt arrival of the unmanned aircraft systems (UAS) industry, which has exacerbated safety and security challenges. Public safety incidents and airspace conflicts between UAVs and civil transport aircraft 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 subjects of future research in order to optimise airspace efficiency while maintaining the current civil air-transport workload.

Recommendations

- Enhance the utilisation of new technologies as well as data interoperability in the aviation sector to ease airspace congestion and improve efficiency in the short term.
- Utilise EU expertise to implement a nation- and system-wide information management-based data communication platform with a centralised pool of data.
- Apply this data-driven approach to derive new applications and operational concepts covering airspace design, flow management and interoperable flight management between flight information regions.



- Improve aircraft arrival capacity at major airports by implementing distance-based and time-based separation.
- Study as early as possible the integration of ATM and UTM to ensure fast and safe development of the UAS market in China.
- Enhance exchanges with EU authorities and industry to enable harmonisation of UAV standards and regulations.

4. Accelerate the Implementation of Sustainable Initiatives in China and Europe by Creating Research, Legal, Standards and Investment Cooperation Frameworks

Concern

While new aeronautical technology and products are ready and scalable to help the aviation industry and China meet environmental protection requirements and emission targets, inefficiencies in both procedures and the legal framework, combined with the impact of the COVID-19 crisis, prevent their deployment.

Assessment

Recent issues between the EU and China have evolved in such a way that existing cooperation schemes have been negatively impacted. These issues include the COVID-19 situation; the position of the EU regarding China as a competitor, rival and partner;¹⁶ and the evolution of the Chinese industry and subsequent political moves to protect it (such as the 'five-one' policy, which has not helped in the opening of airspace in China, and has hindered enforcement of the International Trade Law).

With regard to joint green aviation research, the EU and China launched a number of coordination and support actions (CSA) since 2005, as well as several successful research and innovation actions (RIA), that have benefitted both the Chinese and European Industries. The existing, long-term CSA within the Seventh Framework Programme, the Greener Aeronautics International Networking 2 (GRAIN2),¹⁷ under Horizon 2020, is coming to an end with only two

projects still running and no other joint calls opened for the near future. The working group recommends both the EU and China to recognise the importance of green aviation, in order to launch new cooperation schemes.

On the sustainable aviation fuel (SAF) front, a very promising cooperation initiative was launched to create a SAF industry in China for the benefit of original equipment manufacturers and airlines.¹⁸ Airbus, Sinopec, the CAAC and the EASA cooperated on promoting sustainable fuel for flights, and test flights took place in Shanghai in 2012. Unfortunately, following the non-compatibility of Chinese standards with international standards, the cooperation was suspended. The working group recommends reactivating bilateral discussions in order to promote cooperation on the industrialisation and use of SAF.

The negotiation process for the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) is still ongoing between the ICAO and Chinese authorities. Under Resolution A39-3 of the CORSIA, the ICAO Assembly called for the development of a methodology to ensure that an aircraft operator's offsetting requirements under the CORSIA can be reduced through the use of SAF. Following this request, a methodology has been put in place, one of the key elements of which are Core Life Cycle Assessment (LCA) emissions.¹⁹ LCA could further the CORSIA negotiations on facilitating the deployment of mutually beneficial carbon offset and trade initiatives between the EU and China.

The working group hopes that the EU and China will cooperate on the standardisation and certification of new products and solutions for energy saving and emission reductions in the aviation industry, with the aim of eliminating long and complicated administrative approval procedures. Such a unified approach may save time and labour costs for companies, and facilitate the deployment of eco-technology in the industry in both regions.

Recommendations

- Create a trusted and long-term communication channel between the EU and China to negotiate the emissions' targets within the framework of, but not

¹⁶ "China is a partner, competitor and rival": Interview by Foreign Minister Heiko Maas with Redaktionsnetzwerk Deutschland, German Federal Foreign Office, 12th July 2020, viewed 6th July 2021, <<https://www.auswaertiges-amt.de/en/newsroom/news/maas-md/2367552>>

¹⁷ Coordination and support action-Seventh framework programme GRAIN2, European Commission, 31st March 2015, viewed 23rd May 2021, <<https://trimis.ec.europa.eu/sites/default/files/project/documents/10294/final1-grain2-m36-final-report.pdf>>

¹⁸ New Guidance of Sustainable Fuel of SAF, Tanpaifang, 27th August 2020, viewed 6th June 2021, <<http://www.tanpaifang.com/tanguwen/2020/0827/73530.html>>

¹⁹ Life cycle emissions of sustainable aviation fuels, ICAO, viewed 21st May 2021, <https://www.icao.int/environmental-protection/pages/SAF_LifeCycle.aspx>





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limited to, the CORSIA.

- Leverage existing and previous cooperation frameworks, such as Horizon Europe, to implement concrete projects on sustainable aviation technology.
- Develop a regulatory framework for aircraft lifecycle analysis and management.
- Relaunch projects on alternative fuel industrialisation by creating concrete-use cases.
- Create specific dialogues aimed at developing a certification strategy to ensure improved efficiency of aircraft in the future, including electrification or autonomy.

UAV

UTM

Unmanned Aerial Vehicle

Unmanned Aircraft System Traffic Management

Abbreviations

14FYP	14 th Five-year Plan
ATC	Air Traffic Control
ATM	Air Traffic Management
ATMB	Air Traffic Management Bureau
BASA	Bilateral Aviation Safety Agreement
CAAC	Civil Aviation Administration of China
COMAC	Commercial Aircraft Corporation of China
CORSIA	Carbon Offsetting Scheme for International Aviation
COVID-19	Coronavirus Disease 2019
CSA	Coordination and Support Actions
DG MOVE	Directorate General for Mobility and Transport
EASA	European Union Aviation Safety Agency
EU	European Union
EUROCONTROL	European Organisation for the Safety of Air Navigation
GA	General Aviation
GRAIN2	Greener Aeronautics International Networking 2
IATA	International Air Transport Association
ICAO	International Civil Aviation Organization
LCA	Life Cycle Assessment
MIIT	Ministry of Industrial Information and Technology
MOFCOM	Ministry of Commerce
MOT	Ministry of Transportation
NDRC	National Development and Reform Commission
SAF	Sustainable Aviation Fuel
SOE	State-owned Enterprises
TIP	Technical Implementation Procedures
UAS	Unmanned Aircraft System





Construction Working Group

Key Recommendations

- 1. Promote the Expansion of Responsive and Safe Infrastructure in Rural and Urban Areas, in Particular in Small and Medium-sized Cities, and Utilise the Expertise and Knowledge of Foreign Companies in the Process** 🗳️ 11
 - Expedite reforms that will allow European construction services providers to contribute more towards green buildings and sustainable/eco-cities as well as intelligent buildings, smart cities and smart communities in China.
 - Encourage European companies' bidding participation in large projects without service qualifications.
 - Encourage European firms' contribution to the development of small and medium-sized cities and the improvement of urban utilities and infrastructure.
- 2. Allow European Companies Greater Access to the Bidding Process for Government Procurement Work** 🗳️ 2
 - Join the World Trade Organization's Government Procurement Agreement (GPA) to allow foreign companies greater access to the bidding process for government procurement work.
- 3. Facilitate Market Access for European Planning, Architectural and Design, Construction, and Real Estate Service Providers to Enable Fair Competition, Encourage Expertise-sharing** 🗳️ 11
 - Foster mutual recognition of degrees, certificates and experience to further level the playing field in terms of market access and business for foreign-invested construction and design firms.
 - Improve local standards to reach the same quality as international green building standards.
 - Allow qualification exams to be conducted in English so as to offer fair opportunities for foreign professionals.
- 4. Continue to Ensure a Fair, Balanced and Open Market Exists for Foreign Investment in the Real Estate (RE) Sector** 🗳️ 11
 - Issue further clarifications or implementing rules regarding the relaxation brought by *Circular No. 122* so as to create a fair market environment for foreign companies investing in the Chinese RE market.

Heating Sub-working Group

- 1. Update the Standard for Energy Efficiency of Domestic Gas Appliances and Introduce National Guidelines or Policies to Promote Full Premixed Condensing Boilers with Level I Energy Efficiency** 🗳️ 2
- 1.1 Update the Energy Efficiency Standard, and Refine and Improve Requirements for Domestic Gas Appliances** 🗳️ 2
 - Update and refine the energy efficiency standards for domestic gas appliances.
 - Refine and improve the efficiency requirements for domestic gas appliances.



1.2 Introduce Policy Guidelines for Promoting Energy-saving and Low-emission Gas Boiler Technologies 🗣️ 2

- Introduce policy guidelines for promoting energy-saving and low-emission technologies, starting from key cities and regions.
- Issue relevant policies to encourage consumers to buy full premixed condensing boilers for the first installation of heating in a building.
- Encourage research projects on full premixed condensing technology, including its application, energy-saving and emission-reducing effects.

2. Improve and Effectively Implement Standards for the Installation and Maintenance of Heating Boilers, and Educate Consumers on the Need for Regular Maintenance and Replacement 🗣️ 3

2.1 Strengthen the Standardisation and Management of the Installation of Heating Boilers

2.1.1 Improve the Standards for Installation of Heating Boilers and Strengthen the Standardisation and Management of Responsible Enterprises and Personnel 🗣️ 2

- Formulate and implement regulations for installation of heating boilers.
- Improve the training for personnel and enterprises responsible for installation and establish a vocational certification system.

2.1.2 Reasonably Adjust the Content and Cycle of Product Tests for Local Market Access based on the CCC Policy

- Reasonably reduce repetitive test items for local market access, and extend the test cycle.

2.2 Strengthen the Publicity and Effective Supervision of the Maintenance of Heating Boilers 🗣️ 2

- Strengthen effective supervision of regular maintenance of heating boilers, and educate consumers accordingly.
- Issue regulations for periodic maintenance of heating boilers to ensure their efficient and safe operation.

2.3 Cultivate Consumers' Awareness of the Need for Timely Removal and Replacement of Heating Boilers with High Energy Consumption and Emissions or Those at the End of Their Service Life 🗣️ 2

- Cultivate consumers' awareness of the need for timely removal and replacement of heating boilers with high energy consumption and emissions or those at the end of their service life.
- Formulate policies to encourage and support consumers to replace low-efficiency and high-energy-consumption heating boilers that have reached the end of their service life with more efficient and eco-friendly full premixed condensing boilers.

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, certification bodies and other professional consultants specialising in the construction industry that are operating in China.

The Construction Working Group was first established in 2003, to represent European construction service providers (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 Land and Natural Resources, 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

Market Trends in 2020

Due to the impact of the coronavirus disease 2019 (COVID-19) pandemic, China's infrastructure investment in the first quarter of 2020 experienced a 20 per cent decrease year-on-year,¹ before picking up in April. Diluting the initial downturn, the annual investment growth rate in infrastructure increased by 0.9 per cent over 2019, though this underperforms those of 2019² and 2018³ (both at 3.8 per cent). In 2020, investment in the information and communications technology industry increased by 16 per cent, ecological protection and environmental management by 8.6 per cent, water management by 4.5 per cent, and road transport by 1.8 per cent. Private investment growth took a hit in 2020 compared to previous years, but remained positive at one per cent, with private investment in infrastructure and manufacturing up by 0.8 and 1.5 percentage points respectively. In 2020, total planned investment in new construction projects grew by 11.9 per cent, 10.8 percentage points faster than the previous year.⁴

In 2020, the total construction output value of the construction industry reached Chinese yuan (CNY) 26.4 trillion, up 6.2 per cent year-on-year. Since 2011,

the ratio of value added by the construction industry to China national gross domestic product (GDP) has always remained above 6.8 per cent. The rate in 2020 hit a record high of 7.2 per cent. The construction sector maintained growth of GDP share for four consecutive years despite a slight fall in 2015 and 2016, acting as a pillar industry of the national economy.⁵ According to the Fitch Solutions *China Infrastructure Report*, as the world's largest construction market, China's construction sector is forecasted to grow at an average of 5.2 per cent annually in real terms between 2021 and 2029.⁶

China's Road to Carbon Neutrality

China has pledged to achieve peak carbon by 2030 and carbon neutrality by 2060.⁷ In order to realise this goal, the construction industry—being one of the biggest energy consumers and carbon emitters—will play a significant role, particularly with China's industrialisation and urbanisation process yet to be finished.⁸ About two billion square metres (m²) of new floor area is built in China every year, which is almost one-third of the global total of 6.13 billion m². China's construction sector produces about 11 per cent of the world's total carbon emissions each year, thanks to manufacturing and transportation of building materials such as steel, cement and glass, as well as on-site construction.⁹ The *China Building Energy Consumption Study Report (2020)*, released in January 2021, also shows that the total carbon emissions from the industry in 2018 were 4.93 billion tonnes, accounting for 51.3 per cent of the country's carbon emissions.¹⁰

In order to decarbonise, the sector should take a range of measures to promote 'passive building' design (buildings that require little energy for space heating or cooling), material efficiency, the use of low-carbon

1 *Construction industry: the growth rate of infrastructure investment in 2020 is positive, and the orders of central enterprises grew rapidly*, Sina, 25th January 2021, viewed 9th June 2021, <http://stock.finance.sina.com.cn/stock/go.php/vReport_Show/ind/search/rptid/664900673381/index.phtml>

2 *National fixed asset investment (excluding rural households) up 5.4% from January to December 2019*, National Bureau of Statistics (NBS), 17th January 2021, viewed 9th June 2021, <http://www.stats.gov.cn/tjsj/zxfb/202001/t20200117_1723385.html>

3 *National fixed asset investment up 5.9% from January to December 2018*, NBS, 21st January 2019, viewed 9th June 2021, <http://www.stats.gov.cn/tjsj/zxfb/201901/t20190121_1645780.html>

4 *China steadily recovered and continuously improved structurally in 2020*, NBS, 19th January 2021, viewed 8th April 2021, <http://www.stats.gov.cn/tjsj/sjjd/202101/t20210119_1812641.html>

5 *Statistical analysis report on the development of the construction industry in 2020*, Seetao, 12th March 2021, viewed 9th June 2021, <<https://www.seetao.com/details/69369.html>>

6 *China-Country Commercial Guide*, United States (US) International Trade Administration, 3rd February 2021, viewed 8th April 2021, <<https://www.trade.gov/country-commercial-guides/china-design-and-construction>>

7 *China aims to achieve peak carbon by 2030 and carbon neutrality by 2060*, People's Daily, 6th April 2021, viewed 8th April 2021, <<http://www.sasac.gov.cn/n2588025/n2588139/c17907124/content.html>>

8 J. Zuo et al., *Achieving carbon neutrality in commercial building developments—Perceptions of the construction industry*, *Habitat International*, Vol. 36, 2012, viewed 18th April 2021, <<https://www.sciencedirect.com/science/article/abs/pii/S0197397511000841>>

9 *China's carbon neutrality challenge*, *China Daily*, 27th November 2021, viewed 28th April 2021, <<https://www.chinadailyhk.com/article/150772>>

10 *The construction industry to step up the full cycle of carbon reduction*, *Xinhua*, 28th March 2021, viewed 28th April 2021, <http://www.xinhuanet.com/fortune/2021-03/28/c_1127263429.htm>





materials, insulated building surfaces, and highly-efficient lighting and appliances.

Policies adopted by the Chinese Government so far to reduce carbon emissions and improve energy efficiency include a series of laws and regulations for residential, commercial and public buildings, as well as the introduction of green building evaluation standards. China's 14th Five-year Plan and 2035 Visionary Goals emphasise the need for clean, low-carbon, safe, and efficient use of energy, and the transformation to low-carbon operations in the construction industry.¹¹

Since 2020, the Chinese Government has restricted both operational hours and production quantities for industries with high pollution emissions, with measures such as the *Notice on Further Improving the Normalised Peak Production of Cement*.¹² Furthermore, special preference is given to companies and products that meet environmental standards, with a catalogue compiled for reference and study.¹³ Other catalogues that have been compiled include: the *National Recommended Catalogue of Energy-saving Technologies and Equipment for Industry (2020)*, the *Catalogue of Energy Efficiency Star Products (2020)*, and the *National Catalogue of Advanced and Applicable Technologies for Green Data Centres (2020)*.¹⁴

Synergistic Regional Development

Synergistic regional development is one of China's recently introduced national strategies and thus has become an opportunity for growth for the construction industry. For example, in July 2020, the MIIT released the *Plan for the Collaborative Transformation and Upgrading of the Industrial Resource Comprehensive Utilisation Industry in Beijing, Tianjin, Hebei, and Surrounding Regions (2020–2022) (Plan)*. The Plan proposes that, by 2022, the annual comprehensive

utilisation of industrial solid waste in this region will reach 800 million tonnes; the recycling of major renewable resources 150 million tonnes; the total industrial output value will exceed CNY 900 billion; and 30 distinctive industrial clusters will be formed, 50 industrial innovation centres built, and 100 innovative backbone enterprises cultivated.¹⁵ Furthermore, in February 2021, the *Special Measures for the Management of Central Budgetary Investment in the Construction of Major Regional Development Strategies (Direction of Promoting Hainan's Comprehensively Deepening Reform and Opening-up)* were issued, which aim to promote the reform and opening up of construction projects in Hainan.¹⁶

Yangtze River Delta Integration

The Yangtze River Delta (YRD) region, made up of the three provinces of Jiangsu, Zhejiang and Anhui as well as the city of Shanghai, is the most densely populated—and most affluent—region in China, accounting for one sixth of the country's population, or at least 220 million people.¹⁷

The YRD plan was released on 1st December 2019, with the aim of creating a strong and active growth centre and a gateway for further opening up the economy. In July 2020, the *Industry Development Guidance Catalogue of Yangtze River Delta Ecology and Greenery Integration Demonstration Zone (2020 Edition)* and the *Industrial Project Access Standards of the Yangtze River Delta Ecology and Greenery Integration Demonstration Zone (Trial)* were introduced.¹⁸ As a result, the Ecology and Greenery Demonstration Zone, covering 2,300 square kilometres (km²) across three districts in Jiangsu, Zhejiang and Shanghai, was set up as a pilot scheme for the YRD project.¹⁹

11 *Outline of the 14th Five-year Plan for National Economic and Social Development of the People's Republic of China and the Vision for 2035*, Central Committee of the Communist Party of China, 11th March 2021, viewed 28th April 2021, <http://www.xinhuanet.com/2021-03/13/c_1127205564.htm>

12 *Notice of Two Ministries on Further Improving the Normalised Peak Production of Cement*, Ministry of Industry and Information Technology (MIIT) & Ministry of Ecology and Environment (MEE), 28th December 2020, viewed 8th April 2021, <https://www.miit.gov.cn/zwgk/zcwj/wjfb/jcgy/art/2020/art_6bff7f6bd055439ebd806b7fb230bc37.html>

13 *Notice on the Announcement of the Fifth Batch of Green Manufacturing List*, MIIT, 16th October 2020, viewed 8th April 2021, <http://www.miit.gov.cn/zwgk/zcwj/wjfb/zh/art/2020/art_6dc9386121b945b3927fdca5c79cd1b.html>

14 *Announcement of the Ministry of Industry and Information Technology of the People's Republic of China*, MIIT, 23rd October 2020, viewed 8th April 2021, <https://www.miit.gov.cn/zwgk/zcwj/wjfb/gg/art/2020/art_e0190e6c3c404e54a7958e863d68d6a2.html>

15 *Interpretation of the Plan for the Collaborative Transformation and Upgrading of the Industrial Resource Comprehensive Utilisation Industry in Beijing, Tianjin, Hebei and Surrounding Regions (2020–2022)*, Energy Conservation and Integrated Use Division, MIIT, 17th July, 2020, viewed 8th April 2021, <https://www.miit.gov.cn/zwgk/zcjd/art/2020/art_3ed6316f0ef8422baf062bcd942e98c0.html>

16 *Notice on the Issuance of Special Measures for the Management of Central Budgetary Investment in the Construction of Major Regional Development Strategies (Direction of Promoting Hainan's Comprehensively Deepening Reform and Opening-up)*, NDRC, 1st February 2021, viewed 8th April 2021, <https://www.ndrc.gov.cn/xwdt/tzgg/202102/t20210201_1266687.html>

17 *Big plans for Yangtze River Delta as China takes on the wealth gap and pollution*, South China Morning Post, 2nd December 2019, viewed on 27th April 2021, <<https://www.scmp.com/news/china/politics/article/3040281/big-plans-yangtze-river-delta-china-takes-wealth-gap-and>>

18 *The Yangtze River Delta Ecology and Greenery Integration Demonstration Zone unifies industrial project access standards*, Xinhua, 16th July 2020, viewed 20th May 2021, <http://www.xinhuanet.com/2020-07/16/c_1126244757.htm>

19 *Plan for Yangtze River Delta Ecology and Greenery Integration Demonstration Zone released*, State Council, 20th November 2019, viewed 20th May 2021, <http://www.gov.cn/zhengce/2019-11/20/content_5453710.htm>





Local governments in the delta region have cooperated actively on new infrastructure projects. As early as June 2018, they signed the *5G Early Trial and Early Use to Promote the Strategic Cooperation Framework Agreement for the Early Development of the Digital Economy in the Yangtze River Delta*²⁰ to take the lead in conducting fifth generation (5G) mobile network trials and open the first batch of official 5G commercial areas in China. As the YRD region is already one of the most developed areas in China, investing in innovation-based new infrastructure development will help generate high-quality growth locally.²¹

Guangdong-Hong Kong-Macao Greater Bay Area

The Guangdong-Hong Kong-Macao Greater Bay Area (GBA) comprises the two Special Administrative Regions of Hong Kong and Macao and the nine municipalities of Guangdong Province.²² With less than one per cent of China's land space, the GBA contributed about 11 per cent of China's economy.²³

The Framework Agreement on Deepening Guangdong-Hong Kong-Macao Cooperation in the Development of the Greater Bay Area was signed on 1st July 2017,²⁴ acting as the guideline for the goals and principles of cooperation. In July 2020, the NDRC approved the *Inter-city Railroad Construction Planning of the Greater Bay Area*. The plan sets out the following goals: by 2025, the railroad network in operation and under construction in the GBA will reach 4,700 km, fully covering the central cities, node cities and key metropolitan areas such as Guangzhou and Shenzhen; by 2035, the network will be 5,700 km long, covering 100 per cent of cities above county level.²⁵

Xiong'an New Area

In 2017, China announced the construction of the Xiong'an New Area. Spanning three counties in Hebei Province about 100 km southwest of Beijing, the new area is designed to contain the overspill of the city's non-capital functions and relocated population.

The *2018–2035 Master Plan for Hebei Xiong'an New Area* approved by the State Council at the end of 2018 provided the blueprint for the new area. Its creation is significant as it seeks to pursue high-quality development and the building of a modern economic system. The appearance of the Xiong'an New Area changed significantly in 2020. By October 2020, the area under construction had increased by 89.52 per cent compared to October 2019, with a significant expansion in construction scale.²⁶ By mid-2021, the new area had already fully entered the phase of large-scale construction.²⁷

Chengdu-Chongqing Economic Circle

Located in the upper reaches of the Yangtze River, the two cities of Chengdu and Chongqing are comprised of the most densely populated area with the highest concentration of industries in West China.²⁸ The proposal of forming a dual city economic circle was first put forward on 3rd January 2020 as part of the national strategy to drive high-quality development in central and western China.²⁹ In addition to the YRD in the east, the GBA in the south and the Beijing-Tianjin-Hebei region in the north, the Chengdu-Chongqing economic circle is intended to be the "fourth pole of growth" in China.³⁰ Acting as a junction between the vibrant coastal east and underdeveloped west, the circle aims to rebalance economic development within the country and create an inland strategic region for opening-up.

20 YRD integration: new opportunities in new infrastructure, *Xinhua*, 4th June 2020, viewed 20th May 2021, <http://www.xinhuanet.com/info/2020-06/04/c_139112684.htm>

21 New infrastructure helps high-quality integrated development in the Yangtze River Delta, *Anhui Daily*, 25th August 2020, viewed 20th May 2021, <<http://sjzyj.ah.gov.cn/szjh/xyyj/40341126.html>>

22 Overview, bayarea.gov.uk, 2018, viewed 3rd June 2021, <<https://www.bayarea.gov.hk/en/about/overview.html>>

23 Greater Bay Area in China - statistics & facts, Statista, 22nd September 2020, viewed 3rd June 2021, <<https://www.statista.com/topics/5333/greater-bay-area-in-china/>>

24 Framework Agreement on Deepening Guangdong-Hong Kong-Macao Cooperation in the Development of the Greater Bay Area, bayarea.gov.uk, 1st July 2017, viewed 3rd June 2021, <https://www.bayarea.gov.hk/filemanager/en/share/pdf/Framework_Agreement.pdf>

25 Approval on the Guangdong-Hong Kong-Macao Greater Bay Area Inter-City Railroad Construction Planning by the National Development and Reform Commission, NDRC, 30th July 2020, viewed 3rd June 2021, <https://www.ndrc.gov.cn/xxgk/zcfb/tz/202008/120200804_1235517.html>

26 The City of the Future, Growing by the Numbers – Xiong'an New Area 2020 Big Data Report, *People.cn*, 28th January 2021, viewed 28th April 2021, <<http://www.mxiongan.com/n2/2021/0128/c383557-34553285.html>>

27 Xiong'an New Area 2020 big data report released, the new appearance of the future city is becoming clearer, *Beijing Daily*, 28th January, viewed 27th April 2021, <https://www.sohu.com/a/447342162_163278>

28 Tech Innovation Drives Development of Chengdu-Chongqing Economic Circle, *PRNewswire*, 11th March 2021, viewed on 3rd June 2021, <<https://www.prnewswire.com/in/news-releases/tech-innovation-drives-development-of-chengdu-chongqing-economic-circle-817427660.html>>

29 Alexander, James and Zhang, Deng, *Chengdu-Chongqing Economic Circle to Drive High-Quality Development: Chongqing Opportunity*, *Ichongqing*, 11th December 2020, viewed 3rd June 2021, <<https://www.ichongqing.info/2020/12/11/chongqing-opportunity-chengdu-chongqing-economic-circle-to-drive-high-quality-development/>>

30 Chengdu-Chongqing economic circle gets underway to accelerate development of western region, *Beijing Review*, 12th November 2020, viewed 3rd June 2021, <http://www.china.org.cn/business/2020-11/12/content_76903885.htm>



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Although the plan was released only a year ago, there has already been several policies released to integrate the region's economies. Since the two cities share overlapping pillar industries, a key strategy is to move from competition to cooperation. In June 2020, the customs bureaux of the two cities signed the *Memorandum of Cooperation on Jointly Supporting the Construction of Chengdu-Chongqing Dual City Economic Circle*,³¹ marking a new stage of comprehensive long-term cooperation. In April 2021, the China Council for the Promotion of International Trade and the governments of Sichuan Province and Chongqing Municipality signed the *Cooperation Agreement on Promoting the Construction of Chengdu-Chongqing Dual City Economic Circle*.³²

Real Estate (RE) Sector

Due to the impact of COVID-19, the national RE investment growth rate was negative in the first five months of 2020. As the situation improved, the rate started picking up, and, at time of writing in June 2021, year-on-year growth rate of development investment has remained positive for ten consecutive months.³³ According to the China Index Academy's list of the top 100 RE enterprises' sales performance in 2020, the threshold was CNY 33.3 billion, a 15 per cent increase compared to the previous year.³⁴ Total 2020 RE investment was CNY 1.4 trillion, an increase of seven per cent over the previous year. Residential investment was over CNY 1 trillion, up 7.6 per cent; investment in office buildings reached nearly CNY 650 billion, an increase of 5.4 per cent; while investment in commercial business premises decreased by 1.1 per cent to approximately CNY 130 billion.

Since the beginning of 2021, the RE market has been facing strict policy regulation, with regulators repeatedly stressing that the housing market should not be speculative. The Central Economic Work Conference proposed to promote the stable and healthy

development of the RE market by taking into account local conditions and adopting multiple measures. It also refused to use real estate as a means of short-term economic stimulus.³⁵ According to the *National Real Estate Development Investment and Sales for January to April 2021* report released by the National Bureau of Statistics, in the first quarter of 2021, investment rates rose sharply compared to 2020.³⁶ The building area sold and number of commercial properties continued to rise, and the overall funds in place for real estate development enterprises remained in a relatively good state. However, it is believed that with the gradual implementation of contractionary policies in the industry, sales growth will fall and the RE funding environment will be tight, but stable.

Comprehensive Agreement on Investment (CAI)

On 31st December 2020, the European Union (EU) and China jointly announced the conclusion of the round of negotiations on the CAI.³⁷ With regards to the construction sector, China made commitments to remove all market access limitations originally imposed under the General Agreements on Trade in Services. This is something the working group had been hoping to see for quite a long time, especially because high entry barriers and project limitations are what have previously mostly led foreign construction companies and contractors to leave the Chinese market.

At the same time, while direct market access barriers are set to be lifted, the working group foresees that indirect barriers such as obtaining licences will remain for foreign companies. Nonetheless, provisions on national treatment, as well as on transparency, non-discrimination and due process in licensing, might be helpful to foreign companies in the construction sector if the CAI were to be signed and ratified. However, the working group is sceptical whether even this would encourage foreign contractors to return/increase investments in China's construction market, as it is already heavily saturated with large state-owned enterprises (SOEs).

31 *Chongqing and Chengdu Customs Sign a Memorandum of Understanding to Clarify 7 Major Areas of Cooperation*, Chongqing Customs District PR China, 11th June 2020, viewed on 3rd June 2021, <http://ltj.customs.gov.cn/chongqing_customs/515855/515856/3124182/index.html>

32 *CCPIT signs a tripartite cooperation agreement with Sichuan Province and Chongqing Municipality*, Sichuan China.com, 16th April 2021, viewed 3rd June 2021, <<https://sichuan.china.com/caijing/2021/0416/25301197.html>>

33 *National Real Estate Development Investment and Sales for January to April 2021*, NBS, 17th May 2021, viewed 9th June 2021, <http://www.stats.gov.cn/tjsj/zxfb/202105/t20210517_1817512.html>

34 *China's real estate industry operation review in 2020 and development trend forecast in 2021*, China Business Intelligence Big Data, 10th January 2021, viewed 8th April 2021, <<https://baijiahao.baidu.com/s?id=1688428076941043863&wfr=spider&for=pc>>

35 *Central Economic Work Conference held in Beijing*, Xinhua, 18th December 2020. Viewed 28th April 2021, <http://www.xinhuanet.com/politics/leaders/2020-12/18/c_1126879325.htm>

36 *National Real Estate Development Investment and Sales for January to April 2021*, NBS, 17th May 2021, viewed 9th June 2021, <http://www.stats.gov.cn/tjsj/zxfb/202105/t20210517_1817512.html>

37 *Core elements of the China-EU Comprehensive Investment Agreement*, Sohu, 2nd January 2021, viewed 8th April 2021, <https://www.sohu.com/a/441991731_120220684>





On 20th May 2021, the European Parliament voted to freeze any considerations on the ratification of the CAI. The European Chamber hopes that nonetheless some of the commitments made in the CAI can be further realised so China keeps advancing its reform and opening up agenda.³⁸

Key Recommendations

1. Promote the Expansion of Responsive and Safe Infrastructure in Rural and Urban Areas, in Particular in Small and Medium-sized Cities, and Utilise the Expertise and Knowledge of Foreign Companies in the Process

Concern

Remaining difficulties in accessing the domestic construction sector are preventing European businesses from fully operating and partnering with local companies and contributing to China's continued urbanisation.

Assessment

Despite further opening up in the construction sector, the industry is still included in the *Market Access Negative List*.³⁹ The list stipulates that construction companies in particular have to be approved as qualified construction enterprises. While the relevant requirements are equal for Chinese and foreign invested enterprises, it is naturally much harder for the latter to obtain the said qualifications.

This hardship is further exacerbated by the chronic difficulties that foreign-invested companies face when it comes to public procurement. The working group hopes that European companies can in the future increase their involvement, especially in the two key areas where the contributions of European-invested companies can add a great deal of value: green construction projects and public infrastructure.

European expertise could be of great benefit to China's

ongoing development, especially in the context of realising the 2030 peak carbon emissions and 2060 carbon neutrality goals. The plan for related activity in the construction sector would also benefit from being independently evaluated by a third-party international organisation.

The working group also believes European companies without service qualification should nonetheless, on a case-to-case basis, be encouraged to partake in the bidding process for large projects.

Recommendations

- Expedite reforms that will allow European CSPs to contribute more towards green buildings and sustainable/eco-cities as well as intelligent buildings, smart cities and smart communities in China.
- Encourage European companies' bidding participation in large projects without service qualification.
- Encourage European firms' contribution to the development of small and medium-sized cities and the improvement of urban utilities and infrastructure.

2. Allow European Companies Greater Access to the Bidding Process for Government Procurement Work

Concern

Foreign-invested companies face many constraints when it comes to being able to bid for government procurement work.

Assessment

China currently has two sets of laws governing public tendering: the Government Procurement Law (GPL) and the Tender and Bidding Law (TBL).^{40&41}

After its accession to the World Trade Organization (WTO) in 2001, China committed to join the organisation's Government Procurement Agreement (GPA) 'as soon as

38 *European Chamber Stance on the European Parliament Freezing of the CAI Ratification Process*, European Union Chamber of Commerce in China, 28th May 2021, viewed 18th June 2021, <https://www.eurochamber.com.cn/en/press-releases/3342/european_chamber_stance_on_the_european_parliament_freezing_of_the_cai_ratification_process>

39 *China Releases 2020 Negative List for Market Access*, China Briefing, 23rd December 2020, viewed 10th May 2021, <<https://www.china-briefing.com/news/china-2020-negative-list-market-access/>>; *Chinese official version: Notice of Market Access Negative List (2020 Edition)*, NDRP, 10th December 2020, viewed 10th May 2021, <https://www.ndrc.gov.cn/xxgk/zcfb/ghxwj/202012/t20201216_1252897_ext.html>

40 Broadly speaking, the GPL covers central and sub-central government purchases. See *The Government Procurement Law*, Standing Committee of the National People's Congress, 29th June 2002, viewed on 29th March 2021, <http://www.ccg.gov.cn/zcfg/gjfg/201310/t20131029_3587339.htm>

41 The TBL regulates all state-owned enterprise tenders, in particular, large-scale infrastructure projects (such as in construction, aviation, shipping, engineering, architecture, transportation, power and water), as well as large-scale, privately-invested projects for public interest (mainly joint ventures). See *Tender and Bidding Law*, China.org.cn, 12th February 2011, viewed on 29th March 2021, <http://www.china.org.cn/china/LegislationsForm2001-2010/2011-02/12/content_21908008.htm>



possible', and currently has observer status.^{42&43} On 21st October 2019, China submitted its seventh offer (sixth revised offer) for accession to the agreement.⁴⁴ This offer included further commitments to open up market access to foreign companies.

In this context, on 3rd December 2019, the NDRC proposed revisions of the TBL and invited public comments to be submitted by 1st January 2020. These revisions are part of a wider effort by China to give a new look to its already twenty-year-old procurement framework.⁴⁵

The Ministry of Finance is at time of writing examining how application of the GPL conflicts with the TBL, China's GPA accession and recent reforms in the country's procurement regime.⁴⁶ This is also in line with the Foreign Investment Law that came into effect at the beginning of 2020.⁴⁷ So far, the GPL "is much more closely aligned with GPA requirements than the TBL".⁴⁸

These proposed revisions by the NDRC with regards to the TBL could have a positive impact and lead to an increased transparency and improved fairness in tendering activities, which would "place the law closer to GPA requirements in some areas and less so in others".⁴⁹ The revisions would help China pave the way towards fulfilling its WTO commitments, but it remains to be seen how they will be implemented, as foreign companies still face many issues when it comes to

obtaining government procurement work. It is also worth mentioning that the longer China fails to accede to the GPA and open up its procurement markets, the more likely it is to end up in the crosshairs of the EU's proposed International Procurement Instrument (IPI).⁵⁰

The European Chamber's *Business Confidence Survey 2021* registered that 45 per cent of companies reported missing business opportunities due to market access restrictions and regulatory barriers, such as barriers to government procurement processes.⁵¹ This data serves to illustrate the widespread nature of the problem for European business.

Recommendation

- Join the WTO's GPA to allow foreign companies greater access to the bidding process on government procurement work

3. Facilitate Market Access for Foreign Planning, Architectural and Design, Construction, and Real Estate Service Providers to Enable Fair Competition and Encourage Expertise-sharing

Concern

European CSPs—including architects, quantity surveyors, project managers and contractors—face factual difficulties in entering 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 technology and

42 The GPA is a plurilateral agreement between 48 WTO member countries that have agreed to open up their non-defence public procurement markets to each other. Suppliers of each GPA member country can participate in the public procurement bids of other GPA member countries and be treated no less favourably than local bidders in the award of government contracts. However, out of these, 11 members are in the process of acceding to the Agreement (including China). See *Agreement on Government Procurement*, WTO, viewed on 29th March 2021, <https://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm>

43 Wang, P., 2009, *China's accession to the WTO – challenges and a way forward*, *Journal of International Economic Law*, vol. 12, no. 3, pp. 663–706, viewed on 29th March 2021, <<https://academic.oup.com/jiel/article-abstract/12/3/663/817776>>

44 *China Submits Revised Offer for Joining Government Procurement Pact*, WTO, 23rd October 2019, viewed on 29th March 2021, <https://www.wto.org/english/news_e/news19_e/gpro_23oct19_e.htm>

45 Jean Heilman Grier, *China: Revising Tendering and Bidding Law, Perspectives on Trade: Perspectives and Observations*, 13th April 2020, viewed on 29th March 2021, <<https://trade.djaghe.com/?tag=china-gpa-accession>>

46 *Government Procurement Law (Draft for Comments)*, MOF, 8th December 2020, viewed 13th June 2021, <http://www.gov.cn/hudong/2020-12/08/content_5567837.htm>; *Administrative Measures for the Management of Government Procurement Demand*, MOF, 10th May 2021, viewed 13th June 2021, <http://gks.mof.gov.cn/guizhangzhidu/202105/t20210510_3699403.htm>

47 *Foreign Investment Law of the People's Republic of China*, Investment Policy Hub, UNCTAD, 19th March 2019, viewed on 29th March 2021, <<https://investmentpolicy.unctad.org/investment-laws/laws/317/china-foreign-investment-law-of-the-people-s-republic-of-china>>

48 Jean Heilman Grier, *China: Revising Tendering and Bidding Law, Perspectives on Trade: Perspectives and Observations*, 13th April 2020, viewed on 29th March 2021, <<https://trade.djaghe.com/?tag=china-gpa-accession>>

49 Ibid.

50 *Legislative Train Schedule: A Balanced and Progressive Trade Policy to Harness Globalisation - A New EU International Procurement Instrument (IPI)*, European Parliament, 26th April 2020, viewed on 29th March 2021, <[https://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-international-procurement-instrument-\(ipi\)](https://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-international-procurement-instrument-(ipi))>

51 *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 08th June 2021, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>





management skills—including the proper application of new materials—which reduces the total amount needed for investment and the amount of labour needed, while also minimising disturbance to the environment. In most cases, European CSPs are not allowed to bid for third-parties contracts in Chinese Government projects. As a result, European service providers gain no due recognition for the value they add, cannot control the quality of the final design and their business opportunities in China are extremely limited.

Foreign construction companies have been permitted to establish wholly foreign-owned construction enterprises (WFOCEs) in China for more than 15 years. The relevant limitations on the performance of so-called wholly foreign-owned projects likewise were abolished in connection with the Foreign Investment Law, which is much appreciated.

In order to further level the playing field, fostering the mutual recognition of certificates, degrees and experience between China and the EU may help facilitate the issuance of construction and design licenses to European CSPs operating in China. The working group also recommends that foreign professionals in the field of architecture should be given the opportunity to conduct in English the exams needed to gain local Chinese qualifications, with the qualification based on knowledge of local codes and rules. This would guarantee fair and equal opportunities for foreign professionals in China.

Foreign companies would also like to see local standards and regulations standardised to coordinate with and guarantee the same quality as well-established European and international green building standards.

Recommendations

- Foster mutual recognition of degrees, certificates and experience to further level the playing field in terms of market access and business for foreign-invested construction and design firms.
- Improve local standards to reach the same quality as international green building standards.
- Allow qualification exams to be conducted in English so as to open fair opportunities for foreign professionals.

4. Continue to Ensure a Fair, Balanced and Open Market Exists for Foreign Investment in the Real Estate Sector 11

Concern

In China's RE sector, both foreign and domestic developers face considerable practical hurdles in the form of strict requirements, and European land developers are still locked out due to stringent regulation and government approval process.

Assessment

The RE field in China still has very stringent regulations that cause a lot of problems for both domestic and foreign enterprises. RE foreign-invested enterprises (FIEs) are faced with even more stringent regulations than ordinary FIEs. 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)*,⁵² addresses a variety of measures for controlling the flow of foreign capital. Besides outlining the required 50 per cent proportion between registered capital and investment, it lists two more conditions that affect FIEs: they are not allowed to obtain loans from Chinese or overseas sources before getting land-use rights certification, or before realising 35 per cent of their total investment.⁵³ This creates unfair competition between local and foreign companies, especially in relation to the different requirements for registering capital.

In 2015, the *Notice to Adjust Policies regarding Market Access and Administration of Foreign Investment in China's Real Estate Market (Circular No. 122)* rescinded these requirements relating to the full payment of registered capital by FIEs and on the proportion of registered capital having to equal up to 50 per cent of total investment. Furthermore, *Circular No. 122* simplified the procedure allowing foreign-invested RE companies to register foreign currencies directly.⁵⁴

52 *Impact of Recent Restrictions on Foreign Investors in the Chinese Real Estate Market*, JD, March 2008, viewed on 29th March 2021, <<https://www.jonesday.com/en/insights/2008/03/impact-of-recent-restrictions-on-foreign-investors-in-the-chinese-real-estate-market>>

53 Regarding the realisation of total investment, the rate is also 35 per cent for domestic companies. See, *Guidance to Risk Management of Real Estate Loan for Commercial Banks [2004] No. 57*, Central People's Government of the People's Republic of China, 30th June 2006, viewed on 29th March 2021, <http://www.gov.cn/ztl/2006-06/30/content_323806.htm>.

54 *Notice to Adjust Policies Regarding Market Access and Administration of Foreign Investment in China's Real Estate Market*, MOHURD, 19th August 2015, viewed on 29th March 2021, <http://www.mohurd.gov.cn/wjfb/201508/t20150828_224060.html>





The working group welcomed this improvement and recognised the positive steps undertaken by the Chinese authorities to promote a more mature and international investment environment. However, the working group believes that outdated or obsolete terms and restrictions carried forward from *Circular No. 171* need to be clarified. It has been six years since *Circular No. 122* was released as an update, and no significant improvement has yet been seen on this issue.

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.⁵⁵ Some of the stringent measures introduced in this circular have not been removed yet.

For instance, *Circular No. 122* does not expressly address a major practical hurdle that RE FIEs face when seeking foreign loans, i.e., according to relevant regulations issued by the State Administration of Foreign Exchange (SAFE),⁵⁶ any RE FIE approved and registered with the Ministry of Commerce (MOFCOM) on or after 1st June 2007 is not permitted to register its foreign debts with SAFE. Therefore, unless SAFE makes further clarifications on this point, the benefits and flexibility brought by *Circular No. 122* will be limited.

Recommendation

- Issue further clarifications or implementing rules regarding the relaxation brought by *Circular No. 122* so as to create a fair market environment for foreign companies investing in the Chinese RE market

Abbreviations

5G	Fifth Generation
CAI	Comprehensive Agreement on Investment
CNY	Chinese Yuan
COVID-19	Coronavirus Disease 2019
CSP	Construction Service Provider
EU	European Union
FIE	Foreign-invested Enterprise
GBA	Greater Bay Area
GDP	Gross Domestic Product
GPL	Government Procurement Law
IPI	International Procurement Instrument
km	Kilometre
m ²	Square Metres
MIIT	Ministry of Industry and Information Technology
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOHURD	Ministry of Housing and Urban-rural Development
MOST	Ministry of Science and Technology
NBS	National Bureau of Statistics
NDRC	National Development and Reform Commission
RE	Real Estate
SAFE	State Administration of Foreign Exchange
SAIC	State Administration of Industry and Commerce
SOE	State-owned Enterprise
TBL	Tender and Bidding Law
WFOCE	Wholly Foreign-owned Construction Enterprise
WTO	World Trade Organisation
YRD	Yangtze River Delta

⁵⁵ *Notice on Further Strengthening and Regulating the Examination, Approval and Supervision of Foreign Direct Investment in the Real Estate Industry*, MOFCOM, 23rd May 2007, viewed on 29th March 2021, <<http://www.mofcom.gov.cn/aarticle/b/g/200707/20070704900232.html>>

⁵⁶ *Notice of the Measures for the Administration of Foreign Debt Registration*, SAFE, 28th April 2013, viewed 29th April 2021, <http://www.gov.cn/zwqk/2013-05/03/content_2395170.htm>





Heating Sub-working Group

Introduction to the Sub-working Group

The Heating Sub-working Group (or the Europe China Heating Initiative (ECHI)) seeks to promote European technologies that provide eco-friendly and sustainable heating appliances and components. The goal is to ensure that energy resources are conserved, while air quality is improved by significantly decreasing pollutant emissions. The 'coal-to-gas' (CTG) transition programme¹ is one of China's national strategies to fundamentally reduce particulate matter and nitrogen oxide (NOx) emissions, as well as to achieve increased energy efficiency.² European heating manufacturers can make significant contributions to the successful implementation of the CTG strategy while helping China to realise its carbon neutrality goals. The recommendations in this *Position Paper* aim to provide Chinese stakeholders with valuable industry insights and experience to improve the regulatory environment of the heating industry in China and benefit the Chinese population.

The ECHI was created in 2002. It currently consists of 12 European enterprises involved in the manufacturing of highly efficient and renewable-based heating technologies and heating components. They manufacture heating appliances (such as high-efficiency heating boilers), burners, water heaters, renewables (such as 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 Developments

In 2020, the CTG market drove demand for gas-fired heating and hot water combi-boilers (hereinafter

referred to as heating boilers), whereas the non-CTG market (traditional retail and engineering) for heating boilers declined, primarily due to the pandemic. According to the China Gas Heating Specialty Committee (CGHC), in 2020, the total sales volume of heating boilers in the Chinese market was 4.2 million units, a four per cent increase compared with 2019 (4.02 million units). Specifically, the total sales volume of the CTG market was 2.68 million units, an increase of 17 per cent compared with 2019 (2.3 million units). Only 1.52 million units were sold in the non-CTG market, down 12 per cent on 2019 figures (1.72 million units). The sales volume of imported brands in the non-CTG market was similar to that of Chinese brands; the former fell about 11 per cent on average.³

In terms of product technology, in 2020, the overall sales volume of condensing wall-hung boilers (hereinafter referred to as condensing boilers) was 220,000 units, a slight decrease compared with 2019 (250,000 units). However, the sales volume of condensing boilers in the non-CTG market trended higher, indicating that consumer demand for energy saving is picking up.⁴ In 2020, 210,000 units were sold, an increase of 24 per cent compared with 2019 (170,000 units). This spike was led by rapid growth in sales of semi-condensing Chinese products, rather than in sales of full premixed condensing technology of imported brands.

On 1st October 2020, the production licence scheme for heating boilers was replaced by the China Compulsory Certification (CCC), which counters the sale of parallel imports and facilitates standardisation in the industry.⁵

Regulatory Environment

The Chinese authorities are currently pursuing two clear policy trends in the heating industry. The first is encouraging product standardisation by introducing more rigorous standards to promote the quality and safety of consumer goods. On 5th July 2019, the State Administration for Market Regulation (SAMR) issued

1 CTG strategy refers to the energy efficiency policy of the Chinese central government and the Beijing-Tianjin-Hebei governments to promote replacing coal with natural gas.

2 Notice on the Action Plan for Comprehensive Management of Air Pollution in the Autumn and Winter of 2018/2019 in Beijing-Tianjin-Hebei and Surrounding Areas, Ministry of Ecology and Environment (MEE), 21st September 2018, viewed 31st March 2021, <http://www.mee.gov.cn/gkml/sthjbgw/sthjbjw/201809/120180927_630570.htm>

3 Gas Heating and Hot Water Combi-Boiler 2020 Market Statistics, Chinaburner.com, 12th March 2021, viewed 29th March 2021, <<https://www.chinaburner.com/thread-27047-1-1.html>>

4 Ibid.

5 It's Final! Wall-hung boilers and Other Domestic Gas Appliances Will Be Managed by China Compulsory Certification (CCC) from 1st October, Sohu, 10th July 2019, viewed 29th March 2021, <https://www.sohu.com/a/325952675_787335>





the *Notice on Implementation Measures for Moving Explosion-proof Electrical and Other Products from the Production Licence to China Compulsory Certification Management*. Enterprises had a one-year transition period to prepare for the new CCC scheme to take effect on 1st October 2020.

The national standard *GB 25034-2010 Gas-fired Heating and Hot Water Combi-boilers* was superseded by *GB 25034-2020 Gas-fired Heating and Hot Water Combi-boilers*, to take effect on 1st November 2021. The new standard broadens the scope for heater boilers from 70 kilowatt (kW) to 100kW. It also covers condensing boilers, and amends various requirements for product performance.

The second policy trend is further enhancing ecological and environmental governance and improving environmental quality. The *Government Work Report* delivered by Premier Li Keqiang at the annual National People's Congress and the Chinese People's Political Consultative Conference in March 2021 identified improving environmental quality as a priority for the year. This involves: strengthening the integrated management and joint prevention and control of air pollution; enhancing the coordinated control of fine particulate matter and ozone pollution; and attaining a clean heating rate of 70 per cent in north China.⁶

According to the *Notice of the National Energy Administration (NEA) on Issuing the Guiding Opinions on Energy Work in 2020*, clean heating would be steadily promoted in north China by:



- Preparing for the winter heating season in advance;
- Adhering to the principle of “以气定改、先立后破” - ‘assess natural gas reserves/resources in order to determine the best path for CTG conversion’;
- Clarifying the responsibilities of local governments and enterprises;
- Steadily advancing CTG work in key areas of north China;
- Supporting the development of back-pressure cogeneration;⁷ and
- Actively promoting technological applications of wind power, geothermal energy and biomass energy.

⁶ *Report on the Work of the Government (Delivered at the Fourth Session of the 13th National People's Congress of the People's Republic of China, 5th March 2021)*, gov.cn, 5th March 2021, viewed 29th March 2021, <<http://www.gov.cn/zhuanti/2021lhfgzbg/index.htm>>

⁷ Back-pressure cogeneration technology refers to generator sets that adjust the generation load according to the thermal load

Additionally, ways to promote household-based metered heating would be explored, and the thermal insulation and energy conservation of buildings improved, fostering a new society featuring energy conservation.⁸ Clean heating methods such as CTG and ‘coal-to-electricity’ (CTE) have played an important role in reducing air pollution in winter. The comprehensive control plan for air pollution released every year on provincial or municipal (directly under the central government) levels also emphasises restrictions on the emission of air pollutants. The Heating Sub-working Group hopes that China's efforts to foster energy efficiency and reduce environmental pollution will further boost the market for highly efficient and energy-saving boilers. The heating industry is facing an ever-changing regulatory environment and market demand in China. While the sub-working group is ready to share its experiences to help China achieve its environmental and energy goals, it hopes that the relevant authorities will fully consider the interests of enterprises, and promote collaborative and healthy development of the industry in the process of policy formulation and implementation.

Key Recommendations

- 1. Update the Standard for Energy Efficiency of Domestic Gas Appliances and Introduce National Guidelines or Policies to Promote Full Premixed Condensing Boilers with Level I Energy Efficiency**  2
- 1.1 Update the Energy Efficiency Standard, and Refine and Improve Requirements for Domestic Gas Appliances**  2

Concern

The energy efficiency standard for heating boilers is out of date and does not reflect the energy efficiency levels such appliances can actually achieve.

Assessment

GB 20665-2015 Minimum Allowable Values of Energy Efficiency and Energy Efficiency Grades for Domestic Gas Instantaneous Water Heaters and Gas-fired Heating and Hot Water Combi-boilers,⁹ which took

⁸ *Notice of the NEA on Issuing the Guiding Opinions on Energy Work in 2020*, NEA, 22nd June 2020, viewed 29th March 2021, <http://www.nea.gov.cn/2020-06/22/c_139158412.htm>

⁹ *GB 20665-2015 Minimum Allowable Values of Energy Efficiency and Energy*





effect in June 2016, has played a vital role in promoting the structural upgrading of heating boilers, and implementing energy-saving and emission-reduction requirements for gas appliances. The standard divides energy efficiency into three levels: the thermal efficiency value for Level I equals a minimum of 96 per cent, Level II a minimum of 88 per cent, and Level III a minimum of 84 per cent. Currently, only heating boilers of Level II or higher can enter the market. Some regions and cities have already started to promote a large-scale utilisation of Level I energy efficiency heating boilers only, with Levels II and III becoming obsolete. However, the energy efficiency of the latest full premixed condensing boilers can reach 108 per cent of the current standard,¹⁰ therefore updating the standard would help promote the use of the most efficient products on the market while continuing to weed out products with lower energy-efficiency rates.

In Europe, energy labels for household appliances display seven levels and have specific requirements relating to the energy efficiency of the main components, which helps to better categorise products.¹¹ While European standards for energy efficiency of domestic appliances differ from Chinese standards, a more refined evaluation system in China would encourage manufacturers to pursue higher energy efficiency.

Recommendations

- Update and refine the energy efficiency standards for domestic gas appliances.
- Refine and improve the efficiency requirements for domestic gas appliances.

1.2 Introduce Policy Guidelines for Promoting Energy-saving and Low-emission Gas Boiler Technologies 2

Concern

The government does not sufficiently encourage the adoption of energy-efficient and low-emission heating technologies, such as full premixed condensing

technology, while relevant applications and research are limited, resulting in a lack of active promotion of air pollution control or energy efficiency policies.

Assessment

There are two main types of heating boilers: conventional and condensing. Condensing boilers increase energy efficiency by up to 20 per cent and reduce pollutant emissions; for example, they can cut NOx emissions by up to 75 per cent compared with non-condensing models.¹²

Therefore, it is better when formulating guidelines and policies on energy efficiency and pollution control in construction projects to promote the use of condensing boilers from first installation. Doing so will eliminate the need to rearrange corresponding accessories and pipes in order to replace conventional gas boilers in the future.

Article 26 of Beijing's *Three-year Action Plan for Winning the Battle of Blue Sky Protection*, a guiding document on energy conservation and emission reduction from 2018–2020, states clearly:

Further reduce NOx emissions from heating boilers. The Beijing Municipal Commission of Housing and Urban-Rural Development leads the revision of the *Municipal Catalogue of Promotion, Restriction and Prohibition of the Use of Building Materials*. In new, renovation and expansion projects, the use of condensing boilers with Level II energy efficiency or below is prohibited, and NOx emissions must meet the Level V requirement of the condensing boilers national standard.¹³

This guideline helped to effectively control pollutant emissions while reducing consumers' gas fees.

The relevant institutions lack full understanding of premixed condensing technology applications and its energy-conserving and emission-reducing benefits. China lacks supporting policies to encourage high-efficiency and low-emission heating technologies, such

Efficiency Grades for Domestic Gas Instantaneous Water Heater and Gas-fired Heating and Hot Water Combi-boilers, openstd.samr.gov.cn, 15th May 2015, viewed 19th March 2021, <<http://www.gb688.cn/bzgk/gb/newGbInfo?hcno=75D38814EF3EE95E56E53DC00CF759C6>>

10 *Gas Condensing Technology: Key for Efficiency and Clean Air in China*, ECHI, 3rd June 2019, viewed 19th March 2021, <https://www.bdh-koeln.de/fileadmin/user_upload/ISH2019/Broschueren/broschuere_februar_2019_gas_condensing_technology_en.pdf>

11 *About the Energy Label and Ecodesign*, European Commission, n.d., viewed 19th March 2021, <https://ec.europa.eu/info/energy-climate-change-environment/standards-tools-and-labels/products-labelling-rules-and-requirements/energy-label-and-ecodesign/about_en>

12 *Gas Condensing Technology: Key for Efficiency and Clean Air in China*, ECHI, 3rd June 2019, viewed 19th March 2021, <https://www.bdh-koeln.de/fileadmin/user_upload/ISH2019/Broschueren/broschuere_februar_2019_gas_condensing_technology_en.pdf>

13 *Three-year Action Plan for Winning the Battle of Blue Sky Protection*, Xinhua, 15th September 2019, viewed 19th March 2021, <http://www.xinhuanet.com/2018-09/15/c_1123433365.htm>





as full premixed condensing technology, which offers high energy efficiency and low NOx emissions and has relatively low replacement costs.

Most studies on premixed condensing technology applications are from enterprises and associations, such as the Beijing Association of Building Energy Efficiency and Environmental Engineering. Very few universities have relevant departments or research programmes, except for Tongji University and Tianjin Chengjian University, which have research projects on condensing technology and full premixed combustion. The Heating Sub-Working Group recommends that industry stakeholders and authorities consider the advantages of full premixed condensing technology. It is necessary to strengthen relevant Chinese institutions' research in full premixed condensing technology applications and the effects on energy conservation and emission reduction. Also, the working group recommends implementing subsidies for high-efficiency and low-emission technologies such as full premixed condensing boilers in major cities and regions, and further expanding the projects to more areas to encourage consumers to purchase full premixed condensing boilers.

Recommendations

- Introduce policy guidelines for promoting energy-saving and low-emission technologies, starting from key cities and regions.
- Issue relevant policies to encourage consumers to buy full premixed condensing boilers for the first installation of heating in a building.
- Encourage research projects on full premixed condensing technology, including its application, energy-saving and emission-reducing effects.

2. Improve and Effectively Implement Standards for the Installation and Maintenance of Heating Boilers, and Educate Consumers on the Need for Regular Maintenance and Replacement



2.1 Strengthen the Standardisation and Management of the Installation of Heating Boilers

2.1.1 Improve the Standards for Installation of Heating Boilers and Strengthen the Standardisation and Management of Responsible Enterprises and Personnel

Concern

The development of the heating boiler market is hindered by the lack of adequate installation technical guidelines or standards, as well as the varying competence of enterprises and personnel responsible for installation, which raise safety concerns.

Assessment

Heating boilers are complex products that require the installation of heating and hot water systems. The operation of these products involves the use of gas, running water, electricity, air intake and exhaust pipes. To ensure long-term efficient use and stable and safe operation, equipment manufacturers should provide a complete set of products and systems as well as periodic servicing and maintenance (see Key Recommendation 2.2).

The Chinese Government and authorities have issued new national standards for heating boilers and formulated industry standards for product applications. However, there is still a lack of effective monitoring and maintenance after installation. Although the installation of heating boilers requires professionals and enterprises with technical capabilities to select, design, and install the entire system, the authorities lack effective rules and regulations for monitoring practitioners' and enterprises' capabilities, and for supervising installations. Based on feedback from enterprises, the main issues that arise during warranty are a result of low-quality installation. If installation quality cannot be effectively controlled and improved, it will hinder the further development of the industry.

European Union (EU) Member States have over 50 years of rich experience in using heating boilers. More importantly, EU heating boiler-related standards, products, applications and services are mature and comprehensive. EU Member States also have well-regulated and mature methods and systems for certifying the qualifications of installation engineers and providers. European enterprises represented by the ECHI entered the Chinese market quite early, and therefore have much experience—from both China and Europe—to assist the Chinese authorities in formulating relevant regulations. Establishing a training mechanism in China for heating boilers installers and a vocational threshold would promote the technical skills of qualified installers and ensure the quality of installation as well as safety during subsequent usage.





Recommendations

- Formulate and implement regulations for installation of heating boilers.
- Improve the training for personnel and enterprises responsible for installation and establish a vocational certification system.

2.1.2 Reasonably Adjust the Content and Cycle of Product Tests for Local Market Access based on the CCC Policy

Concern

Since implementing the CCC policy, authorities' requirements for product quality control and supervision have improved, but local repetitive test items and the test cycle remain unchanged.

Assessment

In recent years, as China has amended standards and requirements relating to natural gas supply, the quality of the fuel has improved and stabilised.

According to the SAMR notice on the *Implementation Requirements*, published on 5th July 2019, domestic gas appliances will be managed by the CCC from 1st October 2020. The notice contains high-level requirements for product quality control and management of gas appliance companies. In the *Decision of the State Council on Further Reducing the Catalogue of Production Licences for Industrial Products and Simplifying the Examination and Approval Procedures*,¹⁴ the transition to the CCC system for products involving public health, safety and environmental protection is to 'unify certification standards and reasonably reduce and combine certification test items'. The new management system aims at unifying the market access conditions as well as simplifying the industrial product approval procedure.

Tests for domestic gas appliances under the previous production certification system and tests on the compatibility of local gas sources are not aligned in terms of test items or standards. Additionally, the tests overlap with or exceed test items under the new CCC system. The sub-working group believes that the various tests could be integrated and optimised alongside the implementation of the CCC system and

GB 25034-2020 Gas-fired Heating and Hot Water Combi-boilers.

Recommendation

- Reasonably reduce repetitive test items for local market access, and extend the test cycle.

2.2 Strengthen the Publicity and Effective Supervision of the Maintenance of Heating Boilers 2

Concern

Consumers only pay attention to the initial investment in the purchase and installation of heating boilers, and overlook the servicing and maintenance necessary for long-term operation.

Assessment

In European countries, where technologies and applications for heating boilers are quite developed, the necessity for regular maintenance has been accepted by the public. As a result, Europe has mature supervision measures, which could act as an example for Chinese market regulators and consumers. However, cultivating Chinese consumers' awareness of the need to regularly maintain heating boilers depends on vigorous publicity and effective supervision by relevant authorities, along with appeals and calls from the industry.

Regular maintenance guarantees the efficient operation of heating boilers, increases reliability, prolongs service life, and reduces operation costs and risks. Regular inspection is an indispensable part of maintenance. In Europe, there is a system for periodic inspection for leakage of flue combustion emissions (such as carbon monoxide and NO_x), originally established for environmental protection but which also secures combustion performance and safety of the boilers.

Recommendations

- Strengthen effective supervision of regular maintenance of heating boilers, and educate consumers accordingly.
- Issue regulations for periodic maintenance of heating boilers to ensure their efficient and safe operation.

¹⁴ *Decision of the State Council on Further Reducing the Catalogue of Production Licenses for Industrial Products and Simplifying the Examination and Approval Procedures*, State Council, 30th September 2018, viewed 19th March 2021, <http://www.gov.cn/zhengce/content/2018-09/30/content_5327123.htm>





2.3 Cultivate Consumers' Awareness of the Need for Timely Removal and Replacement of Heating Boilers with High Energy Consumption and Emissions or Those at the End of Their Service Life

Concern

Chinese consumers are not accustomed to replacing heating boilers that have reached the end of their service life or that do not meet relevant regulations.

Assessment

Replacement of heating boilers with high energy consumption and high emissions is not only conducive to improving environmental protection, but also helps to reduce maintenance requirements and costs for users. Heating boilers have been installed and used in China for more than 20 years, and a certain number of products in the market have exceeded their intended service life. If these old products are not replaced in line with relevant regulations, emissions of carbon dioxide and NOx will not be reduced as fast as is needed. The sub-working group is aware that several EU Member States have started programmes to assess the age and efficiency of previously installed condensing boilers. This has raised awareness among consumers that some products need to be replaced and that energy and household expenses could be saved by doing so. In Beijing, new, renovation and expansion projects prohibit the use of heating boilers with Level II energy efficiency or below, and support and encouragement to replace about 800,000 low-efficiency and high-emission heating boilers is to start in the near future.¹⁵ This will help to improve regional air quality and save energy. The Heating Sub-working Group hopes that such replacement work can be embarked on in more places.

Recommendations

- Cultivate consumers' awareness of the need for timely removal and replacement of heating boilers with high energy consumption and emissions or those at the end of their service life.
- Formulate policies to encourage and support consumers to replace low-efficiency and high-

energy-consumption heating boilers that have reached the end of their service life with more efficient and eco-friendly full premixed condensing boilers.

Abbreviations

CCC	China Compulsory Certification
CGHC	China Gas Heating Specialty Committee
CTE	Coal-to-electricity
CTG	Coal-to-gas
ECHI	Europe China Heating Initiative
EU	European Union
kW	Kilowatt
MEE	Ministry of Ecology and Environment
NEA	National Energy Administration
NOx	Nitrogen Oxide
SAMR	State Administration for Market Regulation

¹⁵ Beijing Building Energy-Efficiency & Environment Engineering Association, China Quality Supervising and Test Centre for Gas Appliances, Guangdong Gas Combi-Boiler Chamber of Commerce and the ECHI jointly submit a report on the research project of BCEMA on replacing wall-hung boiler policy in Beijing to Beijing Municipal Government in 2020, BCEMA, 2020, report not available publicly.





Information and Communication Technology Working Group

Key Recommendations

1. Open up China's Value-added Telecoms Services (VATS) Sector Further to International Investment and Ease Internet Access 12

- Reduce further 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 internet resources collaboration, internet protocol virtual private networks, internet access services, online data processing and transaction services, and information services.
- Maintain international companies' full access to the 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 Information and Communication Technology (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 12

- Ensure openness and transparency in the standardisation process, as well as full and equal membership rights for international companies in all ICT-related Standards Developing Organisations (SDOs) in China, including social organisations and industrial alliances.
- Encourage a non-discriminatory and globally-harmonised spectrum policy for mobile broadband and the 60 gigahertz frequency band 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 Agreement for any standard that is applicable to mandatory conformity assessment and market access.

3. Develop and Implement Commercial Cryptography Laws, Regulations, Standards and Conformity Assessment Systems in Such a Way that They are Clear, Fair and Conducive to International Harmonisation 2

- Reference explicitly the primary function test in the revised *Commercial Cryptography Regulation*.



- Define narrowly the scope of commercial cryptography products subject to testing, certification and application security assessment.
- Refrain from mandating or expanding the scope of conformity assessment under the guise of 'application promotion', and revise incompatible regulations, standards and conformity assessment systems.
- Ensure efficient and streamlined conformity assessment processes for commercial cryptography, and that intellectual property (IP) and trade secrets are protected.
- Allow the adoption of international standards related to commercial cryptography.
- Define 'mass consumer products' as 'cryptography features as found in components and products openly available to the public, that can be either charged or free, for personal or business use, and where the cryptographic functionality cannot be modified by the end user'.
- Clarify the scope and processes for commercial cryptography application security assessments in such a way that they are proportionate and non-disruptive to normal business activities.
- Apply clarity and transparency to the design and implementation of the Cryptography Law's implementing regulations and ensure that any such regulations, including standards, are fully in line with the superordinate law.

4. Ensure Equal Opportunities for International Companies in China under Chinese Industrial Policies 12

- Establish fair competition by reforming market access conditions, enhancing post-market supervision and further strengthen IP rights protection through concrete policy measures.
- Ensure China's guiding industrial policies are conducive to innovation and fair competition, and are not used to foster an unlevel playing field for domestic industry.
- Encourage greater reciprocity in ICT innovation and, in line with the Foreign Investment Law, 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 funds, R&D deductions and other supportive policy incentives under China's industrial policies.
- Ensure that government-guidance funds operate under market principles.

Cybersecurity Sub-working Group

1. Ensure that Cybersecurity Schemes do not Create Discriminatory Market Access Barriers 5

- Define the concepts of 'national security' and 'critical information infrastructure' as narrowly as possible, and differentiate them from 'commercial security' in a clear manner.
- Limit the applicability and influence of the various theoretically non-binding documents, such as recommended national standards, in such a manner that they do not overcome the binding legislations.
- Promote mutual recognition and adoption and reliance upon, applicable international standards and global industry best practices.
- Relax restrictions on cross-border data transfer to allow easier market access.
- Take steps to ensure that the terms negotiated in cross-national trade and investment deals are effectively implemented in practice.





2. Eliminate Unnecessary Operational Burdens Created by Extensive and Ambiguous Cybersecurity Schemes, and Potentially Intrusive Enforcement and Inspections 🌐 6

- Develop clear, consistent and harmonised cybersecurity-related rules and promote a design-neutral approach to regulation and rule to ensure flexibility.
- 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 a coordinated and unified approach for oversight and enforcement among the government authorities involved.
- Reduce cybersecurity-related administrative burdens on companies, including those due to duplicative or fragmented certification requirements.
- Remove inspection, system connection and penetration testing requirements in cybersecurity management-related articles.

3. Ensure Transparency, Consistency, Non-discrimination and Proportionality in Cybersecurity Rule-making and Law Enforcement 🌐 2

- Provide an open and transparent platform that allows European industry to engage in cybersecurity rule-making in a timely and meaningful manner.
- Review existing and planned security-related laws and regulations, and release unambiguous implementation guidelines to ensure consistent requirements and enforcement.
- Clarify the roles and responsibilities of government authorities involved in cybersecurity rule-making.
- Recognise international companies as Chinese companies and avoid extensive interpretations of 'national security'.
- Ensure cybersecurity regulations are appropriate to and commensurate with the risk.

Introduction to the Working Group

The information and communication technology (ICT) industry plays a fundamental role in economic and social development that will benefit both the European Union (EU) and China if both sides commit to further cooperation. 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 R&D operations with well-established links to Chinese universities and research institutes that contribute significantly to ICT sectoral development in China.

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, R&D, interoperability and global harmonisation. The Information and Communication Technology Working Group contains the Cybersecurity Sub-working Group.

Recent Developments

COVID-19

With China accounting for approximately 20 per cent of the world's intermediate products for manufacturing, the pandemic has continued to have a considerable impact on global supply chains, especially with demand increasing for critical electronic components. Another consequence of the coronavirus disease 2019 (COVID-19) outbreak that has carried over into 2021 is the risk of accelerated decoupling. These trends were also exacerbated by the United States (US)-China





trade tensions, which both predated and continued throughout the pandemic. Increased securitisation of the ICT sector in both China and the US is adding to concerns that international market players will be forced to choose bifurcated supply-chain strategies, risking further damage to global innovation, efficiency and economies of scale. The working group therefore urges the equal treatment of foreign companies in order to promote greater global cooperation between China and the rest of the world.

14th Five-year Plan (2021–2025)

The 14th Five-year Plan (2021–2025) (14FYP), approved during the 2021 Two Sessions, carries several implications for the European ICT businesses.¹ Most notably, it enshrines China's indigenous innovation objectives. China aims to increase the value-add of products and services in strategic emerging industries—including artificial intelligence (AI), big data, integrated circuits and quantum computing—to reach more than 17 per cent of gross domestic product (GDP) over the next five years. With massive investment increases in science and technology R&D for cutting-edge hinted at in the 14FYP, the working group hopes that foreign companies will be extended equal opportunities in terms of access to upcoming research programmes and related funds.

EU-China Comprehensive Agreement on Investment

The working group welcomed the completion of negotiations for the EU-China Comprehensive Agreement on Investment (CAI). Though the CAI is currently frozen,² if ratified and implemented, the working group believes the CAI will help bolster European business confidence in the China market, particularly in terms of levelling the playing field for foreign business relative to state-owned enterprises (SOEs), and the commitments to prohibit forced technology transfers and other market distorting practices. European ICT companies are also supportive of new market access commitments by China to further open up services, including the cloud services sector, to European investment. The working group hopes

that these important developments will be reliably monitored, implemented and enforced upon ratification, to ensure that commitments are honoured in practice.

New Infrastructure Plans

On 4th March 2020, the Central Politburo Standing Committee of the Communist Party of China called for an accelerated effort in the building of 'new infrastructure'. This concept, first announced in 2018, encompasses fifth generation (5G) mobile networks, ultra-high-voltage power facilities, inter-city transport, electric vehicle charging stations, big data centres, AI and industrial internet. Both the central government and many provincial-level regions have included new infrastructure projects in their government work reports.³ On 20th April 2020, the National Development and Reform Commission (NDRC) further clarified the concept and scope of new infrastructure, which at present includes three main aspects: information-based infrastructure; converged infrastructure supported by applications of new technologies such as the Internet, big data and AI; and innovative infrastructures that support scientific research, technology and product development.^{4&5} It differentiates from 'traditional infrastructure' in that it focusses on the digital intelligent transformation of the economy to promote data-driven industries.

Key Recommendations

1. Open up China's Value-added Telecoms Services (VATS) Sector Further to International Investment and Ease Internet Access 12

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

As China's market continues to develop, ICT revenues will increasingly be derived from the supply of services,

1 The 14th Five-year Plan for the National Economic and Social Development of the People's Republic of China and the Outline of the Long-term Goals for 2035, State Council, 13th March 2021, viewed 9th April 2021, <http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm>

2 European Chamber Stance on the European Parliament Freezing of the CAI Ratification Process, European Union Chamber of Commerce in China, 28th May 2021, viewed 22nd June 2021, <https://www.eurochamber.com.cn/en/press-releases/3342/european_chamber_stance_on_the_european_parliament_freezing_of_the_cai_ratification_process>

3 China Speeds Up 'New Infrastructure' Investment to Combat Economic Pressure, China Daily, 5th March 2020, viewed 27th April 2021, <<http://www.chinadaily.com.cn/a/202003/05/WS5e60b362a31012821727ca4b.html>>

4 NDRC: Speed Up the Introduction of a Package of Macro-Policies to Ensure the Smooth Operation of The Economy, State Council, 20th April, viewed 27th April 2021, <http://www.gov.cn/xinwen/2020-04/20/content_5504535.htm>

5 Getting to Know China's New Infrastructure Projects, CGTN, 6th May 2020, viewed 27th April 2021, <<https://news.cgtn.com/news/2020-05-06/Getting-to-know-China-s-new-infrastructure-projects-QfIOLy9khq/index.html>>





applications and content. The convergence of telecoms, the Internet, consumer electronics and media industries is 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 its market and encourage innovation. While European companies have played an important role in supplying ICT infrastructure, devices, services and applications to and in China, thereby creating a significant source of employment, they have by and large been excluded from new opportunities in the ICT market.

According to China's *2020 Negative List for Foreign Investment*,⁶ 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 sectors 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. In order to better accommodate technological advancements, substantial changes are needed to open up the majority of VATS, which remain restricted.⁷

Although China has announced that it will gradually remove a number of restrictions on foreign shareholding for companies operating in certain free trade or service pilot zones, detailed implementation plans have not yet been released.⁸ Foreign enterprises that want to apply for a VATS licence or qualify to take part in such pilot schemes are therefore not clear on how to do so. Furthermore, even if the pilots do not restrict enterprises based on their shareholding structure, foreign companies still face other existing restrictions; as they are only able to deliver cloud, internet protocol virtual private network (IP-VPN) or other VATS services in specific, limited areas, such as the Hainan free trade port, they are unable to meet national coverage

requirements of national pilot schemes.

a. Internet Resources Collaboration (IRC)

Among the various types of VATS under the 2015 revision of the *Telecoms Catalogue*,⁹ according to working group members, IRC is one of the services that foreign players most wish to be able to provide. IRC is defined as a sub-category of Internet Data Centre (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 providers still find themselves confronted with insurmountable market access barriers in the form of licensing requirements.

b. IP-VPN

International companies in China have limited access to domestic IP-VPN services. Reduced access to information will inevitably negatively impact businesses and innovation in China as well as cross-border transactions and ultimately investments, as all are underpinned by free access to, and flow of, information. Further opening-up of domestic IP-VPN services would therefore help increase competition and bring more affordable solutions to companies, small and medium-sized enterprises in particular.

c. Internet access services

The working group welcomes the new trial policy allowing foreign participation in internet access services announced by the Beijing Government and the State Council in February 2019.¹⁰ Large-scale opening in internet access services is strongly needed at the national level, so this trial will have a positive impact on guiding industry openness and development. However, implementation plans are needed to provide clarity to foreign enterprises that want to apply for such a licence or trial qualification.

d. Online data processing and transaction services

Online data processing and transaction services are growing in relevance for big data service providers and other data platform businesses. However, many foreign

6 *Special Management Measures for Foreign Investment Access (Negative List) (2020)*, NDRC, 23rd June 2020, viewed 27th April 2021, <https://www.ndrc.gov.cn/xxgk/zc/fb/fzggwl/202006/t20200624_1231938.html>

7 According to an *Analysis Report on Domestic Value-added Telecommunications Business Licensing* by the China Academy of Information and Communication Research, as of the end of February 2021, foreign-invested enterprises accounted for only 1.7 per cent of the total number of VATS business operators issued by the MIIT.

8 *Temporary adjustments of relevant administrative regulations in the Pilot Free Trade Zones (2017) No. 57*, State Council, 9th January 2018, viewed 21st June 2021, <http://www.gov.cn/zhengce/content/2018-01/09/content_5254764.htm>

9 *Telecoms Catalogue*, MIIT, 28th December 2015, viewed 27th April 2021, <https://www.miit.gov.cn/zwgk/zcwj/wjfb/tg/art/2020/art_e98406cd89844f7e92ea1bcf3b5301e0.html>

10 *Reply of The State Council on the Comprehensive Pilot Work Plan for Promoting the Expansion and Opening Up of Beijing's Service Industry*, State Council, 22nd February 2019, viewed 27th April 2021, <http://www.gov.cn/zhengce/content/2019-02/22/content_5367708.htm>



companies are concerned about regulatory uncertainty when introducing new data platform business models in China.

e. Information services

Information services are another VATS of particular interest to international companies operating in China, but this area is also highly regulated, and the process of applying for the relevant licences is difficult. As mobile Internet and the Internet of Things (IoT) continue to develop, these kinds of restrictions are an increasingly burdensome obstacle to European businesses that wish to bring their expertise to the Chinese market.

Recommendations

- Reduce further 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, IP-VPN, internet access services, online data processing and transaction services, and information services.
- Maintain international companies' full access to the 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

a. Access to ICT Standard Developing Organisations (SDOs)

In 2015, China launched a new round of standardisation reforms, aimed at making its standardisation system and processes fairer, more transparent, reciprocal and 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 note the opening-up of the TC260's Working Group 3 on Cryptographic Solutions to international participation to a certain extent, though still subject to strict review. The Information and Communication Technology 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 in China 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.

b. 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,¹¹ 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

¹¹ So far, the following national algorithms have been publicly disclosed: SM2 and SM3 (2010), SM4 (2012), SM9 (2016); furthermore, the Zu Chongzhi 4G time division long-term evolution algorithm was accepted as a voluntary international standard in 2011.





user but also avoids unnecessary economic burdens. In addition, the market has proved capable of choosing which technologies are competent enough to solve consumer issues. In order to create a stronger market, the working group therefore urges China to avoid mandates that favour certain companies. Enhancing dialogue with market players would help avoid setting forth requirements that are difficult to implement or that will jeopardise the business ecosystem.

c. 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 included in mandatory conformity assessment requirements (particularly in the field of cybersecurity).
- Checking for blacklisted 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 allow the industry 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 2021/2022* on page 129 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 extra software/hardware details—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.

d. Operating spectrum for greater service efficiency and global harmonisation

The working group has noticed some recent

developments in China regarding the 700 megahertz (MHz) band, 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 700MHz 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 International Telecommunication Union (ITU) World Radiocommunication Conference 2015 identified the potential spectrum for 5G, including both below and above 6 gigahertz (GHz). China is an important stakeholder for global discussion and harmonisation of 5G technology, and close coordination with global and regional regulators is highly desired. Therefore, the working group urges China to allocate more bandwidth to support IMT and 5G development, including the opening of incumbent bands (such as the 700MHz band) and studying new areas of the spectrum (for example, bands above 6GHz) to enhance national 4G and 5G ecosystem development. The working group would like to actively facilitate exchanges and coordination between China and the EU regarding spectrum regulation. For example, the working group encourages close coordination on 5G broadcasting technology and standardisation to create a global ecosystem on 700MHz for the benefit of both the Chinese and European industries.

The working group welcomes the MIIT's decision on the identification of 3300–3600MHz, 4800–5000MHz and 703–733/758–788MHz as 5G frequency bands. 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.

The benefits of global harmonisation also hold true for other critical frequency bands such as 60GHz, the unlicensed use of which is key to the successful take-off of many new functions for security, energy-saving and comfort applications in a multitude of fields including automotive, transportation, smart building and consumer electronics. Such applications enable new product features that are so ground-breaking, if the





ability to build upon them is taken away, the industry could lose out in terms of innovation speed and market share, benefits to society and contributions to China's national strategies on smart manufacturing, green development and consumption upgrading.

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 and globally harmonised spectrum policy for mobile broadband and the 60GHz frequency band 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.

3. Develop and Implement Commercial Cryptography Laws, Regulations, Standards and Conformity Assessment Systems in Such a Way that They are Clear, Fair and Conducive to International Harmonisation 2

Concern

The Cryptography Law's roll-out and the development of its implementing regulations do not always reflect the positive direction on fairness and openness delivered in the law itself.¹²

¹² *Cryptography Law*, National People's Congress (NPC) Standing Committee, 27th October 2019, viewed 13th April 2021, <http://www.oscca.gov.cn/sca/xxgk/2019-10/27/content_1057225.shtml>

Assessment

While most jurisdictions do not apply strict restrictions to the domestic production and use of cryptography, China has long been one of the most challenging environments for international companies to navigate. The country is proposing an overhaul to its commercial cryptography regulatory system, including revising the 1999 *Commercial Cryptography Regulation* and drafting other implementing regulations. The working group expects significant improvements to the substantive and procedural aspects of this system to ensure that it remains aligned with China's Cryptography Law, established international practices and the World Semiconductor Council principles, which call for deregulating commercial cryptography in mass-marketed ICT products.¹³ In particular, the regulatory system should continue to rely on the 'core function' principle clarified by the State Cryptography Administration (SCA) in 2000, or on a similar concept.

Testing and certification

A chief innovation of the Cryptography Law is the replacement of the previous administrative licensing-based market access system with one that features mandatory and voluntary testing and certification. A so-called state-promoted commercial cryptography voluntary certification system has already been established, featuring a first batch product catalogue and the corresponding certification rules.¹⁴

The working group believes that this voluntary certification system needs to be efficient and should be open to international companies for each and every specific product category in the certification catalogue. It is also worth noting that while no international chip makers have so far managed to obtain a certificate for manufacturing security chips in China, their Chinese counterparts can obtain all qualifications necessary to operate in the European market. For example, Tongxin Microelectronics passed the SOGIS Common Criteria Evaluation Assessment Level (EAL) 6+ security certification in July 2020, and it only took Huada Electronic Design three months to pass the same

¹³ *Commercial Cryptography Regulation*, SCA, 7th October 1999, viewed 13th April 2021, <http://www.oscca.gov.cn/sca/xxgk/1999-10/07/content_1002578.shtml>

¹⁴ *Announcement on Releasing the Commercial Cryptographic Products Certification Catalogue (First Batch) and the Commercial Cryptographic Products Certification Rules*, SCA, 11th May 2020, viewed 27th April 2021, <http://www.oscca.gov.cn/sca/xwdt/2020-05/11/content_1060749.shtml>





EAL.¹⁵ Furthermore, the working group recommends the testing and certification system be based on established international standards—to which China has also contributed—where possible, instead of mandating specific Chinese standards. As part of such international harmonisation efforts, commercial cryptography—to the extent considered for testing and certification—needs to be limited to cases where encryption is the primary function. That means a component in a product should not be considered the product's primary function if cryptography is not the core function or set of functions of the component; or the feature set is not specifically designed or fixed and cannot be modified to customer specification. Any future batches of the product catalogue should therefore be drafted in a non-expansive manner.

Last but not least, the working group calls for adequate protection for applicants' IP and trade secrets. Protection should ensure that source code, non-public design information and trade secrets cannot be systematically demanded, and that international laboratories are allowed to conduct relevant testing activities, which would also help to minimise concerns about costs and testing delays.¹⁶

Import licence and export control

China released the import licence and export control lists for commercial cryptography in December 2020, which subsequently went into effect in January 2021.¹⁷ While the working group acknowledges the list's narrower scope for import licensing, it recommends that the following aspects be clarified and/or confirmed in explicit, written form, preferably in the revised *Commercial Cryptography Regulation*, to increase legal certainty while ensuring that China remains aligned with the global trend of deregulation:

- **Primary function test:** As the lists have placed a much stronger emphasis on products whose 'primary function' is encryption, the working group encourages the primary function test to be equally and explicitly

adopted in the revised *Commercial Cryptography Regulation*.

- **Mass consumer product exemption:** While the narrowly-defined lists seem to have implicitly exempted 'commercial cryptography in mass consumer products' as per the Cryptography Law, China should clarify the scope of such an exemption by defining this term as 'cryptography features as found in components and products openly available to the public, that can be either charged or free, for personal or business use, and where the cryptographic functionality cannot be modified by the end user'.
- **Scope of 'security chips':** a clearer definition is needed for 'security chips' subject to export control, by explicitly excluding general-purpose chips with cryptographic functionality, and by clarifying that only security chips with indigenous, non-public algorithms tailor-made for such sectors as electricity, taxation, public security and finance, and which meet the technical thresholds, fall within the controlled scope.

Application promotion

China has adopted a multi-faceted approach towards the regulation of commercial cryptography, and also directs regulatory requirements on networks, systems and vertical industries protected by cryptography. The result is a juxtaposition of interrelated laws and regulations, where any given regulatory requirement might in itself be of a non-restrictive nature, but is in practice much less so when viewed in conjunction with other requirements. Owing to such complexities, practices inconsistent with the Cryptography Law, often under the guise of 'application promotion', might pass unnoticed.

For example, the revised draft of the *Commercial Cryptography Regulation* demands in Chapter VI—which is dedicated to 'application promotion'—that operators of critical information infrastructure (CII) that does not involve secrets, networks with classified cybersecurity protection above Grade 3 or national government information systems, also undergo security assessment for commercial cryptography; and that they only use tested and certified commercial cryptography products, as well as technologies included in a so-called catalogue for guidance of commercial cryptography

¹⁵ CEC Huada Electronics Design Co Ltd achieves SOGIS EAL6+ certificate within 3 months of applying to the Dutch Common Criteria scheme (NSCIB), Brightsight, 18th November 2020, viewed 13th April 2021, <<https://www.brightsight.com/blogs/post/cec-huada-electronics-design-co-ltd.-achieves-sogis-eal6-certificate-within-3-months-of-applying-to>>

¹⁶ For more information on IP protection, please refer to the *Intellectual Property Rights Working Group Position Paper 2021/2022*, p. 129.

¹⁷ *Commercial Cryptography Import Licence and Export Control Lists*, Ministry of Commerce (MOFCOM), SCA & General Administration of Customs of China (GACC), 2nd December 2020, viewed 13th April 2021, <https://www.oscca.gov.cn/sca/xwdt/2020-12/02/content_1060787.shtml>



technologies proposed in Article 9.¹⁸ Such provisions are beyond the Cryptography Law, and would bring unnecessary burdens to the developers and users of commercial cryptography, while failing to explicitly allow the use of internationally-standardised commercial cryptography technologies.

Such regulatory moves have been coupled with industrial policies aimed at promoting voluntary certification and the use of domestic algorithms. The working group is aware of cases where the government has subsidised efforts to replace international cryptography and move towards voluntary certification in key industries like financial services and automotive.¹⁹ Against such a backdrop, companies in certain industries might be pressured to use approved products and technologies that use domestic algorithms.

Common to all the aforementioned practices is China's ability to selectively turn the state-promoted voluntary certification into a *de facto* mandatory system, which runs contrary to the Cryptography Law's legislative intent. The only way to ensure that these practices do not constitute an unfair advantage for domestic enterprises is to certify the products of international companies in a timely, transparent and fair manner, and to narrow the scope of voluntary certification and that of the security assessment down to what has been prescribed in the Cryptography Law.

On the whole, the working group recommends developing a regulatory system for commercial cryptography that contributes to security, minimises costs, protects IP and trade secrets, is technologically neutral and remains open to international participation. Referencing common international practices and subjecting relevant regulatory changes to a compatibility study with the Cryptography Law would help ensure the

fulfilment of these goals.

Recommendations

- Reference explicitly the primary function test in the revised *Commercial Cryptography Regulation*.
- Define narrowly the scope of commercial cryptography products subject to testing, certification and application security assessment.
- Refrain from mandating or expanding the scope of conformity assessment under the guise of 'application promotion', and revise incompatible regulations, standards and conformity assessment systems.
- Ensure efficient and streamlined conformity assessment processes for commercial cryptography, and that IP and trade secrets are protected.
- Allow the adoption of international standards related to commercial cryptography.
- Define 'mass consumer products' as 'cryptography features as found in components and products openly available to the public, that can be either charged or free, for personal or business use, and where the cryptographic functionality cannot be modified by the end user'.
- Clarify the scope and processes for commercial cryptography application security assessments in such a way that they are proportionate and non-disruptive to normal business activities.
- Apply clarity and transparency to the design and roll-out of the Cryptography Law's implementing regulations and ensure that any such regulations, including standards, are fully in line with the superordinate law.

4. Ensure Equal Opportunities for International Companies in China under Chinese Industrial Policies 12

Concern

China's ambitious industrial policies—as well as much of its private sector and economy at-large—have provided only limited benefits to international companies, as full play is not given to market forces, which may exacerbate the current trends of global decoupling of supply chains and increased protectionism.

Assessment

Despite criticisms from the international business community, China continues to press a wide variety of long-term industrial policies that create an unlevel playing field for multinational corporations. National

18 *Commercial Cryptography Regulation (Revised Draft for Comments)*, SCA, 20th August 2020, viewed 13th April 2021, <https://oscca.gov.cn/sca/hdjl/2020-08/20/content_1060779.shtml>

19 For example: *Yellow River Rural Commercial Bank Receives State Secret Renovation Subsidy*, bank yellow river, 21st May 2018, viewed 1st July 2021, <<http://www.bankyellowriver.com/dt/18369.jhtml>>; *Notice of the Chengdu Economic and Information Technology Bureau and nine other departments on the issuance of several policies for accelerating the high-quality development of the network information security industry in Chengdu*, CDJX, 23rd December 2020, viewed 1st July 2021, <http://cdjx.chengdu.gov.cn/cdsjxw/c132869/2020-12/23/content_126b2ed724da4fb7a37d39b966c35d83.shtml>; *Interpretation materials on the 'Implementation Rules of Measures for the Promotion of Commercial Cryptography Technology Innovation and Industrial Development in Guangzhou High-tech Zone, Guangzhou Development Zone, Huangpu District, Guangzhou City'*, Huangpu District and Guangzhou Development District, 7th May 2021, viewed 1st July 2021, <http://www.hp.gov.cn/zwgk/zcjd/zcjd/content/post_7267848.html>





plans and initiatives such as the *National Guidelines for the Development of the Integrated Circuit (IC) Industry*,²⁰ the Industrial Internet 5G+ Plan,²¹ the Next Generation AI Development Plan²² and the Strategy for Innovation and Development of Intelligent Vehicles²³ underscore China's ambitions to master high-end technologies such as AI, robotics, semiconductor chips, IoT and big data analytics.

New policies implemented within the past year demonstrate China's continued emphasis on accelerating the pace of indigenous innovation. For example, in August 2020, the State Council announced an upgraded policy guidance (known as *State Council Rule 8*), which extends and expands preferential tax incentives, finance and policy measures to promote the development of China's IC industry.²⁴ The 14FYP also singles out several frontier technologies to receive further backing from the central government. This includes the development of a *Future Industry Incubation and Acceleration Programme*, which aims to promote the domestic development of strategic and emerging technologies including AI, 5G networks and quantum information, among others.²⁵

Upgrading China's industrial base and pursuing the development of next-generation technologies is a necessary undertaking for the sake of both environment and long-term economic sustainability. However, the working group cautions against the continued use of preferential industrial policies, government funding and market access restrictions against international companies, as the resulting concerns lie at the heart of increasing tensions between China and its global trading partners.

a. Restricted international participation in China's industrial plans

European ICT companies are well placed to support China's forward-looking national industrial plans and boost China's overall innovation capacity. Through investment and participation in the Chinese market, European companies have already played a part in China's innovation strategies and goals. However, as a result of the government's drive to reduce reliance on international technology and imports, China's industrial plans disproportionately support domestic companies through state funds, R&D programmes and a series of other policy initiatives. The result is reduced or restricted international participation in crucial technology segments such as in telecommunications, cloud computing, integrated circuits, AI and IoT.

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 National Key R&D Programmes.²⁶ 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 remains burdensome and often requires the disclosure of private business information and unnecessary documentation. This situation is also complicated by a lack of transparency in the application process and the opaque decision-making process of national 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. It also runs counter to the inclusive practice of similar EU initiatives. 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.

b. Government guidance funds

In practice, government guidance funds remain a key government tool to achieve China's industrial policy

20 *National Guidelines for the Development of the IC Industry*, State Council, 24th June 2014, viewed 9th April 2021, <http://www.gov.cn/xinwen/2014-06/24/content_2707281.htm>

21 *Industrial Internet 5G+ Plan*, MIIT, 19th November 2019, viewed 9th April 2021, <http://www.gov.cn/zhengce/zhengceku/2019-11/25/content_5455303.htm>

22 *Next Generation AI Development Plan*, State Council, 20th July 2017, viewed 9th April 2021, <http://www.gov.cn/zhengce/content/2017-07/20/content_5211996.htm>

23 *Strategy for Innovation and Development of Intelligent Vehicles*, National Development and Reform Commission, 10th February 2020, viewed 9th April 2021, <https://www.ndrc.gov.cn/xxgk/zcfb/tz/202002/t20200224_1221077.html>

24 *Several Policies to Promote the High-quality Development of the Integrated Circuit and Software Industries in the New Era*, 4th August 2020, viewed 9th April 2021, <http://www.gov.cn/zhengce/content/2020-08/04/content_5532370.htm>

25 *The 14th Five-year Plan for the National Economic and Social Development of the People's Republic of China and the Outline of the Long-term Goals for 2035*, State Council, 13th March 2021, viewed 9th April 2021, <http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm>

26 *National Key R&D Programme*, Ministry of Science and Technology, 27th September 2019, viewed 9th April 2021, <https://service.most.gov.cn/2015ztg_all/20190927/3129.html>





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.

The State Council's *Rule 8* reinforces the role of government in coordinating industry development. This includes optimising investments from national and local IC funds, urging state-owned banks to provide greater financial support and loans to the industry, and encouraging private capital to establish funds to complement existing funds. Significant investments in the IC industry by the private equity funds of Huawei and Xiaomi in 2020 point to the accelerated indigenisation of the semiconductor industry chain. It has been reported that, by mid-2020, nearly 1,400 government guidance funds had been established with a target to manage a total of Chinese yuan (CNY) 9.4 trillion.²⁷

Many of these established funds invest across a variety of sectors. For example, one of the largest is the Central SOE Guochuang Guidance Fund, which invests in China's 'strategic emerging industries' such as aerospace, clean energy, high-speed rail, quantum communication and robotics. Others, however, prioritise more targeted investments. Now in its second phase, and valued at CNY 204 billion, the National IC Fund has become influential in driving the development of the domestic IC industry. The use of state funds through the National IC Fund to support domestic industry risks creating overcapacity and other distortions that could lead to decreased profits and reduced innovation capabilities.²⁸ This comes as the National IC Fund Phase I slashed stakes in 12 companies – likely to balance losses and free up capital for Phase II investments that expand the focus into downstream applications. At the same time, Phase II continues unabated by investing over CNY 18 billion in three companies in 2020 – Semiconductor Manufacturing International Corporation (SMIC), UNISOC and

SmartSens Technology.²⁹

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. If allowed to operate on market principles, government guidance funds have the potential to facilitate innovation, necessary infrastructure development and sustainable economic development, and therefore can best ensure the sustainable and healthy development of China's ICT sector. The working group believes that this is preferable to focussing on indigenous innovation targets.

Ultimately, resisting calls for 'domestic substitution' and the 'security and controllability' of products and services, and instead focussing on improving 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 further strengthen IPR protection through concrete policy measures.
- Ensure China's guiding industrial policies are conducive to innovation and fair competition, and are not used to foster an unlevel playing field for domestic industry.
- Encourage greater reciprocity in ICT innovation and, in line with the Foreign Investment Law, 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 funds, R&D deductions and other supportive policy incentives under China's industrial policies.
- Ensure that government-guidance funds operate under market principles.

27 2020 Government Guidance Fund Research Report, China Investment Research Institute, November 2020, viewed 9th April 2021, <<http://www.zfsj.org/download/2020%E5%B9%B4%E6%94%BF%E5%BA%9C%E5%BC%95%E5%AF%BC%E5%9F%BA%E9%87%91%E4%B8%93%E9%A2%98%E7%A0%94%E7%A9%B6%E6%8A%A5%E5%91%8A.pdf>>

28 For more information on the effects of overcapacity in China, please refer to the European Chamber's 2016 report *Overcapacity in China: An Impediment to the Party's Reform Agenda*, available at <<https://www.europeanchamber.com/en/publications-overcapacity-in-china#download-table-163>>

29 National funds re-emerged and settled in Shenzhen Science & Technology for the first time, Sina, 19th October 2020, viewed 9th April 2021, <<https://finance.sina.com.cn/chanjing/gsnews/2020-10-19/doc-iznezxr6713973.shtml>>





Abbreviations

5G	Fifth Generation
AI	Artificial Intelligence
CII	Critical Infrastructure Information
CNY	Chinese Yuan
COVID-19	Coronavirus Disease 2019
GACC	General Administration of Customs of China
IC	Integrated Circuit
ICT	Information and Communication Technology
IDC	Internet Data Centre
IMT	International Mobile Technology
IoT	Internet of Things
IP	Intellectual Property
IPR	Intellectual Property Rights
IP-VPN	Internet Protocol Virtual Private Network
IRC	Internet Resources Collaboration
ITU	International Telecommunication Union
LPWAN	Low-power Wide-area Network
MIIT	Ministry of Industry and Information Technology
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission
NPC	National People's Congress
PaaS	Platform-as-a-Service
R&D	Research and Development
SaaS	Software-as-a-Service
SCA	State Cryptography Administration
SDO	Standards Developing Organisation
SOE	State-owned Enterprise
TBT	Technical Barriers to Trade
TC260	National Information Security Standardisation Technical Committee
US	United States
USD	United States Dollars
VATS	Value-added Telecoms Services
WSC	World Semiconductor Organization
WTO	World Trade Organization

Cybersecurity Sub-working Group

Introduction to the Sub-working Group

China re-emphasised the importance of cybersecurity with its March 2018 upgrade 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 (ICT) Working Group. The Cybersecurity Sub-working Group focusses on cybersecurity legislation, standardisation and enforcement that impact multiple industries.

Recent Developments

Cybersecurity Law and Implementation

Effective as of 1st June 2017,² the Cybersecurity Law outlines a series of general compliance requirements for network operators, as well as specific obligations regarding: critical information infrastructure (CII) protection; data localisation; cross-border data transfer security assessments and personal information protection; the Classified Cybersecurity Protection Scheme (CCPS);³ the promotion of "autonomous and controllable" products and services;⁴ and a comprehensive certification and testing scheme for critical network equipment and specialised network security products, among others. With more implementing regulations being rolled out in 2021, the sub-working group expects enforcement efforts to increase and the Cybersecurity Law's areas of focus to be expanded.

Personal Information and Important Data Protection

On 10th June 2021, China promulgated the Data Security Law, which came into effect on 1st September

2021.⁵ The law is aimed at developing data security management schemes through, for example, calling for classified management of data and risk assessment mechanisms. The law specifically introduces the concept of national core data, and a data protection catalogue, which is to be determined and released by the different regional governments or industry-specific authorities.

In April 2021, the Standing Committee of the National People's Congress (NPCSC) released the second draft of the Personal Information Protection Law.⁶ This draft addresses the concept of "sensitive personal information", the scope of which remains unclear. The sub-working group is concerned about further global fragmentation from other global privacy regimes and the outcome-based definition of sensitive personal information, which currently lacks clarity, making it difficult for companies to comply with the relevant obligations. Although the draft law provides clarification on the concept of 'consent', it leans heavily towards 'explicit' consent and lacks legal guidance with respect to the grounds for data processing, such as 'legitimate interests'.

This is the first time that China has formulated legislation dedicated to data and personal information protection, which will serve as superordinate laws for China's data management framework. Prior to the aforementioned pieces of legislation, and in addition to the Cybersecurity Law, other regulations and standards on data protection—which will be discussed in this paper—have been released or are being formulated by a number of different government authorities.

CCPS and CII Protection Scheme

On 27th June 2018, the Ministry of Public Security (MPS) issued a public consultation on the *Regulation on Classified Cybersecurity Protection (Draft for*

1 *Plan on Deepening Reform of Party and State Institutions*, Xinhua, 21st March 2018, viewed 27th July 2021, <http://www.xinhuanet.com/2018-03/21/c_1122570517.htm>

2 Cybersecurity Law, NPCSC, 7th November 2016, viewed 27th July 2021, <http://www.gov.cn/xinwen/2016-11/07/content_5129723.htm>

3 The CCPS was previously known as the Cybersecurity Multi-level Protection Scheme.

4 In recent years, the term "autonomous and controllable" and similar phrases such as 'secure and reliable', 'secure and controllable' and 'indigenous and controllable' have appeared in a number of Chinese laws, regulations and policies.

5 *Data Security Law of the People's Republic of China (PRC)*, NPCSC, 10th June 2021, viewed 17th June 2021, <<http://www.npc.gov.cn/npc/c30834/202106/7c9af12f51334a73b56d7938f99a788a.shtml>>

6 The draft Personal Information Protection Law has been removed from the official website as of 28th May 2021 in order to further review and consider input provided through their corresponding calls for comments. The NPC has posted information about the most recent drafts in the following link: <<http://www.npc.gov.cn/flcaw/more.html>>



Comments) (*CCPS Regulation*).⁷ This regulation is aimed at implementing Article 21 of the Cybersecurity Law, which requires the establishment of a CCPS. The draft *CCPS Regulation* categorises 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, with some having already been released by the National Information Security Standardisation Technical Committee (TC260). On the basis of the previous *Administrative Measures on the Classified Protection of Information Systems*,⁸ the CCPS's requirements will be expanded from mere information systems to new areas such as cloud computing, mobile Internet, the Internet of Things and industrial control.

Built on the CCPS, the Cybersecurity Law contains a specific section on CII protection, underlining its importance to China's overall cybersecurity agenda. The *CII Protection Regulation (Draft for Comments)*, released in July 2017, did little to narrow down the scope of CII or to clarify its identification procedures.⁹ 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 that 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, including the *Cybersecurity Protection Requirements of CII*,¹⁰ and the *Security Controls for CII*.¹¹ It is noteworthy that the principle of CII interacts with multiple additional regulations, such as mandatory certification and assessment, and the *Cybersecurity Review Measures* (CSRM), as well as requirements under the Cybersecurity Law and the Cryptography Law.

Cybersecurity Review

On 10th July 2021, the CAC released for public consultation the revised CSRM,¹² which will replace an earlier version effective since 2020. The revised CSRM requires reviews for network product and service purchases, as well as for data processing activities that will or may affect national security. This includes the overseas initial public offering of Chinese companies possessing the data of over one million users, thereby demonstrating a strong emphasis on supply chain security and data security, including access to Chinese data by foreign governments. In addition to the revised CSRM's broadened scope, the sub-working group also has persistent concerns over requirements to disclose transaction documents, a lack of transparency on the standards that will be used for the review's purposes, and the review's focus on such non-technical factors as supply disruptions due to political, diplomatic and trade considerations. The sub-working group is aware that standards supporting the review's implementation are being developed by TC260. In addition, the broadened scope means that many categories of products may be considered as network products under the CSRM.¹³

Critical Network Equipment and Specialised Network Security Product Certification and Testing

Under Article 23 of the Cybersecurity Law, critical network equipment and specialised network security products must 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 scheme will not be an additional market entry requirement, but instead has been designed to improve coordination among the existing cybersecurity conformity assessment schemes.

While TC260 is 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,¹⁴

7 *Regulation on Classified Cybersecurity Protection (Draft for Comments)*, MPS, 27th June 2018, viewed 28th April 2021, <<http://www.mps.gov.cn/n2254536/n4904355/c6159136/content.html>>

8 *Administrative Measures on the Classified Protection of Information Systems*, Central People's Government of the PRC, 24th July 2007, viewed 28th April 2021, <http://www.gov.cn/gzdt/2007-07/24/content_694380.htm>

9 Definitions of 'CII' and 'network operators' should be clear and consistent to allow businesses to assess their compliance obligations. 'CII' should also be narrowly defined to ensure that the cost of compliance will not be unnecessarily onerous and aligned with internationally accepted risk management methods.

10 *Cybersecurity Protection Requirements of CII*, TC260, 13th June 2018, viewed 28th April 2021, <https://www.tc260.org.cn/front/bzzqyjDetail.html?id=20180613180740102919&norm_id=20180523160438&recode_id=29222>

11 *Security Controls for CII*, TC260, 13th June 2018, viewed 28th April 2021, <https://www.tc260.org.cn/front/bzzqyjDetail.html?id=20180613180739993240&norm_id=20180523160435&recode_id=29216>

12 *Cybersecurity Review Measures (Revised Draft for Comments)*, CAC, 10th July 2021, viewed 17th July 2021, <http://www.cac.gov.cn/2021-07/10/c_1627503724456684.htm>

13 These categories of products include "core network equipment, important communications products, high performance computers and servers, mass storage devices, large databases and application software, cybersecurity equipment, cloud computing services, and any other network products that have a significant impact on the security of critical information infrastructure": Ibid.

14 *Requirements of National Standards Relating to Critical Network Equipment and Specialised Network Security Products (Draft for Comments)*, TC260, 16th May 2019, viewed 19th April 2021, <<https://www.tc260.org.cn/front/postDetail.html?id=20190516203007>>





the National Technical Committee on Communications (TC485)—under the Ministry of Industry and Information Technology (MIIT)—has been tasked with updating relevant security technical requirements and testing methods for routers and switchers, and transforming them into mandatory national standards. Meanwhile, the MPS is in charge of administering new standard projects on specialised network security products. This is because the revised Standardisation Law has stipulated that the formulation of related mandatory national standards will fall under sectoral government authorities rather than the CAC. The sub-working group believes the industry would benefit from a more up-to-date description of the roles and responsibilities of various authorities in cybersecurity standardisation, based on the 2016 *Several Opinions on Strengthening National Cybersecurity Standardisation Work*.¹⁵

Additionally, the sub-working group believes that related national standards should aim to harmonise with international best practices and standards. For example, the MIIT's mandatory national standard *Critical Network Devices Security Common Requirements*,¹⁶ published in February 2021, contains requirements that may diverge from existing international standards related to security assurance processes and security capabilities, as well as coordinated vulnerability disclosure (specifically, for example, the international standards ISO/IEC JTC1 SC27000 series, the suite of standards ISA/IEC 62443, and ISO/IEC 29147 and ISO/IEC 30111 on matters related to coordinated vulnerability disclosure).

Key Recommendations

1. Ensure that Cybersecurity Schemes do not Create Discriminatory Market Access Barriers 5

Concern

Certain cybersecurity schemes 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.

¹⁵ *Several Opinions on Strengthening National Cybersecurity Standardisation Work*, CAC, 22nd August 2016, viewed 14th April 2021, <http://www.cac.gov.cn/2016-08/22/c_1119430337.htm>

¹⁶ *Critical Network Devices Security Common Requirements*, MIIT, 20th February 2021, viewed 28th April 2021, <<http://www.gb688.cn/bzgk/gb/newGbInfo?hcno=897AC202AE5F385D28F15CEAE75E609>>

Assessment

a) CCPS

The current CCPS framework imposes quite a few limitations on cloud computing businesses: it requires that, for network operators over a certain CCPS level, infrastructure for cloud computing must be placed within China, customer data and personal information stored within China, and operation and maintenance conducted within China. These criteria create challenges and raise *de facto* barriers for businesses that want to manage cloud computing services or that reach the CCPS level specified, especially those with an international presence and globally-connected service networks, as they would have to spend more on local infrastructure. It would also raise concern among their clients with regard to the reliability of the company's international connectivity.

b) CSRM

The CSRM mandates that CII operators must proactively apply for a non-transparent cybersecurity review when their purchases of network products and services affect or may affect national security. In addition to a lack of transparency on the standards involved, the CSRM also significantly broaden the scope of the cybersecurity review, including the criteria that would trigger a review. The review will take into consideration the impact of the purchase of network products or services along the supply chain, by looking at the effect on the security, openness, transparency and diversity of the supply source as well as the “political, diplomatic and trade factors on supply chains.”¹⁷ These factors could lead to market access restrictions for multinational companies. Added to this concern is the fact that relevant government authorities can review the purchases of network products and services by non-CII operators. Furthermore, the CSRM may put suppliers at risk of data exposure through the need to disclose confidential information and trade secrets, since disclosure of transactions and other documents may be required. Due to these considerations, the sub-working group is concerned that the CSRM will create an environment that favours domestic companies over their international peers in the long-term.

c) Cryptography Law

The Cryptography Law specifically requires that all business entities, including foreign-invested enterprises

¹⁷ *Cybersecurity Review Measures (Revised Draft for Comments)*, CAC, 10th July 2021, viewed 17th July 2021, <http://www.cac.gov.cn/2021-07/10/c_1627503724456684.htm>





(FIEs), be treated equally in research, production and sales of commercial cryptography. While the law has removed or loosened some of the long-standing administrative approval requirements, ambiguities in both the law and its implementing regulations have raised the following concerns for the working group: that the scope of the newly-established testing and certification system may be further broadened; that attestation requirements are duplicative; that import licence and export control requirements are unclear; and that there is a reliance on domestic standards. Specifically, certain proposed requirements are incompatible with existing and well-established international principles that call for governments to avoid restrictive or burdensome licensing, certification and other obligations limiting or delaying the import, trade and export of mass-marketed ICT products to which commercial cryptography is ubiquitous.¹⁸

To avoid unnecessary market access barriers for FIEs, it is important that the various regulatory mechanisms the law seeks to establish remain transparent and narrow in scope. This includes ensuring that commercial products with cryptography as a secondary feature are *not* subject to restrictions or regulations (including certification, or import and export requirements); that terms such as ‘national security’, ‘national economy and people’s livelihood’, and ‘public interests’ are not interpreted extensively; that the category of mass consumer products exempted from import and export restrictions is broadly defined; that voluntary certification is not enforced as a *de facto* mandatory requirement; and that the adoption of international standards, protection of sensitive intellectual property and mutual recognition for certification and attestation are all considered.¹⁹

d) Cross-border data transfer

In May and June 2019 respectively, the draft *Administrative Measures for Data Security (Draft for Comments)* and the draft *Measures on Security Assessment of the Cross-Border Transfer of Personal Information (Draft for Comments)* were issued for public consultation. More stringent and detailed requirements

now appear to be the norm, particularly regarding the cross-border transfer of personal information and important data, with the latter still awaiting a definitive and reliable definition and scope. For instance, a network operator cannot transfer personal information or important data collected or generated during its operations in China to anyone outside of China unless certain requirements are met; for example, they have completed an official security assessment.²⁰ Certain Chinese regulations, like those relating to the CCPS and CII protection, also call for local operation and maintenance.

In addition to posing heavy operational burdens, these requirements can essentially act as market access barriers for FIEs, due to their high frequency of cross-border data transfer for normal operational reasons and in response to their headquarters’ requests, among other reasons.

The European business community is hopeful that Chinese regulators will develop policies and regulations that encourage a sustainable and healthy flow of data on a cross-border basis. This would also facilitate more effective and efficient cooperation between Chinese, European and other international businesses, with a view to further promoting China’s digital economy.

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 insurmountable barriers across the entire Chinese market. China will incur problems if the most technologically advanced and cyber-secure products and services are banned or blocked because of the above. Furthermore, conformity assessment requirements in China often differ from international standards, adding complexity and creating extra 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

¹⁸ Joint Statement of the 17th Meeting of the World Semiconductor Council, World Semiconductor Council, 23rd May 2013, viewed 19th April 2021, <http://www.semiconductorcouncil.org/wp-content/uploads/2016/07/May_2013_WSC_-_GAMS_version_Joint_Statement_of_the_17th_Meeting_of_the_WSC_Final_23_M-1.pdf>

¹⁹ For more information, please refer to Key Recommendation (KR) 3 in the *Information and Communication Technology Working Group Position Paper 2021/2022*, p. 327.

²⁰ A clear example can be found in the financial sector. A 2019 China Banking and Insurance Regulatory Commission order prohibits the cross-border transfer of all customer identification and transaction information obtained in the course of performing anti-money laundering or counter-terrorist financing activities unless permitted by law or regulations. For more information, please refer to the Key Recommendation 2 of the *Banking and Securities Working Group Position Paper 2021/2022*, p. 371.



their China market strategies, raising concerns that such schemes will put their trade secrets in jeopardy and harm the market's perception of them and their credibility.

Recommendations

- Define the concepts of 'national security' and 'CII' as narrowly as possible, and differentiate them from 'commercial security' in a clear manner.
- Limit the applicability and influence of the various theoretically non-binding documents, such as recommended national standards, in such a manner that they do not overcome the binding legislations.
- Promote mutual recognition and adoption and reliance upon, applicable international standards and global industry best practices.
- Relax restrictions on cross-border data transfer to allow easier market access.
- Take steps to ensure that the terms negotiated in cross-national trade and investment deals are effectively implemented in practice.

2 Eliminate Unnecessary Operational Burdens Created by Extensive and Ambiguous Cybersecurity Schemes, and Potentially Intrusive Enforcement and Inspections 6

Concern

The ever-increasing complexity of the cybersecurity regulatory environment is leading to administrative, operational and cost challenges for organisations, and may further lead to increased uncertainty and adverse effects on the actual security of information technology (IT) systems, competitiveness and innovation.

Assessment

a) Personal information protection

In the sub-working group's opinion, the draft Personal Information Protection Law's requirements on data localisation and restrictions on cross-border transfer of personal information are too stringent in comparison to the already-strict regional personal information protection regulations, such as the EU's General Data Protection Regulation (GDPR) or the California Consumer Privacy Act. The uncertainty of the current Chinese regulatory framework, as well as the possibility of significant costs being incurred, will irreversibly damage foreign and Chinese entities that have a global footprint and a data protection framework to monitor, and some foreign entities will eventually be driven out.

The draft also imposes strict control over the export of personal information out of China. It requires a relevant government agency or a qualified third party to carry out an assessment, or a signed personal-information sharing agreement. As many multinational companies' headquarters and their servers are located outside China, and usually follow a global personal information policy with adequate protection measures, an additional assessment by a third party (whether governmental or not) will inevitably add an unnecessary administrative burden.

Another key concern relates to the lawful basis of personal information processing. Unlike the GDPR, "legitimate interests" are not included in the draft Personal Information Protection Law as a lawful basis for processing personal information. Common personal information processing scenarios—such as employment, direct marketing or security—that companies typically rely on as a lawful basis, would therefore need to resort to either "consent" or "necessary for the performance of contract" as the lawful basis for data processing. However, the current draft does not address the practical challenges of either obtaining consent from an individual or entering into a contract with an individual or companies in the business-to-business sector. In other words, it is difficult for a company that has received personal information from another company for data processing to contact the individual that the data pertains to in order to obtain their consent or enter into a contract with them for the purposes of processing that data.

There are also additional uncertainties linked to the fact that consent can always be withdrawn, and that after completion of a contract, processing must stop (all situations that have been addressed in practice under the GDPR).

The national standard *Personal Information Security Specification (Specification)* came into effect in October 2020. It puts forward even stricter rules than its 2017 version, including on storage of sensitive personal information, closure of accounts and user profiling, among others. As the *Specification* was issued after the promulgation of the Cybersecurity Law, it is generally expected to serve as a baseline to facilitate implementation of the law and be a major reference document for Chinese authorities. Nevertheless, the *Specification* is not mandatory *per se*, which raises



doubt around its coercive force, especially with view to the future Personal Information Protection Law. Clarification is needed regarding to what extent enterprises must adapt to it.

This clarification is especially important now, given that increasing numbers of such standards are being published. In particular, the draft *Information Security Technology – Guidelines on Consent to Notification of Personal Information* provides detailed explanations of the basic principles, execution methods and other aspects of notification and consent for data collection, and specifies the circumstances under which the need to gain consent may be waived by individuals. Under this standard, many companies would have to overhaul their notification mechanisms, especially their privacy policies.

b) Cybersecurity vulnerabilities management

China's proposed regulations and national standards governing cybersecurity threat information-sharing, and the management and disclosure of vulnerabilities consist of several concurrent initiatives, including the *Administrative Provisions on Security Vulnerabilities of Network Products* published on 12th July 2021 by the MIIT, the CAC and the MPS,²¹ and a mandatory national standard by the MIIT on *Critical Network Devices Security Common Requirements*, which includes provisions related to coordinated vulnerability disclosure. In November 2019, the CAC and the MPS also released for public consultation the draft *Cybersecurity Threat Information Publication Management Measures*, although it remains to be seen whether the draft *Management Measures* have been replaced by the *Administrative Provisions*.²²

The sub-working group took note of positive changes in the *Administrative Provisions*, which appeared to have unified (to a certain extent) the original patchwork regulatory system. They also demonstrated willingness to increase cross-ministerial coordination, by calling for timely information-sharing and joint assessment and handling of major vulnerabilities. While the sub-working group is still monitoring how the *Administrative Provisions* are to be interpreted and rolled out, it

believes the current provisions would still benefit from further alignment with well-established, broadly-adopted best practices and international standards in the field of coordinated vulnerability disclosure (CVD) and vulnerability handling²³ – as articulated in International Standardization Organization (ISO) standards such as ISO/IEC 29147 (2018) and ISO/IEC 30111 (2019). This is because of:

- their overlapping content on cybersecurity vulnerability management;
- their divergence from international standards on coordinated vulnerability disclosure (CVD) and industry best practices, by proposing vulnerability information shall be reported to the MIIT within two days, and additional limitations that may hinder external security research activities, among other issues; and
- the absence of a unified regulatory environment, with one agency coordinating the different government authorities on vulnerability identification and remediation, particularly if the *Administrative Provisions* will, rather than replacing the *Management Measures*, co-exist with the latter in the future.

The sub-working group specifically recommends adopting international practices and providing clarifications as follows:

1. Disclose information related to unmitigated vulnerabilities in confidence and only to the parties necessary to develop and test the proposed mitigation during the CVD process, ensure that vendors notify authorities after mitigation measures are available to the public, and report that information to the public and end-users.
2. Clarify that, in certain limited cases, disclosure of information on an unmitigated vulnerability can support users' response when, for example, the product supplier no longer exists, or the vulnerability is open-source software library/module or a commonly-used protocol and there is no owner of the technology or a different coordinator that is developing a mitigation and leading a CVD process.

Another concern is that of breach notification. For example, the Cybersecurity Law requires that

²¹ *Administrative Provisions on Security Vulnerabilities of Network Products*, MIIT, CAC and MPS, 14th July 2021, viewed 17th July 2021, <http://www.gov.cn/zhengce/zhengceku/2021-07/14/content_5624965.htm>

²² *The Cybersecurity Threat Information Publication Management Measures (Draft for Comments)*, CAC, 20th November 2019, viewed 19th April 2021, <http://www.cac.gov.cn/2019-11/20/c_1575785387932969.htm>

²³ The CVD process is a standardised, multi-step process through which stakeholders identify, develop, validate, distribute and deploy mitigations for security vulnerabilities.





mandatory breaches be notified to the “relevant competent department”, along with penalties for failure to comply in cases of cyber incidents.²⁴ The draft Personal Information Protection Law and the Data Security Law further provide that mandatory notifications must be provided to the “relevant” authorities in case of breaches, which are, incidentally, cyber incidents.^{25&26} These released and proposed pieces of legislation should also be further aligned with global incident response regimes, and should ensure ample protections for end-users and organisations. Multiple notifications to different organs that relate to the same incident may result in potentially different—if not conflicting—viewpoints, reactions, responses or demands in response, which will increase both the administrative burden and the level of uncertainty over the potential outcome and consequences. In this regard, the sub-working group seeks confirmation that, pursuant to Article 7 of the *Administrative Provisions*, which states that the MIIT must share information received with other relevant authorities, notifying the MIIT’s Cybersecurity Threats and Vulnerabilities Information-sharing Platform will be sufficient to meet the Cybersecurity Law, Data Security Law and Personal Information Protection Law’s notification requirements. In addition, Article 7.2 of the *Administrative Provisions* demands notification of vulnerability information to the MIIT within two days. The sub-working group demands this requirement be clarified, and further reiterates its previous recommendation cautioning against the disclosure of unmitigated vulnerabilities.

Overall, these recommendations aim to ensure that China’s new cybersecurity vulnerabilities management framework is both effective and business-friendly. This is particularly important for small and medium-sized enterprises (SMEs), which lack the resources to efficiently tackle the associated increasing breadth and number of mandatory requirements.

c) Intrusiveness

Some recent regulatory developments have led to a steady growth of associated declarative, filing, screening and approval schemes with different supervisory

authorities and governmental agencies, which can be very intrusive and present stark procedural differences. For example:

- The CSRM, with its requirements to proactively apply for review and the fact that it is a case-by-case review system rather than one-off certifications or licensing, presents a heavy operational burden.
- The CCPS requires network operators at level-two and above to perform various filings and assessments—which it seems can no longer to be done online—some of which are quite intrusive, such as connecting their networks with the public security organs’ systems. Network operators at level-three and above also need to undergo non-transparent security reviews when their purchase of network products and services is deemed to affect national security.
- The *Provisions on Internet Security Supervision and Inspection by Public Security Organs*,²⁷ released by the MPS, empowers public security organs to conduct onsite or remote testing by connecting their inspection tools to corporate and business networks in the name of monitoring compliance of both Internet service providers and corporate entities using the networks.
- The draft *Data Security Measures* and the draft *Personal Information Transfer Measures* require all network operators to conduct a security assessment and report the results to the relevant government authorities or provincial cyberspace authorities for approval before they can release, share or trade important data, or provide such data overseas. They must also apply to the provincial cyberspace authorities for a security assessment of their cross-border personal information transfers, keep a record of personal information exported for a period of five years, and submit each year, before 31st December, a record of the circumstances under which personal information was exported and the compliance of any contracts with the relevant data recipients.
- Additionally, the draft *Data Security Measures* also state that network operators, when collecting important data or personal sensitive information for business purposes, should file such collection activities with local cyberspace authorities.

²⁴ *Cybersecurity Law*, NPCSC, Article 25, 7th November 2016, viewed 19th May 2021, <http://www.gov.cn/xinwen/2016-11/07/content_5129723.htm>

²⁵ *Personal Information Protection Law (second draft)*, NPCSC, Article 56, 28th April, viewed 10th May 2021, <<http://www.npc.gov.cn/ficaw/more.html>>

²⁶ *Data Security Law of the People’s Republic of China (PRC)*, NPCSC, 10th June 2021, viewed 17th June 2021, <<http://www.npc.gov.cn/npc/c30834/202106/7c9af12f51334a73b56d7938f99a788a.shtml>>

²⁷ *Provisions on Internet Security Supervision and Inspection by Public Security Organs*, MPS, 15th September 2018, viewed 19th April 2021, <http://www.gov.cn/gongbao/content/2018/content_5343745.htm>





These administrative schemes, even when falling under the same requirement, can also differ from one authority to the other in terms of interpretation and implementation. They constitute a significant administrative burden and increased costs for businesses, in most cases without having a meaningful, positive impact on security or privacy.²⁸

Further to the burdensome filing and approval schemes, sub-working group members are particularly concerned with intrusive cybersecurity requirements and inspection methods. These include the MPS *Draft CCPS Regulations*' requirement for level-three systems to be connected with Public Security Bureau systems, the MPS's requirements for connecting inspection tools with companies' business and operation networks under the *Provisions on Internet Security Supervision and Inspection by Public Security Organs*, and the CSRC's requirement to conduct penetration testing under its *Administrative Measures on IT of Securities and Fund Operation Institutions* in 2019. These, and other intrusive methods, could put corporate and business networks critical to businesses' service offerings at risk.

d) Coordination and cohesion

While the will to create end-to-end, all-encompassing security is understandable, the sub-working group remains doubtful that moving further and further away from technology and sector-agnostic rules, with 1) a growing complexity and inconsistency of such rules, 2) numerous regulatory authorities that are empowered but uncoordinated, and 3) heavy associated administrative procedures, will actually ensure security.

A clear and cohesive approach is critical to ensuring effective cybersecurity management. In practice, as global examples have shown, the undertaking of parallel rules, proceedings and oversight on the same subject by different authorities has often resulted in open competition and rivalry rather than collaboration, effectiveness and the flexibility needed to ensure good security. In fact, this approach often actually weakens supervisory effectiveness.

Excessive regulatory and administrative requirements, in combination with high associated costs, also prevent

new companies from entering a market, thereby stifling innovation, creativity and competition. This affects the extent to which companies can develop and exploit new products, services and operating processes of the said companies.

Recommendations

- Develop clear, consistent and harmonised cybersecurity-related rules and promote a design-neutral approach to regulation and rule to ensure flexibility.
- 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 a coordinated and unified approach for oversight and enforcement among the government authorities involved.
- Reduce cybersecurity-related administrative burdens on companies, including those due to duplicative or fragmented certification requirements.
- Remove inspection, system connection and penetration testing requirements in cybersecurity management-related articles.

3. Ensure Transparency, Consistency, Non-discrimination and Proportionality in Cybersecurity Rule-making and Law Enforcement 2

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 rule-making and law enforcement.

Assessment

China's cybersecurity regulatory landscape has been undergoing rapid changes over the past few years, as a result of released and planned legislation, including but not limited to the Cybersecurity Law, the Cryptography Law, the Data Security Law and the draft Personal Information Protection Law. The sub-working group has witnessed both regulatory improvements and deterioration with regard to the roll-out of such legislation, when evaluated against the principles of transparency, consistency, non-discrimination and proportionality.

²⁸ The Cybersecurity Sub-working Group underlines, for example, that filing of data-processing activities was specifically suppressed in the EU's GDPR. Experience had shown that filing merely increased the costs and complexity of compliance without bringing tangible benefit to data subjects.





Cross-border data transfer

The sub-working group acknowledges the relatively transparent and cautious approach that China is taking towards the regulation of cross-border data flows. For example, the Ministry of Commerce is currently rolling out cross-border data transfer security assessment pilots in Beijing, Shanghai, Hainan and Xiong'an, the underlying intention of which seems to be to ensure relevant rules are effective and proportionate. The sub-working group hopes this will lead to more business-friendly rules being promulgated nationwide across all sectors, particularly in key fields like intelligent connected vehicles and digital healthcare.

Yet at the same time, the sub-working group has noticed that, under the draft Personal Information Protection Law, non-CII operators exporting personal information are subject to government-led security assessments. The expansion of such assessments to commercial sectors at large would be disproportionately disruptive to normal business activities, while being inconsistent with the Cybersecurity Law.

The sub-working group also advises China to refrain from broadening the scope of its cross-border data transfer rules, by limiting 'data exports' to the transfer of data that originated in China from China to other countries/regions, and applying the concept of 'deemed export' only to export-controlled items under the Export Control Law.

Data protection

It is laudable that the draft Personal Information Protection Law expands processing of personal information beyond consent, as it allows for processing to take place when it is necessary for executing a contract, performing a legal obligation, responding to an emergent public health event, protecting the life or property of an individual, publishing news or carrying out supervision by public opinion for the public interest. Such alignment with the *Personal Information Security Specification* demonstrates consistency between regulatory requirements at different levels, and is greatly welcomed by the sub-working group.

Consistency is also important in delineating the roles and responsibilities of different government authorities. Worryingly, a growing number of authorities are having their say in data protection, with overlapping or at least unclear responsibilities. The Data Security Law serves

as a telling example, as it depicts a regulatory system under which localities and sectoral authorities bear primary responsibility for data security; public security bodies and national security bodies are responsible for the supervision and administration of data security within their respective scope of duties; and relevant sectoral authorities and the CAC also enjoy supervision and administration authority in this area. As European experience has shown, the co-existence of different, unsupervised regulators may lead to serious difficulties, inconsistencies and adverse effects and, if maintained, will necessitate an effective, clear and transparent coordination mechanism, with one central leading authority.

Commercial cryptography

With respect to commercial cryptography, the sub-working group underlines the need to ensure consistency and non-discrimination at several levels. First, consistency must be ensured between the Cryptography Law and its own implementing regulations, in particular the *Commercial Cryptography Regulation*.²⁹

Second, consistency is required between the Cybersecurity Law and its associated regulations, and the Cryptography Law, with regard to the various security assessments, reviews and testing and certification systems. One notable example of inconsistency is the fact that certain cybersecurity standards currently mandate compliance with recommended national and industry standards related to cryptography, as well as the use of commercial cryptography products that have been approved or certified by the State Cryptography Administration, although such products are not included in the product catalogue for mandatory certification.

Supply chain security

Other regulatory developments that the working group believes would benefit from further improvements are often associated with those that constitute market access barriers, or in instances where national security imperatives are too broadly defined in scope. For example, while China—like all other countries and regions—has a legitimate right to strengthen the resilience of its supply chains, the sub-working group hopes proportionality could be applied to such initiatives—including through policies, regulations and procurement requirements—so that they remain

²⁹ For more details, please refer to KR 3 of the *Information and Communication Technology Working Group Position Paper 2021/2022*, p. 327.





inclusive and do not place an overly strong emphasis on indigenous innovation and supply chain security. Applying a strict and narrow definition of 'national security' would help avoid discrimination, while allowing China to concentrate resources on what is genuinely important to its national interests.

In the pursuit of more 'controllable' supply chains, China is putting strong emphasis on "autonomous and controllable" ICT products and services. Although there have been official reassurances that these terms are neutral in nature, in reality they still carry a close connotation with indigenous innovation and thus put international companies in China at a competitive disadvantage.

The sub-working group strongly believes that supply chain security regulations need to be business- and innovation-friendly. Intervention at all levels should be appropriate to and commensurate with the risk, and not limit the opportunities offered by digital transformation nor create unreasonable costs for business.

Recommendations

- Provide an open and transparent platform that allows EU industry to engage in cybersecurity rule-making in a timely and meaningful manner.
- Review existing and planned security-related laws and regulations, and release unambiguous implementation guidelines to ensure consistent requirements and enforcement.
- Clarify the roles and responsibilities of government authorities involved in cybersecurity rule-making.
- Recognise international companies as Chinese companies and avoid extensive interpretations of 'national security'.
- Ensure cybersecurity regulations are appropriate to and commensurate with the risk.

Abbreviations

CAC	Cyberspace Administration of China
CCPS	Classified Cybersecurity Protection Scheme
CII	Critical Information Infrastructure
CNCA	Certification and Accreditation Administration of China
CSRM	Cybersecurity Review Measures
CVD	Coordinated Vulnerability Disclosure
EU	European Union
FIE	Foreign-invested Enterprise
GDPR	General Data Protection Regulation
ICT	Information and Communication Technology
ISO	International Standardization Organization
IT	Information Technology
KR	Key Recommendation
MIIT	Ministry of Industry and Information Technology
MPS	Ministry of Public Security
NPCSC	National People's Congress Standing Committee
PRC	People's Republic of China
SME	Small and Medium-sized Enterprise
TC260	National Information Security Standardisation Technical Committee
TC485	National Technical Committee on Communication





Logistics Working Group

Key Recommendations

1. Customs Issues

1.1 Promote the Reform of the 'Two Steps' Declaration Model 2

- Continue to allow the 'One Step' declaration model and the 'Two Steps' declaration model to run in parallel, allowing each enterprise to choose which model they would prefer to use.
- Simplify the number of required declaration elements and customs declaration documents for the 'Step 1' declaration.
- Allow enterprises to resubmit more accurate information during 'Step 2' of the declaration process if mistakes are found during 'Step 1'.
- Increase the efficiency of customs supervision by allowing goods that have passed 'Step 1' to be used or consumed prior to completion of 'Step 2'.

1.2 Continue Normal Clearance Procedures even if the Clearance Lead Time has been Reached

- Continue to follow normal clearance procedures instead of requesting the return of shipments that are not cleared within the stipulated time period.

1.3 Establish Detailed and Enforceable Implementation Guidelines for Voluntary Disclosures and Use of the Customs Declaration Sheet 3

- Establish detailed voluntary disclosure guidelines and executable processes.
- Establish clear rules and requirements that allow enterprises to make amendments to declared information.

1.4 Reform Customs Inspection Procedures for Environmentally-sensitive and Delicate Goods 2

- Design a more reasonable and situational customs inspection mechanism that helps reduce both additional costs incurred due to damaged goods and additional delays resulting from customs inspection procedures.

1.5 Enable 'Full-paperless' Customs Declarations via the Single-window Platform

- Enable 'full-paperless' customs declarations via the single-window platform and only require paperwork in specific situations such as when the shipment is categorised as high-risk.

1.6 Simplify the Low-value Shipment Declaration Process 2

- Adopt a flat duty rate and rescind the Harmonisation System code classification requirement for low-value goods, while balancing duty collection and trade facilitation.

1.7 Streamline Customs Procedures for Temporary Imports

- Expand and clearly define the cases that qualify for a temporary admissions (ATA) carnet, including goods required for internal usage such as events, publicity activities or testing.
- Avoid general wordings such as "goods defined in international agreements".
- Clarify the application channels for the ATA carnet.
- Enable the temporary import of products for exhibitions or internal events without a carnet.

2. Express Delivery Services (EDS)

2.1 Reduce Burdens Created by Cybersecurity Law Enforcement in the EDS Industry 2

- Balance cybersecurity enforcement with the EDS's need to clear customs efficiently, by reducing the additional burdens created with regard to the cross-border transfer of personal information.



2.2 Revert to the Previous Geographical Scope Requirement for Obtaining International Express Licences in China 2

- Manage the approvals for international express delivery licences in accordance with the spirit of opening up and improving of the business environment for foreign-invested enterprises.
- Adjust and amend the geographical scope requirement in the spirit of China's World Trade Organization commitments to market opening.

2.3 Avoid Directly Applying the Management Requirements of the Franchise Model to the Agency Model, Including the Duplicated Licence Requirement 2

- Avoid directly applying the management requirements of the franchise model to the agency model, including the duplicated licence requirement.

2.4 Accelerate the Construction of Infrastructure and Remove Restrictions on City Access to Support the Use of New Energy Vehicles (NEVs) in the EDS Industry 2

- Take into consideration the complex situation of the EDS industry when formulating policies on NEVs.
- Accelerate the construction of infrastructure to support the use of NEVs in the EDS industry, including but not limited to constructing charging stations and car parks for delivery NEVs.
- Support the access of the EDS industry's NEVs to city areas restricted for running during certain hours.

2.5 Avoid Implementing the Same Packaging Requirements for International Express Items as for Domestic Express Items, and Build Public Awareness on Green Packaging Requirements

- Take into account the characteristics of international express delivery.
- Develop differentiated packaging regulations for inbound/outbound express items.
- Build public awareness around the new green packaging requirements for consumers to reduce the potential for consumer disputes.

3. International Hubs

3.1 Establish a Clear Policy for International Hub Management 4

- Establish a complete and comprehensive system covering inbound and outbound air, sea and land shipments of transit goods, transit cargo and through-goods for international cargo.
- Promote cooperation between China customs authorities and relevant central and local government departments in order to facilitate the formulation of clear policies that provide unified guidelines for the management of international hubs.
- Include international hub management in the customs management reform process.

International Liner Shipping Sub-working Group

1. Allow the Transport of International Cargo Between Chinese Ports (International Relay) 21

- Support the development of more efficient Chinese shipping services by permitting international cargo relay by foreign shipping services.
- Initiate a pilot on international relay by appointing selective ports for a trial.

2. Apply Non-discriminatory Treatment in Chinese Free Trade Zones (FTZs) 8

- Give all foreign-flagged vessels equal right to tranship in China's FTZs, irrespective of the vessels' nationality or ownership.



3. Establish Principles and Operational Guidelines for Surcharges, Behavioural Charges and Value-added Service Charges 🗣️ 2

- Issue a written guidance on the criteria for filing new surcharges and adjusting existing surcharges.
- Establish clear guidelines on the differences between mandatory surcharges, behavioural charges and value-added service charges.

4. Set Up a Numerical Percentage as a Minimum Threshold in Determining Non-Compliance in Freight Filing Audits 🗣️ 2

- Set up a numerical percentage as a minimum threshold in determining non-compliance in freight filing audits to replace unattainable zero-tolerance requirements.

5. Reconsider Dangerous Goods Misdeclaration Regulatory Guidelines That Hold Carriers Liable for Shipper Misdeclarations

- Make the party submitting false declarations responsible for misdeclarations and not the carriers, who have no means of verifying declarations.

6. Ratify the Hong Kong Convention for the Safe and Environmentally Sound Recycling of Ships 🗣️ 2

- Ratify the Hong Kong Convention for the Safe and Environmentally Sound Recycling of Ships.

7. Monitor the Impact of Coastal Ports Integration on Fair Competition 🗣️ 2

- Closely monitor potential infringement of competition law (from a merger control and a potential abuse of dominant position standpoints) by the concerned undertakings.
- Implement measures and controls to prevent post-merger port groups creating a monopoly.

8. Facilitate the Use of Foreign Carriers' Empty Containers for Transportation of Domestic Trade Goods During Container Repositioning

- Facilitate the use of foreign carriers' empty containers for the transportation of domestic goods during container repositioning.

9. Collaborate with the International Liner Shipping Community to Decarbonise the Industry

- Build partnerships between research institutions, shipping companies, shipbuilders and their suppliers in China and Europe to develop and adapt carbon neutral technologies.
- Agree on technical standards to avoid potential inefficiencies and waste, through approaches such as enhanced cooperation within the IMO.
- Cooperate on the establishment of a global infrastructure ensuring availability of carbon neutral fuels.





Introduction to the Working Group

The Logistics Working Group was founded in 2003, and represents a diverse spectrum of logistics service providers in freight forwarding, including sea, air, land and express delivery, as well as warehousing and distribution. The Logistics Working Group is also composed of the International Liner Shipping Sub-working Group, with core members from leading international maritime transport enterprises.

Recent Developments

Following the spread of COVID-19 nationwide in January and February 2020, China's logistics industry suffered a significant year-on-year decrease in overall revenue, before returning to normal levels for the rest of the year. In 2021, according to the National Development and Reform Commission (NDRC), the total value of external logistics during the first two months of the year was Chinese yuan (CNY) 44.7 trillion, of which CNY 40.1 trillion was composed of industrial products. This represents a 32.4 per cent year-on-year increase compared with 2020, or an eight per cent growth when compared to 2019.¹

Logistics Under the COVID-19 Pandemic

The COVID-19 pandemic had an enormous impact on the logistics industry, with production lines grinding to a halt, first in China and then overseas. Intra-China and transborder transportation suffered its biggest impact in February 2020, as quarantine measures imposed on different Chinese cities led to a shortage of labour in both manufacturing and logistics. According to the Ministry of Transport (MOT), the completed freight volume from January to April 2020 was 11.66 billion tonnes, a decrease of 13.7 per cent year-on-year.²

Many attempts to keep supply chains running smoothly during the crisis were made by the Chinese Government, including increasing air freight lines and easing the access of air freight companies to airports,³ adopting simplified control measures and rapid customs clearance for international air cargo crews

(provided they met certain conditions),⁴ and increasing coordination between different ministries for the smooth resumption of work by logistics companies.⁵ The entire world has been relying on the strong foundations already created by logistics companies to receive vital deliveries of medical devices and urgently-needed equipment.

Key Recommendations

1. Customs Issues

1.1 Promote the Reform of the 'Two Steps' Declaration Model

Concern

Although the new 'Two Steps' declaration model developed by the General Administration of Customs of China (GACC) is aimed at improving customs clearance efficiency, many companies are not willing to switch to this model due to its complicated requirements and processes.

Assessment

As a global best practice, the 'Two Steps' declaration model has been widely implemented in several countries, including certain European Union (EU) Member States and the United States (US). The model enhances the efficiency of import customs clearance and reduces the administrative burden on enterprises by dividing the declaration process into two steps: first, a bill of lading, and second, the submission of other documents and duty payment.⁶ It is therefore very encouraging that the GACC began working on a 'Two Steps' declaration model in 2019, with subsequent piloting throughout China starting in 2020.

However, only a small number of importers have been willing to switch to the new model, as the burdens brought by changing outweigh the benefits foreseen. In order to incentivise more enterprises to change, the working group suggests simplifying the requirements and processes. One such change would be to further reduce and simplify the documentation and information required for the 'Step 1' preliminary

1 From January to February, the total amount of social logistics in China was 44.7 trillion yuan, NDRC, 30th March 2021, viewed 13th April 2021, <https://www.ndrc.gov.cn/fggz/jjyxtj/xdw/202103/t20210330_1271198.html>

2 Economic Operation of Transportation in April, MOT, 27th May 2020, viewed 13th April 2021, <http://xxgk.mot.gov.cn/jigou/zhghs/202005/t20200527_3383950.html>

3 NDRC: Support for Aviation Logistics Companies with A Full Cargo Fleet to Enter Airports, NDRC, 29th March 2020, viewed 13th April 2021, <<http://news.cctv.com/2020/03/29/ARTI7SbH8ClnVkl9bfkOHTB200329.shtml>>

4 Notice on Precise Epidemic Prevention and Control for International Air Cargo Crews, State Council, 13th May 2020, viewed 6th May 2021, <http://www.gov.cn/zhengce/zhengceku/2020-04/14/content_5502128.htm>

5 Press Conference of the Joint Prevention and Control Mechanism of the State Council, State Council, 6th March 2020, viewed 13th April 2021, <<http://www.gov.cn/xinwen/gwylfjkjz45/index.htm>>

6 GACC Begins "Two-Step Declaration" for Import Goods, First in Zhejiang Pilot FTZ, GACC, 24th September 2019, viewed 23rd April 2021, <<http://english.customs.gov.cn/Statics/1e5f4abc-020e-4e04-8656-c6f8e29eee59.html>>





declaration. A large number of enterprises report that the current requirement for the 'Step 1' declaration is so burdensome it seems to double their workload.

In addition, the 'Step 1' declaration is preliminary and is made before the physical cargo can be released by customs authorities, therefore the information may not be very accurate. Allowing enterprises to resubmit corrected information in the 'Step 2' declaration if mistakes are found during 'Step 1' would provide a strong incentive to consider switching to this new model, as the whole process would be expedited. This would also constitute an essential step forward in facilitating the compliance management of enterprises.

On a different note, under the current 'Two Steps'-related regulation, goods that have passed 'Step 1' are not allowed to be used or consumed until 'Step 2' is completed. This not only increases management costs, the goods imported that have gone through 'Step 2' have to be separated from those that remain at 'Step 1', but also increases the risk of non-compliance, as goods are sometimes used before the declaration process has been concluded. This restriction does not benefit importers, who would like to shorten the customs supervision period.

Recommendations

- Continue to allow the 'One Step' declaration model and the 'Two Steps' declaration model to run in parallel, allowing enterprises to choose which model they would prefer to use.
- Simplify the number of required declaration elements and customs declaration documents for the 'Step 1' declaration.
- Allow enterprises to resubmit more accurate information during 'Step 2' of the declaration process if mistakes are found during 'Step 1'.
- Increase the efficiency of customs supervision by allowing goods that have passed 'Step 1' to be used or consumed prior to completion of 'Step 2'.

1.2 Continue Normal Clearance Procedures even if the Clearance Lead Time has been Reached

Concern

Due to some local customs authorities' strict adherence to the lead-time indicator, they request shipments that have not been cleared within a specified clearance lead

time be returned, which increases companies' costs and administrative burdens.

Assessment

In recent years, the GACC has made great strides in reducing customs clearance lead-times to further facilitate trade. In line with this effort, local customs administrations have been setting specific goals to manage clearance, for example, by stipulating that shipments must be released within a specified time period. However, in cases where clearance has not been made by the lead-time, local customs authorities will often request shipments to be returned, necessitating that entire process be re-done, instead of following normal clearance procedures and extending the clearance time.

Recommendation

- Continue to follow normal clearance procedures instead of requesting the return of shipments that are not cleared within the stipulated time period.

1.3 Establish Detailed and Enforceable Implementation Guidelines for Voluntary Disclosures and Use of the Customs Declaration Sheet (CDS)

Concern

The current Customs Voluntary Disclosure rule in China is very general and lacks actionable guidance and process, while the CDS amendment to the Customs Inspection Regulations has increased compliance risks for enterprises.

Assessment

The GACC made great progress on voluntary disclosure in 2019, with the announcement of *Circular No. 161* on the voluntary disclosure process for dutiable imports.⁷

However, the existing Customs Voluntary Disclosure rule in China is still very strict and lacks actionable guidance and processes. The rules for and consequences of voluntary disclosure are unclear, and local customs authorities enforce them differently. Enterprises are more than willing to undertake voluntary disclosure, yet the inconsistency of enforcement prevents them from doing so.

⁷ GACC 2019 Circular No. 161 (Announcement on the Handling of Matters Related to Voluntary Disclosures of Tax-related Violations), GACC, 17th October 2019, viewed 13th April 2021, <<http://www.customs.gov.cn/customs/302249/302266/302267/2687641/index.html>>





At the same time, the CDS amendment to the Customs Inspections Regulations remains a challenge for enterprises since being introduced in 2016.⁸ For example, enterprises may unintentionally make wrong declarations due to mistakes introduced by overseas suppliers. However, local customs administrations will not allow them to update the declaration, even through voluntary disclosure. This creates non-compliance risks for enterprises.

Recommendations

- Establish detailed voluntary disclosure guidelines and executable processes.
- Establish clear rules and requirements that allow enterprises to make amendments to declared information.

1.4 Reform Customs Inspection Procedures for Environmentally Sensitive and Delicate Goods



Concern

For certain goods that must be handled in a controlled environment, if customs require their outer box or packaging to be opened during inspection, direct damage may be caused to the goods.

Assessment

Based on the current rules in China, during inspections, officials have the authority to inspect the entirety of the goods, which means they can request to open the outer box or packaging to conduct their inspection. One of the issues this raises is that some goods need special conditions for transportation or use, meaning that their outer box or packaging must only be opened in controlled environments, such as dust-free rooms. Therefore, if a customs officer opens the outer box or packaging of such goods in a regular environment during inspection, direct damage may be caused to the goods, which can result in high costs for companies. While enterprises can apply to have certain goods inspected in the appropriate environment, this takes considerable time and effort to execute and, in practice, customs authorities often cannot meet the requirements, thereby delaying the customs clearance process.

Recommendation

- Design a more reasonable and situational customs inspection mechanism that helps reduce both additional costs incurred due to damaged goods and additional delays resulting from customs inspection procedures.

1.5 Enable 'Full-paperless' Customs Declarations via the Single-window Platform

Concern

Although clearance documents can be sent to customs authorities via the single-window platform, as the process is still not fully paperless, it increases the burden on enterprises' operations.

Assessment

Thanks to the efforts of the GACC, China's customs declaration procedure has been simplified during the past few years, which has facilitated international trade. Importers, exporters or customs brokers can now scan clearance documents and send them to customs authorities via the digital single-window platform instead of providing them on paper, as was the previous practice. However, the single-window process is not yet fully paperless. For instance, certain documents, such as invoices, cannot be completed online; the declarant still has to print the necessary documents, fill them out and then scan them into the customs declaration system.

To further improve customs clearance efficiency and better protect the environment, the working group strongly recommends adopting a fully paperless customs declaration model. Paperwork should be only required when absolutely necessary, such as when a shipment is categorised as high risk.

Recommendation

- Enable 'full-paperless' customs declarations via the digital single-window platform and only require paperwork in specific situations, such as when the shipment is categorised as high-risk.

1.6 Simplify the Low-value Shipment Declaration Process



Concern

The import and export volume of low-value goods is much greater than for goods of higher value, and

⁸ Regulation of the People's Republic of China on Customs Inspection (2016 Revised Version), State Council, 19th June 2021, viewed 4th June 2021, <<http://www.customs.gov.cn/customs/302249/302266/302267/632482/index.html>>





the Harmonisation System (HS) code classification requirement results in a huge workload for carriers, thereby slowing down the clearance process.

Assessment

The rapid development of international trade and cross-border e-commerce has resulted in a large increase in the volume of low-value goods being shipped (in China, shipments valued at less than CNY 5,000). The majority of low-value shipments are samples and advertising materials, which are very time-sensitive and require fast customs clearance.

At the same time, while the HS code classification is important for duty/tax calculation, it is a technical and time-consuming job. To assign an appropriate HS code, express operators need to contact the importer to confirm the shipment details. This process greatly slows down the import/export process. In accordance with the World Customs Organization's Immediate Release Guidelines, some international customs administrations set a *de minimis* threshold for low-value goods. This allows shipments below a certain value to be exempted from duty/tax, thus dispensing with the need for HS code classification. The working group recommends that this model be adopted by the GACC, to facilitate the clearance of low-value, time-sensitive shipments.

Recommendation

- Adopt a flat duty rate and rescind the HS code classification requirement for low-value goods, while balancing duty collection and trade facilitation.

1.7 Streamline Customs Procedures for Temporary Imports

Concern

Temporary imports, which are often used for exhibitions or for one-off constructions, need to be imported as normal imports to enter China, which increases customs and compliance costs.

Assessment

Temporary admissions (ATA) carnet

Internationally, the ATA carnet can be used in the temporary import/export of commercial samples and testing equipment. On 9th January 2019, the GACC published *Announcement [2019] No. 13*,⁹ announcing

⁹ GACC Announcement [2019] No. 13 On Matters Relating to the Supervision of Temporarily Imports and Export Goods, GACC, 9th January 2019, viewed 23rd April 2021, <<http://www.customs.gov.cn/customs/302249/302266/302267/2293000/index.html>>

a widening of the scope of ATA carnet applicability. However, this announcement concluded with an unclear definition of its applicability and vague phrases such as “goods defined in international agreements”, which makes compliance more difficult.

Ever since, the ATA document list has been narrowly implemented by relevant authorities, and is applied only to goods bound for exhibitions, trade fairs, conferences or similar activities, with the shipment declaration process for samples, testing equipment or other temporary equipment remaining unclear. For example, temporarily imported goods—such as installation tools—cannot obtain an ATA carnet even though they will be exported back to their country of origin after use.

The working group therefore recommends revising the ATA list by enlarging it and clearly defining cases when an ATA carnet will be issued by referring to GACC *Order No. 233 on Measures for the Administration of Temporary Entry and Exit Goods*,¹⁰ which covers the cases previously mentioned in this key recommendation.

Non-ATA cases

Some governments, like the US Government, will not issue an ATA carnet for certain domestically-produced products. In the absence of an ATA carnet, companies can only use *pro-forma* invoices to apply for temporary importation permission. However, most customs authorities do not allow the temporary import of certain goods without a carnet, while some customs authorities, like China, only accept temporary imports of goods for testing purposes without a carnet. Therefore, if a company wants to temporarily import a US-produced test-product for an internal event in China, the product must be transferred through a third country that does issue carnets, thereby increasing costs and reducing efficiency.

Recommendations

- Expand and clearly define the cases that qualify for an ATA carnet, including goods required for internal usage such as events, publicity activities or testing.
- Avoid general wordings such as “goods defined in international agreements”.
- Clarify the application channels for the ATA carnet.
- Enable the temporary import of products without a carnet for exhibitions or internal events.

¹⁰ GACC Order No. 233 on Measures for the Administration of Temporary Entry and Exit Goods, GACC, 8th December 2017, viewed 21st April 2021, <<http://www.customs.gov.cn/customs/302249/302266/302267/755412/index.html>>





2. Express Delivery Services (EDS)

2.1 Reduce Burdens Created by Cybersecurity Law Enforcement in the EDS industry

Concern

The tedious and burdensome requirements and procedures for enforcement of the Cybersecurity Law limit customs clearance efficiency in the EDS industry, which in turn impedes the competitiveness of the services that enterprises can provide.

Assessment

The Cybersecurity Law came into effect in June 2017,¹¹ with subsequent supporting implementing regulations and policies that regulate the information-sharing of stakeholders. Among these regulations, the EDS industry has been particularly active in providing feedback on draft measures concerning security assessments for cross-border transfers of 'personal information' and 'important data', specifically two releases by the Cyberspace Administration of China (CAC); the 2017 *Measures on the Security Assessment of Cross-border Transfer of Personal Information and Important Data (Draft for Comments)*,¹² which after public consultation was redrafted as the 2019 *Measures on Security Assessment of the Cross-border Transfer of Personal Information (Draft for Comments)*,¹³ both of which included the EDS industry in their scope of supervision.

In April 2021, the National People's Congress solicited public opinions on the draft Personal Information Protection Law,¹⁴ which features similar security assessment requirements for cross-border data transfers of personal information as specified in the 2019 draft measures.

Implementation of the draft law will impact express delivery companies in particular, due to their services being significantly related to customer information and cross-border data transfers. The existing regulations

require express delivery companies to transmit data to the GACC and the relevant local agencies on a daily basis, which delays customs clearance. In cases where the security assessment process materially affects the rate at which packages can clear customs, the non-specification of cybersecurity requirements relating to EDS will have a significant, negative impact on the entire industry.¹⁵

Recommendation

- Balance cybersecurity enforcement with the EDS industry's need to clear customs efficiently by reducing the additional burdens created with regard to the cross-border transfer of personal information.

2.2 Revert to the Previous Geographical Scope Requirement for Obtaining International Express Licences in China

Concern

The adjustment to the geographical scope requirement in the *Notice of the Office of the State Post Bureau on Strengthening the Approval of the Geographical Scope of Express Delivery Business Licences* constitutes an access barrier to the industry for international express companies.

Assessment

At present, neither the Postal Law, the *Interim Regulations on Express Delivery* nor the *Administrative Measures for the Management of Express Delivery Business Licences* define the geographical scope of international express delivery business licences.

Until 2009, regulators required international express companies to file with the Ministry of Commerce and obtain an International Freight Forwarder Record-filing Certificate, which had no geographical scope limitation. A company that obtained this certificate could operate nationwide.

In 2010, the revised Postal Law introduced new requirements for international express delivery enterprises, including the need to obtain an International Express Delivery Business Licence issued by the industry's regulatory authorities. From this point, the geographical scope of international express delivery

¹¹ *Cybersecurity Law*, National People's Congress (NPC), 7th November 2016, viewed 23rd April 2021, <http://www.gov.cn/xinwen/2016-11/07/content_5129723.htm>

¹² *Measures on the Security Assessment of Cross-border Transfer of Personal Information and Important Data (Draft for Comments)*, CAC, 11th April 2017, viewed 23rd April 2021, <http://www.cac.gov.cn/2017-04/11/c_1120785691.htm>

¹³ *Measures on the Security Assessment of Cross-border Transfer of Personal Information (Draft for Comments)*, CAC, 13th June 2019, viewed 23rd April 2021, <http://www.cac.gov.cn/2019-06/13/c_1124613618.htm>

¹⁴ The second draft of the Personal Information Protection Law has been removed from official websites as of 28th May 2021 for further review and consideration. The NPC has posted information about the most recent drafts here: <<http://www.npc.gov.cn/ficaw/more.html>>

¹⁵ For more information on the impacts of data security and personal information protection in China, please refer to the *Cybersecurity Sub-working Group Position Paper 2021/2022*, p. 327.





business licences was restricted to the provincial level, including autonomous regions and province-level municipalities.

However, in 2019 and 2020, when some express companies applied to renew their expiring licences, they found that the State Post Bureau (SPB) had adjusted the geographical scope for express licensing from province/autonomous-region/municipality level to city/district/prefecture and autonomous prefecture level. However, no public policy was issued to support this adjustment, and the lack of information and prior notice constitute an additional market access barrier to the express industry. It is also inconsistent with the State Council's repeated requirements for the expansion, opening up and improvement of the business environment for foreign-invested enterprises, as mentioned in *Circular 2019 No. 23*.¹⁶ It is also incompatible with China's World Trade Organization (WTO) commitments on market opening.

Recommendations

- Manage the approvals for international express delivery licences in accordance with the spirit of opening up and improvement of the business environment for foreign-invested enterprises.
- Adjust and amend the geographical scope requirement in the spirit of China's WTO commitments to market opening.

2.3 Avoid Directly Applying the Management Requirements of the Franchise Model to the Agency Model, Including the Duplicated Licence Requirement 2

Concern

Regulators often do not differentiate between the regulatory management practices of agency models used in the international EDS industry and franchise models used for domestic delivery services, which in practice have fundamental differences.

Assessment

Under the franchise model, an express delivery enterprise can authorise (franchise) others to use its brand, management structure and transportation network to operate in a particular area. In such cases, the

franchised entity fully represents the interests of the authorising company in that area.

But under the agency model, a cooperative relationship between an 'agent' and an express delivery enterprise is established by contractual agreement. Based on the terms of the contract, the agent is responsible for collecting packages for express delivery and forwarding them on to the express delivery enterprise, which acts as a courier. The express delivery enterprise then uses its international express delivery network to transport and deliver packages overseas. The agent and express delivery enterprise operate independently. The collection of packages for delivery remains the complete responsibility of the agency. Once the package has been transferred to the express delivery enterprise, the enterprise then becomes responsible for delivery.

Express industry regulatory bodies in China treat the agency model adopted by international express delivery enterprises in the same way as the franchise model operated by domestic express enterprises. In the franchise model, both the franchisor and franchisee are required to hold an international express licence at the city level, where the franchisee will leverage the franchisor brand to conduct business locally. In the agency model, the agency holds its city-level express licence to serve last-mile pick-up and delivery for multiple international express enterprises, which cover cross-border delivery with their own international express licence at the port city. However, under the agency model in China, the international express enterprise is also required to hold a city-level licence in the agency city. In terms of actual operation, the express company cooperates with the local agency because it has a very limited local business scale. When the regulator requires express companies to also have a licence in the areas where it cooperates with an agency, this goes against the business logic of the agency model and results in duplicated licences.

Recommendation

- Avoid directly applying the management requirements of the franchise model to the agency model, including the duplicated licence requirement.

¹⁶ *Opinions on Further Utilising Foreign Capital (Circular 2019 No. 23)*, State Council, 7th November 2019, viewed 2nd June 2021, <http://www.gov.cn/zhengce/content/2019-11/07/content_5449754.htm>





2.4 Accelerate the Construction of Infrastructure and Remove Restrictions on City Access to Support the Use of New Energy Vehicles (NEVs) in the EDS industry 2

Concern

Infrastructure construction and city-access rights are not on par with the strict NEV-use requirements imposed on the EDS industry, creating additional operational burdens.

Assessment

Vehicles used for international express delivery not only have to withstand the wear-and-tear of transporting packages over long distances, but also must be eligible to make deliveries within a city. Companies must therefore consider city access, energy conservation and environmental protection while adapting their transportation fleet to address a range of issues, including the 'last mile' delivery.¹⁷ With the promotion of green policies, a series of challenges need to be tackled to realise the better usage of NEVs in the logistics industry.

While the working group strongly believes that energy conservation and environmental protection must be supported by the industry, it also asserts that policymakers need to be aware of the complex and unplanned-for situations that EDS operators face. For example, if express carriers are required to replace their large fleets of conventional vehicles with NEVs within a tight timeframe, it will create excessive costs and logistical burdens for the whole industry. Therefore, governments and authorities should provide additional support to help ease express delivery companies' transition to NEVs. There are currently three main challenges:

- a) **In-depot charging:** Vehicles used in express deliveries do not stop long enough while in use to be able to take advantage of on-street charging infrastructure. In-depot charging solutions for overnight use are therefore essential.
- b) **City infrastructure:** The working group notes that, due to NEV quotas for express delivery in urban

¹⁷ The 'last mile' refers to the final step from the nearest distribution hub of the goods to the door of the recipient. These last few kilometres or miles require cars of sizes that are more suitable for urban mobility, and the associated costs can be quite substantial. This part of the delivery entails a number of short stops throughout the city, in order to complete all deliveries assigned each day. Therefore, there is a need to be able to recharge NEV batteries to accommodate the complexity of this delivery process.

areas, certain provinces and cities have introduced requirements and metrics that hold the EDS industry to a higher standard than other industries. However, infrastructure in China's cities is currently not up to a level of development that can support mass replacement of conventional EDS vehicles with NEVs. For example, there are not enough charging stations, and cities need to be better designed to allow for 'last-mile delivery'.

- c) **City access:** Players in the EDS industry strongly rely on time-efficient deliveries to remain competitive. The working group would therefore welcome a harmonisation of city-access measures that allows EDS vehicles to enter inner-city areas during peak hours, so that express operators can plan fleet investments efficiently.

Recommendations

- Take into consideration the complex situation of the EDS industry when formulating policies on NEVs.
- Accelerate the construction of infrastructure to support the use of NEVs in the EDS industry, including but not limited to constructing charging stations and car parks for delivery NEVs.
- Support the access of EDS industry NEVs to city areas that have restrictions during certain hours.

2.5 Avoid Implementing the Same Packaging Requirements for International Express Items as for Domestic Express Items, and Build Public Awareness on Green Packaging Requirements

Concern

Regulators often apply the same packaging policies to domestic and international express shipping without taking into account the type of packaging required to ship goods overseas safely, which may prevent international couriers from meeting certain local requirements.

Assessment

In 2020, the SPB and other regulators rolled out a number of policies concerning green packaging in the EDS industry. The industry is fully supportive of environmental protection efforts, as being environmentally friendly and engaging in sustainable practices is part of the corporate social responsibility of the EDS industry.

However, some of the green packaging regulations,



such as promoting and using recyclable packaging, favour domestic express delivery entities. Given that international express delivery packages will be delivered globally, policies that promote domestic packaging requirements for all packages may be inconsistent with requirements in other jurisdictions and not feasible to comply with.

Also, several newly-issued policies and draft regulations published for public consultation have included provisions specifying that consumers' own packaging materials should meet established requirements regarding the use of green packaging for express delivery mail. For example, according to the *Green Packaging Specification for Express Mail* issued in June 2020,¹⁸ express delivery enterprises cannot accept items from consumers whose own packaging fails to meet green packaging requirements and who refuse to replace the materials. If such a situation persists, it is likely to increase incidences of disputes with consumers, decrease consumer confidence in the EDS industry, and place the burden of communicating the need for green packaging to consumers on express delivery entities. The working group therefore encourages regulators to build public awareness around these new green packaging requirements and work with the EDS industry to increase public understanding, thereby reducing consumer disputes stemming from their use of non-compliant packaging materials.

Recommendations

- Take into account the characteristics of international express delivery.
- Develop differentiated packaging regulations for inbound/outbound express items.
- Build public awareness around the new green packaging requirements for consumers to reduce the potential for consumer disputes.

3. International Hubs

3.1 Establish a Clear Policy for International Hub Management 4

Concern

There is no unified supervision policy, such as a customs transit policy, for international hubs in China, which holds back the development of such facilities.

Assessment

The role of an international hub is to gather different manufacturing and service industries to establish a complete logistics supply chain, integrate different resources and improve transportation efficiency. There is no unified supervision policy for international hubs in China, and the country lacks developed customs transit policies. For instance, transit-regulated goods—including strategic goods and biological substances—are treated as imports that require import permits and approvals from the relevant regulators, even if just being transferred between aircraft in an airport secured zone. For this reason, when dealing with a variety of goods, enterprises often encounter multiple challenges in warehousing, transportation and centralised shipping, which reduce the transportation efficiency of international hubs and thereby the overall operational efficiency of companies.

This is further reflected in the management of inbound and outbound international transit cargo in international hubs in China, for which the existing customs system has very few regulatory requirements or guidelines.

Recommendations

- Establish a complete and comprehensive system covering inbound and outbound air, sea and land shipments of transit goods, transit cargo and through-goods for international cargo.
- Promote cooperation between China customs authorities and relevant central and local government departments in order to facilitate the formulation of clear policies that provide unified guidelines for the management of international hubs.
- Include international hub management in the customs management reform process.

¹⁸ *Green Packaging Specification for Express Mail*, SPB, 22nd June 2020, viewed 23rd April 2021, <http://www.spb.gov.cn/zc/ffgjzc_1/202007/120200714_2705975.html>





Abbreviations

ATA	Temporary Admission
CAC	Cyberspace Administration of China
CDS	Customs Declaration Sheet
CNY	Chinese Yuan
EDS	Express Delivery Services
EU	European Union
GACC	General Administration of Customs of China
HS	Harmonisation System
MOT	Ministry of Transport
NDRC	National Development and Reform Commission
NEV	New Energy Vehicle
NPC	National People's Congress
SPB	State Post Bureau
US	United States
WTO	World Trade Organization



International Liner Shipping Sub-working Group

Introduction to the Sub-working Group

Ocean shipping transports 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.¹ 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 '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, environmentally sustainable and competitive maritime transport environment in China. 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

The impact of the COVID pandemic on the industry and lessons to take forward

The outbreak of the Coronavirus Disease 2019 (COVID-19) has caused serious disruption to trade flows and unprecedented swings in demand for shipping services. Demand collapsed during the first half of 2020, only to rebound very strongly in the second half of the year. Carriers have been impacted by the COVID-19 restrictions in overseas markets, leading to delays and congestion in ports, equipment imbalances and market volatility. The liner shipping industry has responded by mobilising all available tonnage and equipment. However, simply adding more vessels will not resolve bottlenecks when the congestion comes primarily from the discharge of cargo at the overseas port with long dwell time for the

return of containers. All links in the transport chain must work together to address the challenges arising from the impact of the COVID-19 pandemic.

Market forces will restore a balance to supply and demand if markets are not obstructed, but the question remains: how can supply chains become more resilient and efficient? Dealing with the ongoing supply chain bottlenecks has provided several learning points: For example, allowing carriers to engage in international relay in China would give them the flexibility to optimise networks. Also, the extremely high number of overbookings and 'no-shows' in China² compared to other countries has made it hard for carriers to manage the present spike in demand, as carriers normally accept higher numbers of bookings than vessel capacity to compensate for the no-shows. This will create problems when all booked cargo shows up at times of vessel capacity scarcity. This significant inefficiency is likely to persist as long as double or triple-booking with carriers remains unsanctioned.

The pursuit of carbon neutrality

In September 2020, President Xi Jinping announced that China would become carbon neutral by 2060, while the European Union (EU) has committed to doing so by 2050. In many industries, maritime transport in particular, there are limits to the carbon emission reductions that can be achieved by using existing technologies. New technologies need to be developed in order to ensure carbon neutrality, whether by 2050 or 2060. Developing and implementing entirely new maritime propulsion technologies and fuels requires international collaboration, due to the scale and urgency of the challenge. In this respect, China and Europe are natural partners within the maritime industry. They are global leaders within the industry, with the world's five largest container shipping companies being based in either China or Europe. Moreover, China is the world's largest shipbuilding nation, accounting for about 50 per cent of all tonnage being built globally, while many European companies and institutions are leaders in maritime technology. Also, to achieve carbon reduction

¹ Introduction to IMO, International Maritime Organization, 2019, viewed 23rd March 2021, <<http://www.imo.org/en/About/Pages/Default.aspx>>

² 25-30 per cent of booked volumes in China never show up, in Japan the corresponding number is close to zero.





targets, it will be critically important that technical standards are agreed upon, so global efforts towards reducing emissions become mutually reinforcing and not mutually excluding. With this in mind, the International Liner Shipping Sub-working Group strongly suggests that China, Europe and other stakeholders in the maritime industry, prioritise collaboration within research, development, standard-setting and implementation.

The Annual EU-China Maritime Dialogue

The International Liner Shipping Sub-working Group appreciates the annual EU-China Maritime Dialogue between the European Commission and the Chinese Ministry of Transport (MOT). The dialogue is a 'best practice' of government-to-government communication, giving industries the opportunity 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.³ While the 2020 dialogue was cancelled due to the pandemic, the 2021 meeting will take place online.

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 foreign liner shipping community in China.

Assessment

International relay refers to the practice of a company carrying cargo from one port in a country 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 another 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, foreign shipping lines are currently forced to

route cargo originating in China via overseas ports, or to use Chinese services for the leg between domestic ports, even if the destination of the cargo is overseas, to carry out international relay. This contrasts with the situation in the EU which, as a single market, allows for unrestricted transport of cargo between its major container hub ports (many individual Member States are also fully open to Chinese-flagged ships carrying out international relay).

Permitting international relay by all ships at Chinese ports will create flexibility for shipping lines, allowing them to optimise route networks, thereby 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. Permitting international relay would also bring significant benefits to China's domestic economy.

Economic benefits for China

1. International relay will help to develop international hub ports in China and 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.
2. International relay will benefit Chinese importers and exporters by enabling flexible service choices with lower supply chain costs.
3. International relay will create a competitive advantage for the Chinese economy, as 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.

Meanwhile, permitting international relay would only have a marginal effect on domestic Chinese shipping lines. International shipping liners currently choose to tranship containers outside of China rather than using a domestic feeder service, which increases costs. Therefore, domestic shipping lines are not benefitting from the ban on international relay. Alternatively, regulators could consider appointing selected ports as a pilot for international relay. Thereafter, mass implementation may be rolled out to all Chinese ports.

Recommendations

- Support the development of more efficient Chinese shipping services by permitting international cargo relay by foreign shipping services.

³ EU-China Maritime Dialogue a Good Template, says European Shipowners, ECSA, viewed 23rd March 2021, <<https://www.ecsa.eu/news/eu-china-maritime-dialogue-good-template-say-european-shipowners>>





- Initiate a pilot on international relay by appointing selective ports for a trial.

2. Apply Non-discriminatory 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 international 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 of a ship, 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, in regard to other issues, the zones have also placed foreign companies at a further disadvantage to Chinese companies. The sub-working group is however greatly encouraged by a study presently being carried out by the Shanghai Municipal Transportation Commission (and to be reviewed by the MOT) on the possibility of allowing international relay in Shanghai. The International Liner Shipping Sub-working Group hopes that this will ultimately lead to a relaxation of relay restrictions.

Recommendation

- Give all foreign-flagged vessels equal right to tranship

in China's FTZs, irrespective of the vessels' nationality or ownership.

3. Establish Principles and Operational Guidelines for Surcharges, Behavioural Charges and Value-added Service Charges

Concern

The regulations related to the collection of surcharges, behavioural charges and value-added services charges in China's maritime transportation industry remain vague and seemingly arbitrary, making it difficult for carriers to achieve compliance and causing misunderstandings among both shippers and regulators, as well as problems for carriers in filing their rates with the Shanghai Shipping Exchange (SSE).

Assessment

A lack of clear written guidelines makes it difficult for shipping lines to know which criteria must be fulfilled for a local surcharge filing to be compliant with regulations. This creates legal uncertainties for carriers on whether a new surcharge or an adjustment to an existing surcharge can be accepted.

The MOT has confirmed during meetings with sub-working group representatives that the collection of local surcharges is a practice regulated by the market, as was also confirmed during the annual EU-China Maritime Transport Agreement Implementation Meeting in Finland in June 2019.⁴ However, at the same time, investigations into carriers' surcharge collection practices in China and requests for reductions, specifically on Terminal Handling Charges (THC), appear to assume a cost recovery principle. In addition, sub-working group members report that customers, the SSE and some authorities do not appear to distinguish between:

1. mandatory surcharges, such as the THC;
2. behavioural charges, which are imposed due to customer behaviour, such as delays in submitting required information that incurs additional cost; and
3. charges for value-added and optional services, which

⁴ The meeting took place from 17th–19th June in Helsinki. The EU delegation was led by Magda Kopczynska, director of Waterborne Transport and Ports Affairs at the EU Commission, and the Chinese delegation by Liu Peng, deputy director general, Water Transport Bureau, MOT. See *Finland Hosts an EU-China Maritime Meeting*, Finnish Ministry of Transport and Communications, 17th June 2019, viewed 23rd March 2021, <<https://www.lvm.fi/-/finland-hosts-an-eu-china-maritime-meeting-1013640>>.



are carried out based on customer requests, such as making changes to created documentation.

The distinction between the three above categories is of essence, since most surcharges are in fact incurred by customers or at the customers' request, and therefore not controlled by carriers.

Recommendations

- Issue a written guidance on the criteria for filing new surcharges and adjusting existing surcharges.
- Establish clear guidelines on the differences between mandatory surcharges, behavioural charges and value-added service charges.

4. Set Up a Numerical Percentage as a Minimum Threshold in Determining Non-Compliance in Freight-filing Audits

Concern

Carriers are frequently audited on compliance in regards to the accuracy of their freight-related information—which can involve massive amounts of data—and regulators have adopted a zero-tolerance policy so that even minor inaccuracies are punished.

Assessment

Carriers have spent significant resources on enhancing the accuracy of their freight-rate filing, and substantial improvements have been achieved so far. Considering the volume of filing carriers submit every day and the complexity in freight rate determination, it is practically impossible to achieve 100 per cent accuracy, not to mention the inevitable human errors in the filing process. Nonetheless, carriers are still penalised up to Chinese yuan (CNY) 100,000 for sporadic mismatches during audit processes. It is therefore suggested that a small margin of error be tolerated when determining the overall compliance level during an audit. This would also encourage carriers to invest in continuous improvements to their filing systems and processes, as they would have a realistic chance of meeting compliance requirements through additional efforts.

Recommendation

- Set up a numerical percentage as a minimum threshold in determining non-compliance in freight-filing audits to replace unattainable zero-tolerance requirements.

5. Reconsider Dangerous Goods Misdeclaration Regulatory Guidelines That Hold Carriers Liable for Shipper Misdeclarations

Concern

Carriers are held liable and fined in cases of dangerous goods misdeclaration made on the basis of misdeclarations by shippers.

Assessment

The *Regulation on Safety Administration of Dangerous Goods in Port* issued by the MOT stipulates that the carrier is the ultimate entrusting party for terminal operation.⁵ Therefore, the carrier is liable for dangerous goods misdeclarations and will be fined if cargo is misdeclared. In reality, the carrier only receives cargo information from the shipper upon booking, and does not have the right to check the actual content of the containers. In other words, dangerous goods misdeclarations (whether intentional or not) arise from shippers, and are outside of the control of carriers. Making a carrier liable for dangerous goods misdeclarations is unfair, as it punishes the wrong party.

Recommendation

- Make the party submitting false declarations responsible for misdeclarations and not the carriers, who have no means of verifying declarations.

6. Ratify the Hong Kong Convention for the Safe and Environmentally Sound Recycling of Ships

Concern

The Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships,⁶ which could have a very positive environmental impact, is yet to enter into force due to lack of ratification, including by China.

Assessment

The Hong Kong Convention will enter into force in two

⁵ The *Regulation* was first issued on 4th September 2017 by the MOT and revised in 2019: *Decision of the Ministry of Transport to amend the Regulations on the Safety Management of Dangerous Goods in Ports*, State Council, 28th November 2019, viewed 8th June 2021, <http://www.gov.cn/zhengce/zhengceku/2019-12/26/content_5464224.htm>

⁶ *The Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships*, IMO, viewed 23rd March 2021, <<http://www.imo.org/en/About/Conventions/ListOfConventions/Pages/The-Hong-Kong-International-Convention-for-the-Safe-and-Environmentally-Sound-Recycling-of-Ships.aspx>>





years after 15 states—which must represent 40 per cent of global merchant shipping by gross tonnage, and on average three per cent of recycling tonnage for the previous 10 years—have either signed it without reservation as to ratification, acceptance or approval, or have deposited instruments of ratification, acceptance, approval or accession with the Secretary General of the International Maritime Organization (IMO).

The Hong Kong Convention was adopted by the IMO in 2009. Over a decade later, it is yet to enter into force. The Convention intends to address all issues relating to ship recycling, including concerns about working and environmental conditions in many of the world's ship-recycling facilities. Ships sold for scrapping may contain environmentally hazardous substances such as asbestos, heavy metals, hydrocarbons, ozone-depleting substances and others. Under the Convention, each ship sent for recycling will be required to carry an inventory of hazardous materials. Recycling yards must provide a Ship Recycling Plan, specifying the manner in which each individual ship will be recycled. Parties to the Convention will be required to take effective measures to ensure that ship-recycling facilities under their jurisdiction comply with the Convention.

China places high priority on environmental protection and regulation, as evidenced by the focus on the environment in the 14th Five-year Plan. The country is also a leading shipping and shipbuilding nation. As such, ratification of the Hong Kong Convention by Beijing would send a strong signal to the global shipping community that China supports sustainable ship recycling and expects the shipping industry to take responsibility for assets from cradle to grave.

Recommendation

- Ratify the Hong Kong Convention for the Safe and Environmentally Sound Recycling of Ships.

7. Monitor the Impact of Coastal Ports Integration on Fair Competition 2

Concern

The integration of coastal ports and formation of port groups over the past three years may erode the free market and competition and lead to monopolies, which ultimately undermines the competitiveness and efficiency of Chinese ports and by extension China's foreign trade.

Assessment

The integration of ports in China over the past two years may weaken competition. For example, the Shandong Port Group listing dated 2nd August 2019⁷ covers Qingdao, Rizhao, Yantai, Weihai and the Bohai Bay Area (Weifang, Dongying and Binzhou),⁸ and the Liaoning Province Port Group listing from 4th January 2019 covers Dalian, Yingkou, Panjin, Huludao, Dandong, and Jinzhou (under plan).⁹ Such integration creates monopolies and limits terminal operator choices in the region, as all are operated by the same operator. This could result in ports increasing handling charges for carriers, which would have no alternative options to turn to.

Recommendations

- Closely monitor potential infringement of competition law (from a merger control and a potential abuse of dominant position standpoints) by the port groups.
- Implement measures and controls to prevent post-merger port groups creating a monopoly.

8. Facilitate the Use of Foreign Carriers' Empty Containers for Transportation of Domestic Trade Goods During Container Repositioning

Concern

Current limitations on using foreign carriers' empty containers during repositioning for domestic transportation increases inefficiency and wastes resources.

Assessment

It is common practice for foreign carriers to arrange empty container repositioning.¹⁰ According to current China customs regulations, these containers should remain empty during repositioning from one place to another within Chinese territory. Given the shortage of containers since the outbreak of COVID-19, leaving a container empty during repositioning is a waste of scarce transport resources. Combining repositioning of international empty containers with domestic

7 *Seven Ports in Shandong*, Xinhua, 22nd August 2019, viewed 23rd March 2021, <http://www.xinhuanet.com/fortune/2019-08/22/c_1124905404.htm>

8 *Shandong Port Group Sees Throughput Rebound After Outbreak Subsides*, China Daily, 19th March 2020, viewed 23rd March 2021, <http://shandong.chinadaily.com.cn/2020-03/19/c_463929.htm>.

9 *About Us, Group Events*, Liaoning Port Group, viewed 23rd March 2021, <http://www.liaoningport.com/wap/about/jtdsj_wap.html>.

10 *What is Empty Container Repositioning (and What Causes It)?*, Shipsta, 20th May 2021, viewed 8th June 2021, <<https://blog.shipsta.com/en/empty-container-repositioning>>



transportation of goods would reduce costs not only for carriers but also domestic traders. Furthermore, it will reduce the carrier's carbon footprint.

Recommendation

- Facilitate the use of foreign carriers' empty containers for the transportation of domestic goods during container repositioning.

9. Collaborate with the International Liner Shipping Community to Decarbonise the Industry

Concern

For the maritime industry to deliver on decarbonisation targets set by governments in China, Europe and elsewhere, international collaboration and alignment is critically important.

Assessment

China has committed to becoming carbon neutral by 2060 and the EU by 2050. These are ambitious targets, which will require efforts by multiple stakeholders – governments, consumers and companies alike. However, in many industries, it has become evident that there are limits to the level of decarbonisation that can be achieved using existing technologies.

Therefore, entirely new technologies will need to be invented in many industries in order to enable carbon neutrality, whether by 2050 or 2060. Developing and implementing entirely new carbon neutral technologies and fuels will require international collaboration, due to the scale and urgency of the challenge, as well as the costs.

There have been signs in some industries of technological decoupling, and of different standards emerging in different geographies. If this were to happen within the shipping industry as it attempts to realise carbon neutrality, it could lead to significant waste of resources, delays and, in a worst-case scenario, prevent critically important global decarbonisation targets being met.

Recommendations

- Build partnerships between research institutions, shipping companies, shipbuilders and their suppliers in China and Europe to develop and adapt carbon neutral technologies.

- Agree on technical standards to avoid potential inefficiencies and waste, through approaches such as enhanced cooperation within the IMO.
- Cooperate on the establishment of a global infrastructure ensuring availability of carbon neutral fuels.

Abbreviations

CNY	Chinese Yuan
COVID-19	Coronavirus Disease 2019
EU	European Union
FTZ	Free Trade Zone
IMO	International Maritime Organization
MOT	Ministry of Transport
SSE	Shanghai Shipping Exchange
THC	Terminal Handling Charge



5

Section Five

Financial Services

Financial Services

The European Chamber has three separate working groups that cover the financial services sector:

- Banking and Securities
- Non-banking Financial Institutions
- Insurance

European financial services companies in China have witnessed in recent years a significant reduction in market access barriers and the acceleration of opening-up measures in the sector. For example, equity caps and certain restrictions on the business scope of foreign banks, securities companies and fund management companies were removed in 2020. The 14th Five-year Plan (14FYP) further encourages the development of financial products, including insurance products that are tailored for companies pursuing technological and scientific research and development, and commercialisation.

Although the financial services' working groups acknowledge the Chinese Government's efforts in further opening up the financial services market to foreign-invested enterprises, foreign financial institutions (FI) continue to face indirect market access barriers that prevent them entering or expanding in the Chinese market. According to the European Chamber's *European Business in China Business Confidence Survey (BCS) 2021*, foreign banks and insurers still face a number of difficulties in conducting planning and resource management due to complex, and often unnecessary, regulations. These include licensing requirements that only allow a foreign FI to apply for approval to set up a branch in one province at a time, with a lengthy process that can take up to a year. It is also worth noting that, long before the opening-up measures were implemented, Chinese banking and insurance markets were saturated by large domestic players that had already established extensive branch networks. Therefore, working group members perceive the opening-up to be "too little, too late".¹

Meanwhile, the non-banking financial institutions (NBFI) segment has been open to foreign investment since 2009. Many current concerns are shared by foreign and domestic consumer finance companies (CFCs), auto finance companies (AFCs) and equipment leasing companies (ELCs) alike. However, foreign-invested NBFIs experience greater limitations on funding and profitability due to their different operating models (as a result of their parent company being based overseas). Opening up within the NBFI segment takes the form of aligning Chinese regulations with international practices on intangible financing and strengthening protection over assets, with an ongoing commitment from the regulator to clean up shell companies. The Non-banking Financial Institutions Working Group advocates for the recognition of foreign-invested ELCs as responsible and mature players in the Chinese market. In addition, the working group recommends that foreign-invested CFCs and AFCs be included in the pilot project on sales of non-performing loans in batches, which is a breakthrough for the industry.

Furthermore, according to the BCS 2021, regulatory reforms such as the evolving Cybersecurity Law, the Data Security Law and the Personal Information Protection Law are likely to have a significant negative impact on foreign financial services companies in China. Data localisation requirements and vague data transfer rules will force European FIs to adopt highly conservative stances on cross-border transfers,

¹ *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 08th June 2021, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>



often meaning that they simply will not send data to be aggregated at headquarters. Meanwhile, critical information infrastructure will push financial service providers to adopt local solutions rather than those used globally. Combined with the aforementioned data and cybersecurity issues, the net result may be a need for extensive localisation, which can be prohibitively expensive.²

The biggest issue from the first half of 2021 for the foreign banking industry arose from recent changes introduced jointly by the People's Bank of China (PBOC) and the State Administration of Foreign Exchange (SAFE) regarding the Macro-prudential Assessment (MPA) framework, which had major impacts on the business operations of most foreign banks in China.

Effective from 25th May 2021, after many advocacy efforts by the European Chamber, the PBOC increased the cross-border MPA limit for relatively small-sized banks (including subsidiaries and branches of foreign banks) whose capital size is below Chinese yuan (CNY) 100 billion. The leverage ratio for the MPA limit was increased from 0.8 to 2.0, providing an additional initial financing quota of CNY 10 billion for each bank.

These changes helped ease the burden on many in the foreign banking community, and the European Chamber greatly appreciates the regulator's efforts to take the business operations of foreign banks in China into account when introducing these new measures.

Nonetheless, there are two major components in the MPA framework that still have a significant impact on foreign banks in China; 1) cross-border financing policy growth, and its subsequent hindering of foreign banks' ability to generate growth, and 2) broad credit growth, and its effect on the MPA capital adequacy ratio. The working groups recommend the regulators consider making further changes so to ameliorate such impacts on foreign banks.

Another very welcome move, this time from the China Banking and Insurance Regulatory Commission (CBIRC), took place on 2nd April 2021, when it announced that foreign FIs in China would be exempted from intra-group exposure during large exposure management as part of the *Circular of the General Office of the China Banking and Insurance Regulatory Commission on Clarifying the Regulatory Requirements for Foreign-funded Banks on Large Risk Exposures of Their Parent Bank Groups*.³ The Banking and Securities Working Group had advocated on this issue to the CBIRC, and is therefore pleased to see that the regulator took these suggestions into consideration and implemented them in the *Circular*.

The financial services working groups will continue to monitor progress in the opening up of China's financial sector. Through careful observations and detailed recommendations in the following papers, the working groups hope to make meaningful contributions to this end.

² Ibid.

³ *Notice of the People's Bank of China and the State Administration of Foreign Exchange on Adjusting the Macro-Prudent Adjustment Parameters of Enterprise Cross-border Financing*, SAFE, 7th January 2021, viewed on 24th March 2021, <<http://m.safe.gov.cn/safe/2021/0107/18011.html>>



Banking and Securities Working Group

Banking & Securities Key Recommendations

1. Lift Restraints Affecting Organic Growth

1.1 Address the Major Impacts of the Macro-prudential Policy on the Foreign Banking Industry

- Revise the calculation method for cross-border derivatives (including changing to netting method and recognition of collateral) in the cross-border financing Macro-prudential Assessment exposure control.
- Carve out investment in government bonds and policy bank bonds from broad credit growth calculation.
- Carve out from the 'broad credit' indicator the cash receivables from bonds sales.
- Carve out margins placed with the Shanghai Clearing House.
- Carve out inter-group lending to offshore parent bank from broad credit growth calculation.

1.2 Allow Flexible Treatments on Certain Liquidity Ratios and Deposit Ratios 2

- Consider local Tier 1 capital as a stable resource in the liquidity ratios (liquidity matching ratio (LMR) and loan to deposit ratio (LDR), and treat deposits from parent institutions as corporate deposits.
- Treat deposits from Consumer Finance Companies (CFCs) as corporate deposits in the liquidity ratio calculation, taking into account their stability.
- Give intragroup funding the same value as 'corporate deposits' in the liquidity ratio.
- Treat auto finance company loans as corporate loans in the LMR.
- Increase the weight for bonds and certificates of deposit in the LMR for a residual maturity below three months, and include intragroup funding in the LDR at a reasonable weight.
- Consider foreign banks' situation and give flexible treatment or waive the requirement of deposit deviation ratio for banks with a small balance sheet size.

1.3 Allow Foreign Banks to Underwrite Foreign Government Bonds 2

- Increase access to the bond underwriting market and further extend the scope for foreign banks to underwrite foreign enterprise bonds issued in the onshore market, i.e. panda bonds, and align the process with the new regulation.
- Grant European financial companies/ banks custodian licences for cross-border and onshore activities.

1.4 Address Funding Limitations for Foreign Banks 14

- 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.
- Simplify the procedures for foreign banks to issue RMB-denominated bonds (panda bonds), 'Chinese yuan (CNY bonds)' and asset-backed securities for funding purposes.
- Permit foreign bank branches to issue 'CNY bonds'.





1.5 Allow Easier Branch and Sub-branch Business Expansion and Grant Financial Institutions Flexibility in the Adaptation of their Local Set-up 🗳️ 14

- Enable foreign 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.
- Publish comprehensive, systematic guidelines for selling/ closing a business or reducing a product offering in an orderly fashion.

1.6 Remove the Long-term Foreign Debt Quota 🗳️ 10

- Remove the long-term foreign debt quota for foreign financial institutions as well as foreign-invested enterprises in China.

1.7 Allow Foreign Banks to Become Bond Connect Market Makers Without the Pre-condition of Being a Chinese Interbank Bond Trial Market Maker 🗳️ 2

- Grant qualified foreign banks the status of Bond Connect Market Makers without first becoming a Chinese Interbank Bond Trial Market Maker, or grant them Chinese Interbank Bond Trial Market Maker qualifications so as to enable them to become Bond Connect Market Makers.

1.8 Implement Consolidated Value-added Tax (VAT) Filing Mechanism for Banks to Reduce VAT Burden Imbalances Across Subsidiaries/ Branches 🗳️ 2

- Accelerate the introduction of the VAT Law to bring back the consolidated VAT filing mechanism
- Keep a wide scope for those entitled to enjoy consolidated VAT filing, and do not limit it to specific industries or large-scale enterprises.

1.9 Publish the Market Infrastructure Central Counterparty (CCP) Regulation so the European Commission (EC) can Grant the Shanghai Clearing House (SCH) Recognition as a Qualifying Central Counterparty (QCCP)

- Publish the *Market Infrastructure CCP Regulation* in a timely manner so the EC can grant recognition to the SCH as a QCCP as stipulated under the *Capital Requirements Regulation*.

2. Limit Data Localisation and Prescriptive Cybersecurity Requirements

2.1 Allow Free Cross-border Data Flow, Narrowly Scope “Important Data” and Facilitate Cross-affiliate Information-sharing 🗳️ 2

- Refrain from mandating banks to localise their data or their entire information technology systems.
- Explicitly allow companies and their headquarters/ subsidiaries to conduct intra-party cross-border data transfers and uphold the principles of free movement of data that China signed up to in the G20 Osaka Leaders Declaration.
- Remove unnecessary information-sharing firewall rules and allow cross-affiliates information-sharing.
- Narrowly scope “important data” while specifying the security assessment procedure for cross-border data transfer to avoid creating unreasonable compliance risks and costs for multinational financial institutions.

2.2 Adopt International Best Practice on Cybersecurity and Technology and Narrowly Scope Critical Information Infrastructure (CII) 🗳️ 2

- Adopt a regulatory approach to cybersecurity and CII management that is risk-based, aligned with global best practices and avoids mandating the adoption of certain products or services.
- Narrowly scope CII to ensure efficient and effective protection.





2.3 Adopt Safe and Sound Cybersecurity and Technology Supervisory Practices 2

- Recognise risks associated with mandated penetration testing and allow for firm-led penetration testing for firms with such capabilities and resources.
- Adopt industry best practices for penetration testing as outlined in the updated Global Financial Market Association's *Framework for the Regulatory Use of Penetration Testing in the Financial Services Industry*.

3. Enforce Close-out Netting Protections 2

- Amend the Bankruptcy Law or publish the Futures Law (which is in market consultation stage) to remove uncertainty with regards to the enforceability of close-out netting.
- Issue netting legislation; or clarify the process for applying close-out netting.

Introduction to the Working Group

The Banking and Securities Working Group represents around 40 banking and securities financial institutions in China. The working group engages with the China Banking and Insurance Regulatory Commission (CBIRC) and other financial services regulators in order to improve the operating environment for European banking and securities enterprises in China.

Recent Developments

Although there has been an acceleration of the opening up in the sector, the financial services industry and its liberalisation are still strictly controlled. It should also be noted that foreign banks' market share in terms of total assets continued to decline in recent years to 1.2 per cent in 2019,¹ which is significantly lower than in other emerging markets.

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. While the *2020 Negative List for Foreign Investment* reiterated China's commitment to abolishing these limits,² the response from the international community and working group was "too little, too late".

China's financial sector has come to a point where it is increasingly necessary for regulators to take a systematic approach, which will require implementing many essential reforms, such as: overhauling the Bankruptcy Law and ensuring that the bankruptcy mechanism is enforced; setting up a clearer market governance framework; allowing more international rating agencies into the market; and implementing better auditing regulations.

At the beginning of 2020, the United States (US)-China 'Phase One' Trade Deal was seen as a small step forward in cementing market openings for foreign banks in China, particularly on custody licences, underwriting and the elimination of foreign equity limits. However, the coronavirus disease 2019 (COVID-19) outbreak delayed any concrete opening up. Despite these setbacks, foreign financial institutions (FIs) remain committed to the Chinese market, with the goal of growing their onshore business in China.

Pursuit of an inclusive policy-making and standard-setting process

Chinese regulators have made strong efforts to grant equal rights to foreign FIs in the standard-setting process, such as in the *Regulation for Implementing the Foreign Investment Law*.³ This has also been expressed to the working group directly, such as during a meeting with the China Financial Standards Technology Committee (CFSTC) on 22nd December 2020. The working group reiterates its desire to have foreign FIs as members in the CFSTC to represent the viewpoints

¹ The latest figures show that total assets of foreign banks in China are CNY 3.37 trillion, less than 1.2 per cent of total assets of the Chinese banking industry. See *Foreign Banks Establish 41 Legal Person Lenders in China, Total Assets Approach \$480 Billion*, China Banking News, January 2020, viewed 25th March 2021, <<http://www.chinabankingnews.com/2019/12/12/foreign-banks-establish-41-legal-person-lenders-in-china-total-assets-approach-480-billion/>>

² *People's Republic of China National Development and Reform Commission and Ministry of Commerce Notice*, State Council, 24th June 2020, viewed 25th March 2021, <http://www.gov.cn/zhengce/zhengceku/2020-06/24/content_5521520.htm>

³ *Order No. 723*, State Council, 26th December 2019, viewed 25th March 2021, <http://www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm>





of international FIs, and encourages the People's Bank of China (PBOC) and the CFSTC to provide equal opportunities to foreign FIs.⁴

Exclusion of intra-group exposure in large exposure management calculation

On 2nd April 2021, the CBIRC announced that they would be exempting foreign FIs in China from intra-group exposure during large exposure management as part of the *Circular of the General Office of the China Banking and Insurance Regulatory Commission on Clarifying the Regulatory Requirements for Foreign-funded Banks on Large Risk Exposures of Their Parent Bank Groups*.⁵ The working group had advocated on this issue to the CBIRC and is therefore pleased to see that the regulator considered these suggestions and implemented them in the *Circular*.

Lifting of cross-border financing macro-prudential assessment (MPA) limit for banks with capital below Chinese yuan (CNY) 100 billion

Effective from 25th May 2021, the PBOC increased the cross-border MPA limit for relatively small-sized banks (including subsidiaries and branches of foreign banks), whose capital size is below Chinese yuan (CNY) 100 billion.⁶ The leverage ratio in MPA limit was increased from 0.8 to 2.0 and an additional initial financing quota of CNY 10 billion for each bank provided for. The working group appreciates the regulator's efforts to take into account the business operations of foreign banks in China when introducing these new measures.

Key Recommendations

1. Lift Restraints Affecting Organic Growth

1.1 Address the Major Impacts of the Macro-prudential Policy on the Foreign Banking Industry

Concern

Two major components in the MPA framework are causing a significant impact on foreign banks in China: 1) cross-border financing policy growth, and its

subsequent impact on foreign banks' ability to generate growth and 2) broad credit growth, and its subsequent impact on the MPA capital adequacy ratio.

Assessment

1) Cross-border financing policy

The lifting of the cross-border financing MPA limit for relatively small-sized banks solves the constraints set by *Circular YF [2020] No. 301* (see Recent Developments). However, the working group notes that the in-scope items and calculation method for cross-border financing MPA exposure remains unchanged; thereby hindering business growth.

Under the original *Notice of the People's Bank of China concerning Relevant Matters on Prudent Macro Management of Full-covered Cross-border Financing* (YF [2017] No. 9),⁷ the derivatives calculation method only takes into account negative mark-to-market (MTM) trades. Consequently, overall liabilities arising from derivative transactions are exaggerated, as many mechanisms commonly used to mitigate credit exposures are not being recognised, in particular:

- a) the 'close-out netting' clause present in the guidelines of both the International Swaps and Derivatives Association and the National Association of Financial Market Institutional Investors (NAFMII),
- b) the credit supplementary annex, both margin (in various formats like cash, bonds and so on) and collateral; and
- c) repurchase agreement activities collateralised along with securities.

Foreign banks are active players in capital markets and derivatives transactions, and can provide:

- Non (RMB) derivative products catering to onshore corporate and FI clients' risk hedging demands, which will be back-to-back with offshore parent banks.⁸ If the derivatives hedging transactions of foreign banks with offshore counterparties cannot be carried out due to cross-border financing limits, the availability of those non-RMB products for domestic corporates and

⁴ The CFSTC (or TC 180) is a specialised committee within PBOC.

⁵ *Circular of the General Office of the China Banking and Insurance Regulatory Commission on Clarifying the Regulatory Requirements for Foreign-funded Banks on Large Risk Exposures of Their Parent Bank Groups*, CBIRC, 2nd April 2021, viewed 23rd June 2021, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=981215&itemId=928>>

⁶ *Notice of the PBOC and the SAFE on Adjusting the Macro-Prudent Adjustment Parameters of Enterprise Cross-border Financing*, SAFE, 7th January 2021, viewed 24th March 2021, <<http://m.safe.gov.cn/safe/2021/0107/18011.html>>

⁷ Omar Puertas, *Macroprudential Management of Crossborder Financing Revised*, Lexology, 17th February 2017, viewed 25th March 2021, <<https://www.lexology.com/library/detail.aspx?g=3b381bce-4344-4a6b-96cb-024e7a0dcf25>>

⁸ 'A back-to-back transaction consists of two legally separate but economically linked sale and purchase transactions which otherwise share the same trade details', Iotafinance, viewed 15th June 2021, <<http://www.iotafinance.com/en/Financial-Definition-back-to-back-transaction.html>>





institutions will be significantly affected.

- Hedging solutions to offshore qualified investors for their risk management demands arising from onshore RMB securities investments. Typical clients are overseas central banks, sovereign wealth funds, qualified foreign institutional investor and retail qualified foreign institutional investor (QFII and RQFII), Bond Connect investors, China Interbank Bond Market (CIBM) Direct investors and offshore RMB settlement banks. It takes time for these offshore clients to build up the infrastructure needed to trade with Chinese banks (such as master agreements, credit lines), so foreign banks in China with a well-established worldwide client franchise can help facilitate with their onshore derivatives capacity.

Therefore, the Banking and Securities Working Group urges the regulator to re-evaluate the impact on foreign banks of the abovementioned policy, and recommends that the calculation method in the original measure for cross-border derivatives be reinstated. The regulator, for instance, could consider carving out derivative MTM values from the calculation of risk-weighted balance of cross-border financing, acknowledging the various netting arrangements in derivative trading activities and applying a haircut⁹ to the netted amount, given its contingent liability nature.

2) Broad credit growth

China's market has become an important part of the global strategy of most major foreign banks. In recent years, foreign banks have been trying to expand into the Chinese market by lending more to onshore clients to support the real economy. However, due to liquidity management requirements (see Key Recommendation 1.2 for more details) and the risk appetite of foreign banks, foreign banks' bond inventories are mainly Chinese Government bonds and policy bank bonds, which are not intended to grant credit to the issuers. Currently, there are no other feasible alternatives to those bond investments as risk-free assets. Therefore, the working group recommends carving out investment in government bonds and policy bank bonds, as well as inter-group lending to offshore parent bank, from the broad credit growth calculation.

With China's efforts to boost RMB internationalisation and the opening up of the CIBM to foreign investors, foreign banks often act as a RMB bond market maker to offshore investors. Foreign banks in China need to have sufficient bond inventories to carry out market-making activities on a daily basis. In the prevailing accounting rule in China, cash bond transactions are recorded on a trade day basis (not on settlement day). However, for foreign banks' transactions that cross month-end, trade day is prior to or at month-end; but settlement day falls at the beginning of the next month. This means that the cash leg to be received from the investor for the sell ticket is recorded as 'receivable' and counted in the broad credit balance, while the bond balance remains unchanged, as it is offset by a buy ticket and a sell ticket if the market maker sources the bond in the market. Such an accounting rule and the MPA-reporting method negatively affect foreign banks that adjust bond portfolios at month-end or quarter-end. Therefore, the working group recommends carving out from the broad credit indicator the cash receivables from bonds sales, as they shall peak every month-end in the wake of monthly portfolio rebalancing from external benchmarked clients.

At the same time, there has been a global and regulatory push for mandatory central counterparty (CCP) clearing for over-the-counter (OTC) derivatives, in order to improve transparency and prevent systemic risks. Foreign banks are active in derivative markets, and participation in CCPs will greatly alleviate capital charge pressure and bilateral counterparty risks. As more products are accepted for clearance at the Shanghai Clearing House (SCH), the margins posted by foreign banks are expected to grow. The SCH margins have no financing purpose, and their nature is very different to other items booked in terms of accounting as 'receivables and prepayments'. Therefore, the working group recommends carving out the margins with the SCH or other exchanges.

Recommendations

- Revise the calculation method for cross-border derivatives (including changing to netting method and recognition of collateral) in the cross-border financing MPA exposure control.
- Carve out investment in government bonds and policy bank bonds from broad credit growth calculation.
- Carve out from the 'broad credit' indicator the cash receivables from bonds sales.

⁹ A 'haircut' refers to the lower-than-market value placed on an asset being used as collateral for a loan. The haircut is expressed as a percentage of the markdown between the two values. See Cory Mitchell, *Haircut Definition and Example*, Investopedia, 14th July 2020, viewed 17th May 2021, <<https://www.investopedia.com/terms/h/haircut.asp#:~:text=A%20haircut%20refers%20to%20the,markdown%20between%20the%20two%20values.>>





- Carve out margins placed with the SCH.
- Carve out inter-group lending to offshore parent bank from broad credit growth calculation.

1.2 Allow Flexible Treatment on Certain Liquidity Ratios and Deposit Ratios

Concern

Constraints on liquidity ratios and deposit deviation ratio (DDR) affect the capacity of foreign banks to serve clients' borrowing and deposit needs.

Assessment

According to the *Administrative Measures on Liquidity Risk of Commercial Banks*,¹⁰ banks have to maintain a liquidity matching ratio (LMR) and a high-quality liquid asset adequacy ratio (HQLAAR) of over 100 per cent, as well as a low loan to deposit ratio (LDR). In the eyes of the working group, the development of a bank's corporate lending capabilities with its local clients could be improved if some constraints on the local liquidity ratio imposed on subsidiaries are modified:

- Local Tier 1 capital¹¹ is not considered a stable resource for 'sources of weighted funds' in the LMR.¹² Tier 1 capital is also not counted as a resource for the LDR, whereas in practice it is a stable source of funding used to develop a foreign bank's corporate lending capacity.
- For the LMR, 'interbank lending' does not distinguish between intragroup and 'external/market' interbank borrowing, although the funding comes from different types of sources.¹³
- In the HQLAAR, the intragroup deposit is treated as an interbank deposit for financing purposes, with a less favourable weight (100 per cent) than corporate deposit (35 per cent). However, the intragroup deposit is very stable and tends to stay with the

subsidiary in China for longer periods than normal corporate deposits.¹⁴

- In the LMR, an auto finance company (AFC) is treated as interbank instead of a 'corporate' counterpart, which requires higher LMR funding. However, the banking relation with AFCs is driven more by a corporate relation rather than an interbank relation and should be treated as such.
- In the LMR, the weight for bonds issued and certificates of deposit (CD) below three months (zero per cent), similar to interbank borrowing or deposits from banks, are too low and would not favour the market of bonds or CD issuances from foreign banks.

While initially the CBIRC had allowed some flexibility for small foreign banks in cases of DDR ratio overshoot due to passive deposit-taking from customers, this was prohibited as of June 2018.¹⁵ As a result, it is more difficult for small banks to control the DDR ratio variation due to passive deposit banking. Sometimes banks have to sacrifice customers deposit needs and service quality to meet the DDR ratio requirement, or face regulatory penalties such as access restriction, downgraded ratings, business restrictions and punitive DDR requirements.

Recommendations

- Consider local Tier 1 capital as a stable resource in the liquidity ratios (LMR and LDR) and treat deposits from parent institutions as a corporate deposit.
- Treat deposits from corporate finance companies (CFCs) as corporate deposits in the liquidity ratio calculation, taking into account their stability.
- Give intragroup funding the same value as 'corporate deposits' in the liquidity ratio.
- Treat AFC loans as corporate loans in the LMR.
- Increase the weight for bonds and CDs in the LMR for a residual maturity below three months, and include intragroup funding in the LDR at a reasonable weight.
- Consider foreign banks' situation and give flexible treatment or waive the DDR requirement for banks with small balance sheets.

¹⁰ *CBIRC Issues Measures to Manage Liquidity Risk for Commercial Banks*, Moody's Analytics, 25th May 2018, viewed 25th March 2021, <<http://www.cbirc.gov.cn/chinese/newShouDoc/8189EEE949DB48F8993ACCCA638ED24B.html>>

¹¹ 'Tier 1 capital describes the capital adequacy of a bank and refers to core capital that includes equity capital and disclosed reserves. From a regulator's point of view, tier 1 capital is the core measure of the financial strength of a bank because it is composed of core capital'. See *What Is Tier 1 Capital?*, Investopedia, 9th May 2019, viewed 25th March 2021, <<https://www.investopedia.com/terms/t/tier1capital.asp>>

¹² *CBIRC Issues Measures to Manage Liquidity Risk for Commercial Banks*, Moody's Analytics, 25th May 2018, viewed 25th March 2021, <<http://www.cbirc.gov.cn/chinese/newShouDoc/8189EEE949DB48F8993ACCCA638ED24B.html>>

¹³ Intragroup funding is more stable than interbank funding given the relation between the subsidiary and its parent entity.

¹⁴ In the same fashion, in the HQLAAR, corporate finance companies (CFCs) deposits are treated as interbank deposits. However, CFCs' funding are in large part made up of deposits of group member entities that are more than three months old, and hence are very stable.

¹⁵ *Order [2018] No. 48*, CBIRC, 18th June, 2018, viewed 25th March 2021, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=181941&itemId=928&generality=0>>





1.3 Allow Foreign Banks to Underwrite Foreign Government Bonds 2

Concern

European banks' access to the bond underwriting market in China is still limited in practice.

Assessment

In February 2016, the CIBM was opened up to foreign institutional investors with the PBOC promulgation of *Announcement No. 3*,¹⁶ which complemented the QFII and the RQFII schemes. Yet to date, only three locally incorporated foreign banks have been allowed to underwrite corporate bonds as lead underwriters.¹⁷

There are also strict requirements for becoming a qualified primary dealer (PD),¹⁸ and—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.¹⁹

For European banks seeking to obtain cross-border and onshore custodian licences, the main difficulty is the high capital requirement. While it may be targeted at smaller Chinese banks, the CNY 20 billion requirement²⁰ also effectively excludes foreign banks, as their overseas balance sheet cannot be included in this calculation. The working group recommends allowing European banks to apply for onshore licences based on their overall size. Chinese banks can access these licences in the European Union (EU), so the working group calls for the same, reciprocal rights for European banks in China.

Meanwhile, the NAFMII has yet to change its application process to allow foreign bank branches to qualify for underwriting foreign government bonds, despite the 2019 revision of the *Detailed Implementation Rules on*

Administration of Foreign Banks stipulating that foreign banks can do so.²¹

Recommendations

- Increase access to the bond underwriting market and further extend the scope for foreign banks to underwrite foreign enterprise bonds issued in the onshore market, i.e. panda bonds, and align the process with the revised regulation.
- Grant European financial companies/ banks custodian licences for cross-border and onshore activities based on their overall size.

1.4 Address Funding Limitations for Foreign Banks 14

Concern

Foreign banks face funding restrictions due to stringent regulatory approvals, have limited access to the China Foreign Exchange Trade System (CFETS) interbank market and also encounter problems associated with the issuance of RMB-denominated debt instruments in China, all of which stifle their growth.

Assessment

Access to the CFETS interbank market for foreign banks is capped at two times their operative capital in China, which heavily impacts their operations as these banks have limited capital. Lifting this restriction would result in a more active and liquid RMB interbank market that would benefit all banks.

Besides the two-times capital restriction, State Administration of Foreign Exchange (SAFE) approval is required before the foreign debt of international FIs can be exchanged to RMB or sold on through a swap deal. Considering foreign banks' limited access to onshore liquidity (small balance sheet size, limited corporate deposits base, no retail banking activity), allowing them to swap overseas sources into RMB would help the origination of commercial loans to Chinese clientele and support the local economy.

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:

16 *New PBOC Regulation Welcomes More Foreign Participation in Interbank Bond Market*, Chambers and Partners, 29th November 2016, viewed 25th March 2021, <<https://chambers.com/articles/new-pboc-regulation-welcomes-more-foreign-participation-in-interbank-bond-market>>

17 *BNP Paribas Gains Licence to Underwrite 'Panda Bonds' in China*, Financial Times, 9th December 2018, viewed 25th March 2021, <<https://www.ft.com/content/f9ff7dea-fc2a-11e8-aebf-99e208d3e521>>

18 *Regulation for Open Market Operation and Primary Dealer*, China Bond, 21st April 2007, viewed 25th March 2021, <<https://www.chinabond.com.cn/cb/en/C318913/regulations/20080920/805854.shtml>>

19 *List of Primary Dealers in the Open Market Business*, China Bond, 27th March 2019, viewed 25th March 2021, <<https://www.chinabond.com.cn/Info/151209093>>

20 *China Securities Regulatory Commission Measures for the Administration of the Securities Investment Fund Custody Business (Draft for Comments)*, Ministry of Justice, 9th May 2020, viewed 25th March 2021, <http://www.moj.gov.cn/news/content/2020-05/09/zlk_3248314.html>

21 *State Council Order No. 720*, State Council, 30th September 2019, viewed 25th March 2021, <http://www.gov.cn/zhengce/content/2019-10/15/content_5439956.htm>





onshore bonds issued by onshore Mainland-based issuers; onshore bonds issued by offshore issuers ('panda bonds'); and bonds issued offshore by both onshore and offshore issuers (for example, Dim Sum, Lion City).²²

Qualifying locally incorporated foreign banks are allowed to issue debt securities and onshore asset-backed securities (ABS) in the CIBM for funding purposes once pre-approved by the CBIRC and the PBOC.²³ However, foreign banks' branches are still not allowed to do so.

Recommendations

- Remove the two times capital limitation for all foreign banks in China.
- Allow foreign banks to borrow money overseas and swap directly to RMB to fund themselves or their loan portfolio.
- 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'.

1.5 Allow Easier Branch and Sub-branch Business Expansion and Grant Financial Institutions Flexibility in the Adaptation of their Local Set-up

Concern

Foreign banks face difficulties in business planning and resource management due to the complex requirements involved in expanding their branch and sub-branch network, while the process of exiting certain business activities lacks clear rules.

Assessment

China lacks a planned strategic approach whereby multiple branch and sub-branch applications are allowed on an annual basis to facilitate foreign banks' 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 EU.

Furthermore, after a foreign bank has obtained a licence for a local branch, it is almost impossible to close the branch, even if it has not become profitable after several years. FIs are expected to demonstrate their long-term commitment to the province, and maintain an overly-large, minimum set-up – usually around 10 people, including branch manager, deputy branch manager, and managers of operations, compliance, finance and customer relationships.

The same applies at the provincial level to new products or client segments. Exit barriers are significant, with FIs being prohibited from selling or transferring certain portfolio assets, or ceasing certain activities, for which a licence has been obtained.

This results in FIs being considered as non-performing in China and reduce institutions' appetite to explore opportunities in new locations, clients or products. The working group suggests therefore that the CBIRC and regional authorities provide detailed guidelines on how foreign banks can exit the market or dispense with product offerings.

Recommendations

- Enable foreign 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.
- Publish comprehensive, systematic guidelines for selling/ closing a business or reducing a product offering in an orderly fashion.

1.6 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

China's strict long-term debt quota limits under the administration of the National Development and Reform Commission (NDRC) make foreign currency funding unnecessarily expensive for foreign and Chinese enterprises. No similar restrictions are imposed on Chinese banks operating in Europe, highlighting the

²² *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.

²³ *National Bond Market Issuance Regulations for Financial Bonds*, ChinaBond, 1st June 2005, viewed 25th March 2021, <<http://www.chinabond.com.cn/Info/843356>>





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, no matter whether the financing is denominated in RMB or foreign currency. Once the long-term foreign debt quota is consumed, it cannot be renewed for certain business scenarios.
- Financing for FIEs, especially small and medium-sized enterprises, often depends on collateral by guarantee of foreign banks or their parent companies. Since foreign guarantees to secure financing are limited by FIEs' foreign debt quota, 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 for foreign FIs, as well as FIEs in China.

1.7 Allow Foreign Banks to Become Bond Connect Market Makers Without the Pre-condition of Being a Chinese Interbank Bond Trial Market Maker 2

Concern

Foreign banks encounter difficulties in obtaining the Bond Connect Market Makers qualification, and thus cannot serve their offshore clients' needs for bond price quotes on this channel.

Assessment

Foreign banks—very often stricter in terms of compliance requirements and smaller than their Chinese peers in terms of balance sheet size—cannot easily compete on bond-trading turnover and inventory size. However, foreign banks usually have bigger overseas client bases that are eager to trade with them via Bond Connect, and to get market updates and recommendations to access the onshore CIBM. Therefore, difficulties in obtaining the Bond Connect Market Makers qualification are limiting foreign banks' ability to develop business and bring investment into China.

Recommendation

- Grant qualified foreign banks the status of Bond Connect Market Makers without first becoming a Chinese Interbank Bond Trial Market Maker, or grant them Chinese Interbank Bond Trial Market Maker qualifications so as to enable them to become Bond Connect Market Makers.

1.8 Implement Consolidated Value-added Tax (VAT) Filing Mechanism for Banks to Reduce VAT Burden Imbalances Across Subsidiaries/ Branches 2

Concern

The lack of a consolidated VAT filing mechanism leads to a high VAT compliance administrative cost, and an imbalance in the VAT burden across the different subsidiaries/ branches of the same bank/group.

Assessment

Based on *Caishui [2016] No. 36*,²⁴ two or more taxpayers can apply for VAT consolidation and be regarded as one taxpayer if approved by the Ministry of Finance (MOF) and the State Taxation Administration (STA). However, this was abolished by *Caishui [2017] No. 58*.²⁵ In November 2019, the MOF and the STA jointly issued the draft VAT Law, which brought back this consolidation principle, a very welcome development.²⁶ According to the legislation roadmap, the VAT Law is expected to be reviewed and approved by the National People's Congress (NPC), but the date of submission and the detailed legislation status are not clear at time of writing.

Recommendations

- Accelerate the introduction of the VAT Law to bring back the consolidated VAT filing mechanism.
- Keep a wide scope of those entitled to enjoy consolidated VAT filing, and do not limit it to specific industries or large-scale enterprises.

²⁴ *Caishui [2016] No. 36*, STA, 23rd March 2016, viewed 25th March 2021, <<http://www.chinatax.gov.cn/n810341/n810755/c2043931/content.html>>

²⁵ *Caishui [2017] No. 58*, STA, 11th July 2017, viewed 25th March 2021, <<http://www.chinatax.gov.cn/chinatax/n810341/n810765/n2511651/201707/c2801704/content.html>>

²⁶ *Notice on Soliciting Public Opinions on the Draft Value-added Tax Law of the People's Republic of China*, State Council, 27th November 2019, viewed 25th March 2021, <http://www.gov.cn/xinwen/2019-11/28/content_5456569.htm>





1.9 Publish the Market Infrastructure Central Counterparty (CCP) Regulation so the European Commission (EC) can Recognise the Shanghai Clearing House (SCH) as a Qualifying Central Counterparty (QCCP)

Concern

The SCH remains unrecognised as a QCCP by the EC, which can have a major impact on the derivatives activities or solutions provided to clients of EU bank subsidiaries in China.

Assessment

The SCH permits EU banks to access the onshore interbank market for CNY liquidity – for example, CNY interest rate swaps mandatory clearing and CNY forex (FX) voluntary clearing. Article 497 of the *Capital Requirements Regulation* (CRR) set 28th June 2021 as the deadline for the European Securities and Markets Authority's (ESMA's) recognition of the SCH. However, the ESMA is still waiting publication of the *Market Infrastructure CCP Regulation* by the PBOC in order to consider the compatibility of the Chinese CCP regulatory regime with the EU's. As this legislation remains under drafting, the June deadline was extended by one year. Without the recognition of equivalence, the SCH cannot be recognised as a QCCP, which will have a major impact on the derivatives activities or solutions provided to clients of EU bank subsidiaries in China.

Recommendation

- Publish the *Market Infrastructure CCP Regulation* in a timely manner so the EC can grant recognition to the SCH as a QCCP as stipulated under the CRR.

2 Limit Data Localisation and Prescriptive Cybersecurity Requirements

2.1 Allow Free Cross-border Data Flow, Narrowly Scope 'Important Data' and Facilitate Cross-Affiliate Information-sharing 2

Concern

Stringent data localisation requirements risk breaking financial institutions' global operating models, and increase foreign banks' operational risks and associated costs, which are the main barriers for market entry.

Assessment

European banks continue to encounter a host of

problems in relation to data localisation and prescriptive cybersecurity requirements in China, in both financial regulations and the Cybersecurity Law (CSL) and the draft Personal Information Protection Law, as well as associated implementation measures.²⁷

Cybersecurity Law

The CSL's lack of clear definition of key terms, such as 'important data', and inconsistencies among subsequent draft regulations and implementation measures, create huge uncertainties and unpredictability for European FIs investing in China. For more information on CSL-related measures, please refer to the *Cybersecurity Sub-working Group Position Paper 2021/2022* on page 327.

Data localisation

Data localisation and limitations on the free flow of data can seriously hinder financial service firms' ability to deliver core products and services to customers, manage risk, and comply with financial regulatory requirements in various jurisdictions. Unfortunately, data localisation requirements are pervasive in the financial sector. Those requirements, in particular relating to the anti-money laundering and counter-terrorism financing regulations, are challenging for FIs operating in China and make it impossible for multinational FIs to use their global operational model. This also raises the threshold for new FIs attempting to enter the Chinese market.

While the working group applauds China's endorsement of the G20 Osaka Leaders Declaration promoting free data flow with trust,²⁸ it urges China to uphold those principles and explicitly allow cross-border transfer of data internally and among affiliates as a first step to truly open up the domestic financial sector.

²⁷ Those measures include, but are not limited to: the PBOC's *Notice to Urge Banking FIs to Protect Personal Information* (2011), State Council, 2011, viewed 25th March 2021, <http://www.gov.cn/gongbao/content/2011/content_1918924.htm>; CBIRC's *Banking FIs Anti-money Laundering and Counter Terrorist Financing Management Measures* (2019), State Council, 29th January 2019, viewed 25th March 2021, <http://www.gov.cn/gongbao/content/2019/content_5446227.htm>; *Notice on Soliciting Public Opinions on the Measures for Cybersecurity Censorship (Draft)*, Cyberspace Administration of China (CAC), 24th May 2019, viewed 25th March 2021, <https://www.cac.gov.cn/201905/24/c_1124532846.htm>; *Notice on Soliciting Public Comments on the Administrative Measures on Data Security (Draft)*, CAC, 28th May 2019, viewed 25th March 2021, <https://www.cac.gov.cn/2019-05/28/c_1124546022.htm>; *Notice on Seeking Public Comments on the Measures for Security Assessment for Cross-border Transfer of Personal Information (Draft for Comment)*, CAC, 13th June 2019, viewed 25th March 2021, <https://www.cac.gov.cn/2019-06/13/c_1124613618.htm>

²⁸ *G20 Osaka Leaders' Declaration*, European Council, 29th June 2019, viewed 25th March 2021, <https://www.consilium.europa.eu/media/40124/final_g20_osaka_leaders_declaration.pdf>





Data-sharing among affiliates

Regulatory restrictions over information-sharing among affiliates are costly for foreign FIs as different information technology (IT) systems are required, and discourage foreign investment. The working group advocates for the removal of unnecessary information-sharing firewall rules and recognition of the importance of cross-affiliates information-sharing within the same financial group.

Recommendations

- Refrain from mandating banks to localise their data or their entire IT systems.
- Explicitly allow companies and their headquarter/subsidiaries to conduct intra-party cross-border data transfers, and uphold the principles of free movement of data signed up to in the G20 Osaka Leaders Declaration.
- Remove unnecessary information-sharing firewall rules and facilitate cross-affiliates information-sharing.
- Narrowly scope “important data” in the security assessment procedure for cross-border data transfer to avoid creating unreasonable compliance risks and costs for multinational FIs.

2.2 Adopt International Best Practice on Cybersecurity and Technology and Narrowly Scope Critical Information Infrastructure (CII)



Concern

Prescriptive cybersecurity requirements and mandatory requirements on technology severely limit firms' ability to adopt the best cybersecurity strategy for their own profile and negatively impact their cybersecurity capability.

Assessment

The CSL requires multi-level protection scheme 2.0 (MLPS 2.0) compliance from all network operators in China, which imposes local maintenance and support for systems rated Level 3 and above, mandates the use of certain products and requires cryptographic-related reviews. These requirements will have significant implications for the financial sector's globalised systems and operating models. A regulatory approach to cybersecurity ought to be risk-based, aligned with global best practices and avoid mandating the adoption of certain products or services. The same principle is applicable to CII management.

Additionally, the working group advocates for CII to be narrowly scoped to prioritise the protection of truly critical systems. In view of foreign FIs' already limited portion of the Chinese market, including them in the scope of CII would deviate from the prioritised protection approach demanded by the CSL, and be counter-productive from a security and cost-effectiveness perspective.

Recommendations

- Adopt a regulatory approach to cybersecurity and CII management that is risk-based, aligned with global best practices and avoids mandating the adoption of certain products or services.
- Narrowly scope CII to ensure efficient and effective protection.

2.3 Adopt Safe and Sound Cybersecurity and Technology Supervisory Practices

Concern

Increasing cybersecurity inspections and penetration testing requirements brings unintentional risks to FIs and interconnected global financial systems.

Assessment

In 2020, the CBIRC kicked off a round of penetration testing (also known as pen-testing) on banks' IT systems. The working group has also noticed similar requirements in the China Securities Regulatory Commission's (CSRC's) *Measures for the IT Management of Securities and Fund Operators (2018)*.²⁹ While the working group understands regulators' intention of underpinning cyber resiliency, this approach may increase or exacerbate existing risks, as pen-testing has the potential to introduce new vulnerabilities and unintentionally, or needlessly, expose FIs' most sensitive information to a third party.³⁰

The working group advocates for the adoption of

29 Order No. 152, CSRC, 19th December 2018, viewed 25th March 2021, <http://www.csrc.gov.cn/pub/zjhpublic/zjh/201812/t20181221_348485.htm>

30 'Penetration testing, also called pen testing or ethical hacking, is the practice of testing a computer system, network or web application to find security vulnerabilities that an attacker could exploit. Pen-testing can be automated with software applications or performed manually. The process involves gathering information about the target beforehand, identifying possible entry points, attempting to break in—either virtually or for real—and reporting back the findings. See *pen test (penetration testing)*, TechTarget, viewed 25th March 2021, <<https://searchsecurity.techtarget.com/definition/penetration-testing#:~:text=Penetrationper cent20testingper cent2Cper cent20alsooper cent20calledper cent20pen,softwareper cent20applicationsper cent20orper cent20performedper cent20manually.>>>





the Global Financial Market Association's (GFMA) *Framework for the Regulatory Use of Penetration Testing in the Financial Services Industry*, which would allow banks to conduct a firm-led test if they have the capability to do so. Moreover, firm-led testing results have been shown to be far more informative for regulatory purposes.

In the meantime, the working group would like to highlight the potential sensitivity of some data in pen-testing reports, and urges regulators to limit the collection of sensitive data to that, which is directly relevant and necessary to accomplish a specific purpose.

Recommendations

- Recognise risks associated with mandated penetration testing and allow for firm-led penetration testing for enterprises with such capabilities and resources.
- Adopt industry best practices for penetration testing as outlined in the GFMA *Framework for the Regulatory Use of Penetration Testing in the Financial Services Industry*.

3. Enforce Close-out Netting Protections



Concern

China is currently the only major global economy that is not perceived to have enforceable close-out netting protection,³¹ causing legal uncertainty for European banks trading in the market, since they must set capital against offsetting trades on a gross basis.

Assessment

Where neither party is insolvent, the enforceability of close-out netting provisions in a derivative's master agreement is not generally controversial. This is because close-out netting is enforceable as a matter of contract law.

However, in China, under Article 18 of the Enterprise

Bankruptcy Law (Bankruptcy Law), the right of a non-defaulting party to terminate transactions is subject to a stay after a bankruptcy petition is accepted by the court. This leads to a market perception that close-out netting may be unenforceable. Some participants have opted to 'switch on' the automatic early termination (AET) provision, which terminates all transactions automatically before a bankruptcy petition is accepted. Nevertheless, the AET provision with retroactive effect (under which the AET would be triggered upon the mere presentation of a bankruptcy petition) may not be recognised by Chinese courts.

The working group notes that the NPC has released a draft Futures Law for public consultation. Crucially, the draft recognises the concept of single agreement and enforceability of close-out netting mechanism adopted under the relevant industry-wide master agreements. The working group is working closely with Chinese regulators on the close-out netting issue but uncertainty over enforceability remains.

Recommendations

- Amend the *Bankruptcy Law* or publish the Futures Law (which is in market consultation stage) so there is no remaining uncertainty with regard to the enforceability of close-out netting.
- Issue netting legislation, or clarify the process for applying close-out netting.

Abbreviations

ABS	Asset-backed Security
AET	Automatic Early Termination
AFC	Auto Finance Company
AML	Anti-money Laundering
CAC	Cyberspace Administration of China
CBIRC	China Banking and Insurance Regulatory Commission
CCP	Central Counterparty
CD	Certificate of Deposit
CFC	Corporate Finance Company
CFETS	China Foreign Exchange Trade System
CIBM	China Interbank Bond Market
CII	Critical Information Infrastructure
CNY	Chinese Yuan
COVID-19	Coronavirus Disease 2019
CRR	Capital Requirements Regulation
CSL	Cybersecurity Law

³¹ Netting is the consolidation of multiple payments, transactions or positions between two or more parties; the aim is to create a single amount out of all the exchanges to determine which party is due remuneration and to what amount. It can be used in bankruptcy cases, offsetting money owed to the defaulting company with money owed by the company, and to determine an amount due to creditors. Close-out netting is used specifically to reduce pre-settlement risk. See *Payment Netting vs. Close-Out Netting: What's the Difference?*, Investopedia, 26th June 2019, viewed 25th March 2021, <<https://www.investopedia.com/ask/answers/062515/what-difference-between-payment-netting-and-closeout-netting.asp>>





CSRC	China Securities Regulatory Commission
DDR	Deposit Deviation Ratio
EU	European Union
FI	Financial Institution
FIE	Foreign-invested Enterprise
GFMA	Global Financial Market Associations
HQLAAR	High-quality Liquid Asset Adequacy Ratio
IT	Information Technology
LDR	Loan to Deposit Ratio
LMR	Liquidity Matching Ratio
MLPS	Multi-level Protection Scheme
MOF	Ministry of Finance
MPA	Macro-prudential Assessment
MTM	Mark-to-Market
NAFMII	National Association of Financial Market Institutional Investors
PBOC	People's Bank of China
PD	Primary Dealer
SAFE	State Administration of Foreign Exchange
SCH	Shanghai Clearing House
STA	State Taxation Administration
UK	United Kingdom
VAT	Value-added Tax





Non-Banking Financial Institutions Working Group

Key Recommendations

1. Strengthen the Protection of Ownership of Leased Assets 2

- Confirm that when an equipment leasing company (ELC) is financing a vehicle by sale and leaseback (SALB) contract, the asset registration on the Zhongdengwang platform is sufficient to protect the ownership right of the ELC.
- Confirm that when an ELC is financing equipment other than vehicles under a SALB contract, the sole asset registration on the Zhongdengwang platform protects the ownership right of the ELC.
- Ensure that the transfer of the vehicle registration certificate cannot be completed by any local bureaus of the Department of Motor Vehicles (DMV) without properly checking the Zhongdengwang platform.
- Improve the Zhongdengwang platform by adding the serial number of the asset as a preferable field.

2. Maintain the Right for Equipment Leasing Companies to Provide Assignment of Receivables (AOR) and/or Factoring Without Having to Establish a Separate Entity 2

- Promote innovation in financial services by granting a dedicated licence to ELCs for factoring and/or AOR.

3. Ease the Tax Burden on ELCs and Ensure Consistent Tax Schemes

3.1 Clarify the Basis for Value-added Tax (VAT) Deductions between Headquarters (HQ) and Branch Offices of a Leasing Company

- Clarify that the branch office of a leasing company whose main operation is financial leasing is qualified to deduct loan interest, bond interest and vehicle purchase tax from its sales amount.
- Recognise returned vehicles as goods with partial use value, allowing for simplified VAT calculation at two per cent for remarketing income.

3.2 Align Taxation of ELCs with Financial Institutions

- Allow ELCs to enjoy some of the rights and benefits of a financial institution, and issue guidance and procedures for financial control of the leasing industry.
- Benchmark tax policy relating to ELCs against that of other financial institutions.

4. Allow ELCs to obtain Cross-border Corporate Guarantees and Cross-border Bank Guarantees 2

- Allow ELCs to obtain cross-border corporate guarantees and cross-border bank guarantees.

5. Include Consumer Finance Companies (CFCs) and Auto Finance Companies (AFCs) in the Pilot Programme to Sell Non-performing Loans (NPLs) in Batches to Asset Management Companies (AMCs) 5

- Lift restrictions on batch transfers of NPLs in the consumer finance industry and the automotive





finance industry and issue clear supportive guidance on this process.

- Include CFCs and AFCs in the NPL pilot project and set up relevant rules and policies to support/facilitate the sale of NPLs by CFCs and AFCs, including an end-to-end process for realising NPL transfer to sale.
- Detail how mortgaged vehicle loans can be dealt with, either within the scope of the pilot programme or separately.

6. Establish a System for Managing Personal Bankruptcy 2

- Adopt a personal bankruptcy law and develop a proper personal bankruptcy system throughout China.

Introduction to the Working Group

The Non-banking Financial Institutions (NBFI) Working Group was established in 2008. It includes leading European consumer finance specialists who operate consumer finance companies (CFCs), auto finance companies (AFCs), small loan companies and other entities engaged in consumer finance services in cooperation with third parties (for example, guarantee companies) in China. As of 2020, the working group also includes equipment leasing companies (ELCs). This working group reflects the importance attached to the emerging non-banking financing sector in China, its relevance to the State Council's major policy objectives and the attention European players pay to this agenda. In 2021, the name of the working group was changed from the Consumer Finance and Non-banking Financial Institutions Working Group to the Non-banking Financial Institutions Working Group to better encompass the many distinct players within the non-banking segment of the economy.

Recent Developments

Boosting domestic consumption has been a policy objective for China since first being set forth during the 17th National Congress of the Communist Party of China in October 2007. To this end, non-banking financing serves as a fundamental engine for financial inclusion in China and is an important catalyst for transforming the Chinese economy from one that is export-driven to one that is consumption-driven.

In his *Government Work Report 2021*, Premier Li

Keqiang re-affirmed the Chinese Government's long-term commitment to increase consumer spending, especially on home appliances and automobiles.¹ In the wake of the economic distress caused by the coronavirus disease 2019 (COVID-19) pandemic, better access to loans and overall financing for self-employed individuals, very small and micro enterprises (VSMEs) and small and medium-sized enterprises (SMEs) was promised.² Policies allowing VSMEs and SMEs to defer principal and interest repayments as part of pandemic recovery is set to continue throughout 2021, and financial institutions are encouraged to increase credit loans and first-time loans.³ In the 14th Five-year Plan (14FYP), China's leadership has further emphasised the need for the financial sector to serve the real economy and to strengthen regulation and supervision. The working group expects that non-bank financing will continue to develop rapidly over the next few years as reforms are further intensified to open up China's financial services sector and greater emphasis is put on protection of consumers and small businesses.

Leasing Industry

Under the current regulatory framework, leasing institutions in China fall into three categories: financial leasing, domestic-funded and foreign-funded. The main sectors that are leased to include construction and agricultural machinery, automotive and truck leasing,

1 *Report on the Work of the Government 2021*. State Council, 5th March 2021, viewed 12th April 2021, <<http://english.www.gov.cn/2021special/govtworkreport2021>>

2 *Key Points from China's Report on the Work of the Government*, CGTN, 22nd May 2020, viewed 12th April 2021, <<https://news.cgtn.com/news/2020-05-22/Key-points-from-China-s-report-on-the-work-of-the-government-in-2020-QH9lns4daw/index.html>>

3 Ibid.





medical equipment, printing equipment and software. By the end of 2020, China had 12,156 financial leasing companies with a total outstanding balance of Chinese yuan (CNY) 6.5 trillion.⁴ According to *Caixin*, almost all of the financial leasing companies had foreign investment. However, according to the China Banking and Insurance Regulatory Commission (CBIRC), only 2,985 of them were conducting operations, while a striking 72 per cent had halted business or were on the verge of bankruptcy.⁵

Several important regulations and documents related to leasing were issued in 2020. In February, the CBIRC released the *Interim Measures for the Supervision and Management of Financial Leasing Companies (Draft for Comments)*, which the working group submitted comments on. The *Measures* took effect in June 2020, requiring financial leasing companies to improve corporate governance, risk management and legal responsibilities. The implementation of the *Measures* has contributed to the steady, standardised development of the industry. However, members of the working group have noticed different interpretations across provinces of administration requirements, especially for vehicle leasing. In addition, the document is relatively ambiguous, and working group members are still struggling to comply with some of the provisions.

In June 2020, the CBIRC promulgated the *Provisional Rules of Financial Leasing Companies for Financing Purpose*, lowering the risk assets/ equity ratio from 10:1 to 8:1.⁶ In the eyes of the working group, this could have a significant impact on the ability of ELCs to finance SMEs and VSMEs.⁷ In July 2020, the CBIRC also promulgated the *Notice on Regulatory Rating Measures for Financial Leasing Companies (Trial for Implementation)*, which serves as the basis for the regulator to measure a bank-owned leasing company's

operating conditions.⁸

The working group believes the tightening of regulation in the industry has resulted in two outcomes. First, the growth rate of leasing investment volume has dramatically decreased. Second, foreign-invested leasing companies have had to cut business ties with local government funding vehicles because of unprofitable business. Local financial regulatory bureaus (including Beijing, Shanghai and Shenzhen) conducted on-site compliance inspections of leasing operations throughout 2019 and 2020 and have continued to do so in 2021. The working group believes that the effects of this regulatory reform will continue over the coming years, and, as more shell companies are closed, the overall compliance level of the leasing market will improve.

The leasing market in China is mainly driven by sales-and-lease back (SALB), with an estimated 80 per cent share of the market versus direct lease with a 20 per cent share. This is contrary to European countries where direct lease tends to be the main financing model for leasing, whereas SALB is rather limited.

More and more leasing companies are making the effort to replace SALB models with direct leases. The rationale is that SALB triggers additional risks due to the fact that the equipment is sold by the lessee – this could lead to overfinancing if the leasing company does not have strong compliance and risk management. Direct lease is considered preferable because it finances the real economy and real assets, and allows for easy tracking of the origin of funds and assets price.

However, in China, SALB is mandatory for registration of movable assets such as vehicles (further detailed under Key Recommendation 1), and for subsidies granted by local government authorities who request the value-added tax (VAT) *fapiao* to be in the name of the lessee.

Consumer Finance and Auto Finance Industry

In November 2020, the CBIRC issued the *Notice Concerning Driving Consumer Finance Companies and Vehicle Finance Companies to Strengthen Their Sustainable Development Capability and Raise the*

4 2020 China Leasing Industry Development Report, China Leasing Alliance and the Tianjin Binhai Financial Leasing Research Institute, 21st January 2021, viewed 28th April 2021, <http://www.gtziw.com/gtziweb/xwzx_gszx.jsp?messageId=000045000780>

5 Hu, Yue and Han, Wei, *China Issues New Rules to Clean Up Financial Leasing Industry*, *Caixin Global*, 9th January 2020, viewed 12th April 2021, <<https://www.caixinglobal.com/2020-01-09/china-issues-new-rules-to-clean-up-financial-leasing-industry-101502385.html>>

6 The risk assets/ equity ratio means total assets – (cash+bank deposits+treasury bond/ shareholders' equity. It is in the nature of financial leasing companies to have high risk assets/ equity ratio, because their business is to provide funding to third parties.

7 Lowering the risk assets/ equity ratio means less funding to customers for the existing amount of equity of the financial leasing companies. It results in increasing the costs for the customers as more equity (which is a more expensive source of funds) is required for the same amount of business than before.

8 *Notice on Regulatory Rating Measures for Financial Leasing Companies (Trial for Implementation)*, CBIRC, 3rd July 2020, viewed 7th May 2021, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=913689&itemId=915>>





Quality and Efficiency of Financial Services (Notice). Not only does the *Notice* expand funding channels for CFCs and AFCs by allowing them to issue Tier-2 capital bonds on the interbank market for capital supplementation purposes and to undertake regular loan asset ownership transfer operations, but it also allows them to apply to local CBIRC offices to have their required provisions coverage ratio lowered to 130 per cent. In order to qualify for lower ratios, they must meet the precondition of categorising all loans in arrears for more than 60 days as non-performing loans (NPLs). To the working group's knowledge, around half of China's domestic CFCs have reduced their NPL standard from 90 days in arrears to 60 days.

In January 2021, the CBIRC issued the *Notice Concerning the Undertaking of Non-Performing Loan Transfer Trial Work*, which includes credit card overdrafts and personal business loans in the scope for sales of consumer loans.⁹ The working group views this development as a breakthrough for the sale of NPLs in batches. It also believes the move will ease pressure on capital requirements and open more funding options, while setting a trend towards tightening regulation of non-licensed players coupled with more support for licensed players. As of June 2020, there were 26 CFCs with total registered capital of CNY 43.34 billion operating in China, two of which are foreign-invested (See Key Recommendation 5 for more details).^{10,11}

Online Lending

Following the collapse of the peer-to-peer (P2P) online lending sector,¹² the working group has noticed a considerable tightening of online lending and co-lending operations with two disruptive regulations being promulgated one after the other during autumn 2020. The first was the CBIRC's and the People's Bank of China's (PBOC's) *Online Micro-loan Operations Provisional Administrative Measures (Measures)*, and the second was the CBIRC's *Notice on Further*

Standardising the Internet Lending Business of Commercial Banks (Notice). Among other things, the *Notice* stipulates strict control of cross-regional operations for local corporate banks conducting digital lending business,¹³ while the *Measures* stipulate that micro-loan companies are only permitted to engage in cross-provincial operations if they have obtained approval of the State Council. The working group has noticed that large internet companies in particular are coming under compliance scrutiny.¹⁴ Moreover, in the 14FYP, China's financial leadership has pledged to promote the identification and disposal of NPLs, address shadow banking and improve the supervision of internet finance. The working group views this as yet another step in regulators' ongoing commitment to eliminating financial risk and increasing overall consumer protection, while allowing the state to exert greater control over financial technology (fintech).

Key Recommendations

1. Strengthen the Protection of Ownership of Leased Assets 2

Concern

Registration of an asset with the Department of Motor Vehicles (DMV) under the Vehicle Administrative Office is not recognised as registration of ownership, therefore the owning leasing company is at significant risk of a leased asset title being transferred without its consent or knowledge to one or multiple third parties.

Assessment

When leasing a vehicle, registration with the DMV is done in the name of the lessee (the customer/permit holder). The name of the lessor is not mentioned in the registration certificate, which places the ELC at risk of the registration certificate being transferred without the consent to one or multiple third parties. The lessor could potentially lose ownership of the vehicle due to the *bona fide* position of the new registered party with the DMV, despite the ELC's ownership of the vehicle being stipulated under the SALB contract. To guard against this, ELCs follow the practice of registering a mortgage on the vehicle in the DMV platform (mortgage

9 *China Commences Trial for Bulk Transfer of Personal Non-performing Loans to Asset Management Companies*, China Banking News, 12th January 2021, viewed 26th April 2021, <<https://www.chinabankingnews.com/2021/01/12/china-commences-trials-for-transfer-of-personal-non-performing-loans-to-asset-management-companies/>>

10 *CBIRC Loosens Consumer Finance Regulations, Reduces Provisions Coverage Ratio to 130%*, China Banking News, 10th November 2020, viewed 23rd March 2021, <<https://www.chinabankingnews.com/2020/11/10/cbirc-loosens-consumer-finance-regulations-reduces-provisions-coverage-ratio-to-130/>>

11 Czech-owned Home Credit Consumer Finance, and French bank BNP Paribas through its joint venture with Suning Consumer Finance.

12 *China's P2P Platforms Drop from 5000 to Less Than 6*, China Banking News, 22nd October 2020, viewed 23rd March 2021, <<https://www.chinabankingnews.com/2020/10/22/chinas-p2p-platforms-drop-from-5000-to-less-than-6/>>

13 *Notice on Further Standardising the Internet Lending Business of Commercial Banks*, CBIRC, 18th February 2021, viewed 23rd March 2021, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=967210&itemId=926>>

14 *In Halting Ant's IPO, China Sends a Warning to Business*, The New York Times, 6th November 2020, viewed 12th April 2021, <<https://www.nytimes.com/2020/11/06/technology/china-ant-group-ipo.html>>





of self-owned property) as well as registering the vehicle in the PBOC's Credit Reference Centre of Movable Financing Registry Platform (Zhongdengwang).^{15&16} However, this double registration process increases the administrative and financing costs of an ELC, and negatively impacts financing pricing.

On 28th May 2020, the National People's Congress released the People's Republic of China's Civil Code, which took effect on 1st January 2021.¹⁷ Article 745 states that 'The lessor's ownership over the leased object shall, without being registered, not be asserted against a *bona fide* third person'.

Following the promulgation of the *Civil Code*, the State Council issued the *Decision of the State Council on the implementation of Unified Registration of Guarantee over Chattels and Rights* on 22nd December 2020.¹⁸ In this document, the Zhongdengwang¹⁹ is appointed as the unified registration centre for registration of financial leasing transactions. By registering financial leasing transactions on Zhongdengwang, the lessor's ownership should be protected. This policy intends to cover all leasing types (regardless whether direct lease or SALB) and leased assets (regardless whether general equipment or vehicles).

As a result, on 29th December 2020, China's Supreme People's Court (SPC) amended some earlier judicial interpretations.²⁰ In this document, Article 9 recommended the mortgage self-owned leasing assets option, as in the *Interpretation of the SPC on Issues concerning the Application of Law in the Trial of Cases Involving Disputes over Financial Leasing Contracts*, promulgated on 24th February 2014, be deleted.

After all these recent legal developments and

enhancements for the financial leasing industry, the working group is questioning whether the ownership of ELC is sufficiently protected by registering the financial leasing on Zhongdengwang under SALB transactions of general equipment. If so, there would be no need to register an additional mortgage on Zhongdengwang of the self-owned leased assets. This uncertainty is particularly pressing for leasing of vehicles, as it remains unclear whether ELCs still need to register a mortgage at the DMV in order to avoid losing the position of *bona fide* third party. In addition, the working group is concerned that a mortgage of leased assets by ELCs under the current new legal environment may become counter-productive, as it may lead to different interpretation of the transaction nature from financial leasing to mortgage loans.

The concern was highlighted in a recent case of vehicle financing in the city of Ningbo, whereby an ELC financed a vehicle by SALB and registered a mortgage in the DMV platform to protect its ownership rights. However, the court rejected the claim that the lessor had obtained vehicle ownership due to the fact that there was no registration under the lessor's name in the DMV and thus reclassified the financing from SALB to a mortgage loan.²¹ This case has raised concern among industry players that there is no proper methodology for an ELC to have its ownership recognised unconditionally through SALB. In May 2021, the PBOC released the *Uniform Registration Measures for Moving Property and Rights Guarantees (Revised Draft for Comments)*, which are implementation measures of the *Civil Code*.²² However, as vehicles are excluded from the draft regulation, the working group has submitted comments advocating for this to be amended in the final draft.

In the EU and other mature markets, the interests of ELCs are legally protected through registration on

15 Credit Reference Centre of the PBOC website, 14th January 2013, viewed 6th May 2021, <http://www.pbccrc.org.cn/crc/dsj/index_list.shtml>

16 CCRC Movable Financing Registration Platform (the Zhongdengwang), <<http://www.zhongdengwang.com/>>

17 *People's Republic of China Civil Code*, National People's Congress, 31st March 2021, viewed 7th June 2021, <<http://www.npc.gov.cn/englishnpc/c23934/202103/c487476d061844beb093bc3f22e729ae/files/4aaa35619b4c446dbc704f4376bfcc6d.pdf>>

18 *Decision of the State Council on the implementation of Unified Registration of Guarantee over Chattels and Rights*, State Council, 22nd December 2020, viewed 1st July 2021, <https://www.pkulaw.com/en_law/6938bfb6624beb87bdfb.html>

19 Credit Reference Centre of the PBOC (Zhongdengwang), 14th January 2013, viewed 6th May 2021, <http://www.pbccrc.org.cn/crc/dsj/index_list.shtml>

20 *Decision of the Supreme People's Court to Amend 27 Civil Judicial Interpretations Including the Interpretation of the Supreme People's Court on Several Issues Concerning the Application of the Trade Union Law of the People's Republic of China in Civil Trials*, SPC, 29th December 2020, viewed 1st July 2021, <https://www.pkulaw.com/en_law/6938bfb6624beb87bdfb.html>

21 *Summary of Financial Lease Contract Dispute*, Ningbo Intermediate People's Court, 28th September 2020, viewed 12th April 2021, <<https://wenshu.court.gov.cn/website/wenshu/181010CARHS5BS3C/index.html?https://wenshu.court.gov.cn/website/wenshu/181107ANFZ0BXSK4/index.html?docId=ec1d55fdefbc4bafaa93ac86009f3c6d>>

22 *Uniform Registration Measures for Moving Property and Rights Guarantees (Revised Draft for Comments)*, PBOC, 19th May 2021, viewed 24th May 2021, <<http://www.pbc.gov.cn/tiaofasi/144941/144979/3941920/4251286/index.html>>





similar platforms.^{23,24&25} The working group believes the Zhongdengwang has the same potential because it provides a favourable basis for the process of taking back defaulted vehicles and indirectly supports the development of a healthy market. In addition, the platform already allows for a serial number to be entered or the uploading of invoice documents when registering, but it is neither a mandatory nor a recommended field.

In addition, the Zhongdengwang and the DMV's identification codes for vehicles currently do not correspond, which could lead to the same vehicle being registered by different parties. The working group therefore recommends that the DMV bureaus be granted access to the Zhongdengwang platform for the purpose of checking the existence of any right privilege on a vehicle, and that they be permitted to obtain consent from the legal owner prior to authorising any change or transfer of the registration certificate. The working group also suggests that the Vehicle Administrative Office confirm whether the sole asset registration on the Zhongdengwang is sufficient to protect the ownership of an ELC under SALB contract.

It is notable that the financing of equipment/assets other than vehicles are also of concern, as mortgage registration in the DMV is limited to vehicles only. The working group stresses the need to clarify whether the registration of the asset on the Zhongdengwang platform by an ELC is sufficient to protect its ownership rights under a SALB contract.

Recommendations

- Confirm that when an ELC is financing a vehicle by SALB contract, the asset registration on the Zhongdengwang platform is sufficient to protect the ownership right of the ELC.
- Ensure that vehicle registration certificate transfers

cannot be completed by local DMV bureaus without first checking the Zhongdengwang platform.

- Improve the Zhongdengwang platform by making the serial number of an asset a preferable field.
- Confirm that when an ELC is financing equipment other than vehicles under a SALB contract, the sole asset registration on the Zhongdengwang platform protects the ownership right of the ELC.

2. Maintain the Right for ELCs to Provide Assignment of Receivables (AOR) and/or Factoring Without Having to Establish a Separate Entity

Concern

Limiting or requiring the establishment of a specialised entity to manage AOR and/or factoring will have a dramatic impact on the industry and bring into question the continuity of the equipment leasing sector.

Assessment

Leasing companies must sometimes finance intangible products or solutions—such as software, maintenance, and repairs—by factoring or assignment of receivables (AOR) to help provide the sale by payment terms on either a single transaction or on a project basis. AOR business represents a substantial proportion of the international business conducted by ELC members of the Non-banking Financial Institutions Working Group, accounting for 10–20 per cent of their overall financing.²⁶ Captive ELCs do inventory finance through AOR to support their network of dealers, which are often VSMes or SMEs that are not eligible for banks or factoring companies' loans.²⁷ Due to captive ELCs knowledge of the market and assets, they are prepared to accept and manage an adequate level of risk in the VSME and SME segments.

ELCs also support sales of key information and communication technology companies (ICTs) by enabling them to propose payment terms to their end-customers on up-to-date and expensive software and/or hardware. The payment terms solutions are included in the documentation of the ICT, with the ELC purchasing the related receivables and thereby enabling ICTs to

²³ In Spain, a property register in commune with the Traffic Department ensures that there is a limitation over the vehicle in the name of the leasing company until the contract period is terminated. To remove this limitation, a special document from the leasing company has to be sent to the register or the customer. <<https://www.registradores.org/el-colegio/registro-de-bienes-muebles>>

²⁴ In Portugal, registration is done directly in the Traffic Department. <<http://www.imt-ip.pt/SITES/IMTT/PORTUGUES/VEICULOS/Paginas/Veiculos.aspx>>

²⁵ A by-the-book example is the Personal Properties Security Register (PPSR) Platform covering Australia and New Zealand. The platform includes a direct link from the enterprise resource-planning software to the government website to register pledges. ELCs may also register their encumbrance on the vehicle using VIN number of the vehicle and register it against the customer. The PPSR Platform allows for registration by multiple customers, for example, borrower and operator. The customer still registers the vehicle in their name, but ELCs maintain the legal rights to the vehicle. See the PPSR Platform website: <<https://www.ppsr.gov.au/>>

²⁶ According to information provided by the working group's ELC members.

²⁷ A captive finance company is a subsidiary that finances purchases from the parent firm, and are usually found in the automobile industry, retail sector and the healthcare equipment sector. When it comes to the auto sector, captive finance companies offer car loans to buyers in need of financing.





recognise their sales.^{28&29}

The working group believes these product offerings are consistent with the spirit of the State Council's *Accelerating the Development of the Financial Leasing Industry (Guobanfa [2015] No. 68)*, which seeks to strengthen financial innovation.³⁰ Furthermore, the State Council's *Promoting the Experience of the Pilot Reform of China (Shanghai) Pilot Free Trade Zone (Circular 65)*, issued in December 2014, enabled ELCs to conduct factoring business related to their main business nationwide.³¹ Since then, many ELC have obtained such a factoring licence. However, since 2019, members of the working group that have obtained this licence have reported being challenged on a regular basis in relation to their factoring business.³² Others had applied to expand their business scope to include factoring but were rejected by the local financial bureau. The working group is engaging in constructive discussion with local financial bureau on this topic.

The working group is fully aligned with the regulator's ultimate goal of establishing sound and innovative financial services in China, but the different opinions and interpretations that prevail nationwide regarding software financing and inventory financing by ELCs hinder members' efficiency. ELCs play an important and unique role in serving the real economy and achieving high-quality development for Chinese corporates, as well as their ability to share their experiences of best practices in Europe or other foreign markets. However,

the working group estimates that if members do not establish a factoring company before the transition period ends in 2023, they will then not be permitted to do any factoring business afterwards, leading to a potential loss of new business in 2023 of around CNY 200-250 million.

Recommendation

- Promote innovation in financial services by granting a dedicated licence to ELCs for factoring and/or AOR.

3. Ease the Tax Burden on ELCs and Ensure Consistent Tax Schemes

3.1 Clarify the Basis for Value-added Tax (VAT) Deductions between Headquarters (HQ) and the Branch Office of an ELC

Concern

Inconsistency among tax authorities in interpreting VAT regulations not only increases the tax burden on ELCs but also hinders the development of the industry by forcing companies to change their business model or, even worse, give up their operations.

Assessment

To support the rapid development of the leasing industry, the Chinese Government has provided a preferential VAT regulation allowing for the deduction of loan interest, bond interest and vehicle purchase tax from the sales amount when calculating VAT liability. However, this preferential VAT regulation does not apply to branch offices of an ELC. Many European investors operate several different entities throughout China, and inconsistency in interpreting tax regulation is frequently encountered in different locations, especially for emerging industries such as leasing. For instance, *Circular No. 36 (Caishui [2016] 36)* indicates that an ELC that has obtained approval from the Ministry of Commerce (MOFCOM) and is engaged in financial leasing operations can avail of the preferential VAT, provided its paid capital reaches CNY 170 million. However, in practice, the interpretation by most tax authorities is that there is no paid capital for a branch office.

Furthermore, considering the conditions of SALB business, vehicles returned by a lessee to an ELC should be recognised as goods with a partial-use value (i.e., used goods). Therefore, the remarketing income

28 The working group acknowledges that some pilot cases for software financing through leasing are currently being conducted. However, this does not address the ICT's expectations for ELC's support. As a global rule also applicable to the Chinese market, payment terms are only defined between the ICT and its customer. The stream of payments is then sold to the ELC. Very important to note also is that the discounting cost is born by the ICT to facilitate the sales. Therefore, financing of software through intangible leasing is not a common practice globally, because that would require the ICT and its end customer to have signed a specific leasing contract with the ELC, which would lengthen and potentially endanger the ICT's sales of the software solution. This financing practice facilitates customers' access to the latest software technology. It is a key practice by all major ICTs.

29 Discounting cost is the interest cost generated by the ELC to purchase the stream of receivables from the ICT. It is a discounted rate (a stream of payments, which are discounted at the present value based on a discount rate). It allows for costs incurred by the ICT to be sold to the ELC immediately and transfers the risk to a financial third-party institution. This allows the ICT to recognise the revenue.

30 *Guiding Opinions of the General Office of the State Council on Accelerating the Development of the Financial Leasing Industry*, State Council, 31st August 2015, viewed 26th April 2021, <<http://lawinfochina.com/display.aspx?id=26921&lib=law>>

31 *Promoting the Experience of the Pilot Reform of China (Shanghai) Pilot Free Trade Zone (Circular 65)*, State Council, 21st December 2014, viewed 26th April 2021, <http://www.gov.cn/jzhengce/content/2015-01/29/content_9437.htm>

32 For a detailed description of the change in supervision of foreign-invested financial leasing companies, commercial factoring companies and pawn mortgage industry actors from the MOFCOM to the CBIRC, please see the *European Business in China Non-banking Financial Institutions Working Group Position Paper 2020/2021*, p. 384.





should be subject to the simplified VAT calculation method at three per cent rate and then subsequently lowered to two per cent as soon as possible.

Recommendations

- Clarify that the branch office of an ELC whose main operation is financial leasing is qualified to deduct loan interest, bond interest and vehicle purchase tax from its sales amount.
- Recognise returned vehicles as goods with partial-use value, allowing for simplified VAT calculation at two per cent for remarketing income.

3.2 Align Taxation of ELCs with Financial Institutions

Concern

Financial leasing businesses are treated and taxed as financial companies under the 'Business to VAT' tax reform, yet financial institutions and ELCs often receive different tax treatment.

Assessment

There are two main ways in which ELCs often receive different tax treatment under China's current regime.

The first is related to VAT. Based on the *Notice on Clarification of VAT Policies for Finance, Real Estate Development and Education Support Services*, (CaiShui [2016] No. 140), a financial institution is exempted from VAT on interest incurred if a client has defaulted after 90 days, in which cases VAT shall be paid when interest is collected. An ELC, on the other hand, is required to pay VAT throughout the entire contract period regardless of any client default. This can lead to significant losses for the ELC in cases of non-payment.

The second situation is related to the thin-cap ratio. Under the *Notice on Tax Collection Policy Issues Relating to Standards for Pre-tax Deduction of Interest Payment Expenses of Related Parties of Enterprises* (Caishui [2008] No. 121), a financial institution is subject to a 5:1 thin-cap ratio when calculating non-deductible interest actually paid, while an ELC, which is categorised as a non-financial institution, is subject to a 2:1 thin-cap ratio.³³ The comparably low thin-cap ratio leads to intense funding pressure on ELCs

³³ Cap ratio is used in asset pricing (or company evaluation) as an input to the discount rates. The thin-capitalisation rules operate as a tax deduction for excess interest expense with respect to related party financing. The debt-to-equity ratio is specified at 5:1 for financial institutions and 2:1 in other cases under most international tax schemes.

and increases their costs. However, if ELCs were to be regulated as financial institutions, it would greatly increase their compliance costs. The working group therefore encourages the regulator to issue guidance and procedures on taxation of ELCs.

Recommendations

- Allow ELCs to enjoy some of the rights and benefits of financial institution taxation, and issue guidance and procedures for financial control of the leasing industry.
- Benchmark tax policy relating to ELCs against that of other financial institutions.

4. Allow ELCs to Obtain Cross-border Corporate Guarantees and Cross-border Bank Guarantees

Concern

European leasing companies can use their international connections to finance the Chinese subsidiaries of multinational companies they have strong business ties with in their home country, but certain restrictions still remain in this respect.

Assessment

The *Regulations on the Administration of Foreign Exchange for Cross-Border Guarantees*, issued by the State Administration of Foreign Exchange (SAFE) on 15th May 2015, only allow banks and financial institutions registered in Mainland China to obtain cross-border guarantees.³⁴ This limits the ability of European ELCs in terms of risk appetite to support foreign investment in China. As a result, Chinese SME subsidiaries of foreign companies have difficulties accessing local structured financing.

Foreign-invested ELCs receive cross-border guarantees in some lease contracts for securing the lessee in China (to fulfil the rental payment obligation under the lease agreement). Currently, it is difficult to receive real payment from the parent company outside of China if the lessee is in default. This is because leasing companies are not regarded in China as financial institutions, and therefore are not eligible for the *Onshore Borrowing with Offshore Guarantee* (waibao neidai), which allows China-based subsidiaries

³⁴ *Notice of the State Administration of Foreign Exchange on the Issuance of the Regulations on the Administration of Foreign Exchange for Cross-Border Guarantees* [2014] No. 29, SAFE, 15th May 2015, viewed 24th April 2021, <<http://www.safe.gov.cn/shenzhen/2015/0515/133.html>>





to receive money from their parent company outside of China.³⁵ The working group estimates that around 20 to 30 per cent of additional business is not realised due to this constraint on foreign ELCs.

Recommendation

- Allow ELCs to obtain cross-border corporate guarantees and cross-border bank guarantees.

5. Include CFCs and AFCs in the Pilot Programme to Sell NPLs in Batches to Asset Management Companies (AMCs) 5

Concern

According to the current regulations, it is not feasible for CFCs to sell NPLs, as individual loans cannot be transferred in batches and other NPLs sold in batches can only be assigned to financial AMCs or a locally recognised AMC.

Assessment

With the development of the CFC industry and the AFC industry in China, a large amount of NPLs have accumulated in the market. It is difficult for CFCs and AFCs to dispose of NPLs, as individual loans (including all kinds of loans with individuals as the main borrowers, such as housing, automobile or student loans, and credit card debts cannot be transferred in batches (equal to 10 or more NPLs). Other NPLs sold in batches can only be assigned to AMCs or a local recognised AMC. CFCs' business particularity is to grant small ticket loans to multiple individual borrowers. Considering this, it is not practical for CFCs to dispose of NPLs in batches of less than 10 loans. As NPLs accumulate, CFCs and AFCs must often resort to writing them off. Unfortunately, China still has no regulatory mechanism that allows and guides the sale of NPLs by CFCs and AFCs, however some, albeit small, positive developments have been noticed on this front by the working group.

In January 2021, the CBIRC issued the *Notice Concerning the Undertaking of Non-Performing Loan Transfer Trial Work*, including in its scope sales of consumer loan, credit card overdrafts and personal business loans. Under this pilot programme, six Chinese state-owned banks and 12 commercial banks

are eligible to sell NPLs in batches to AMCs.³⁶ As of March 2021, ICBC Bank and Ping An Bank are able, through open bidding, to dispose of the first batch of NPLs in accordance with the pilot programme.³⁷ It is reported that ICBC had sold 41 individual consumer loan NPLs at outstanding principal of CNY 14.89 million, and Ping An had sold 111 individuals business loan NPLs at CNY 6.18 million.³⁸

The working group views this development as a breakthrough in the sale of NPLs in batches. Sale of NPLs are now expected to accelerate, which will help to improve the asset quality of banks and financial institutions in China. However, it remains to be seen what the market impact and revenue of such NPLs sales would be. Therefore, if the pilot is successful and opening is consolidated, the working group advocates for the inclusion of CFCs and AFCs, and for relevant rules and policies to be formulated that support and facilitate NPL sales, including an end-to-end process for realising NPL sales.

Recommendations

- Lift restrictions on batch transfers of NPLs in the consumer finance industry and the automotive finance industry and issue clear supportive guidance on this process.
- Include CFCs and AFCs in the NPL pilot project and set up relevant rules and policies to support/ facilitate the sale of NPLs by CFCs and AFCs, including an end-to-end process for realising NPL transfer to sale.

6. Establish a System for Managing Personal Bankruptcy 2

Concern

Currently, there is no national personal bankruptcy law in China, although recent market developments justify the need for it.

³⁵ Notice on the Administration of the Registration of External Debt, SAFE, 3rd May 2013, viewed 6th May 2021, <http://www.gov.cn/jwqk/2013-05/03/content_2395170.htm>

³⁶ China Commences Trial for Bulk Transfer of Personal Non-performing Loans to Asset Management Companies, China Banking News, 12th January 2021, viewed 26th April 2021, <<https://www.chinabankingnews.com/2021/01/12/china-commences-trials-for-transfer-of-personal-non-performing-loans-to-asset-management-companies/>>

³⁷ The open bidding process was administered through the Bank Credit Asset Registration Exchange Centre, (the Yin Deng Centre, 银行信贷资产登记流转中心, "银登中心"). As of early March 2021, 22 banks have registered in the Yin Deng Centre.

³⁸ Breaking the Ice: ICBC and Ping An Have a Fresh Taste of Personal Bad Bulk Transfer and Bid Successfully, Sina Finance, 2nd March 2021, viewed 18th June 2021, <https://finance.sina.cn/2021-03-02/detail-ikftprnz0501715.d.html?sinawapshare=resource=newsapp&wm=3200_0001>





Assessment

One of the main objectives of enacting a personal bankruptcy law is to provide a lawful mechanism for an individual to return to normal life, even though he or she is unable to fully settle his/her debts. Once an individual's bankruptcy is implemented, legal procedures should be in place to protect an 'honest and unfortunate defaulter' from being indefinitely chased by debt collectors. It should also prevent bankrupt individuals from being permanently granted a lower social credit score³⁹ or being distrusted by their peers due to debts unpaid.

As for creditors, a personal bankruptcy law would provide pragmatic means to resolve longstanding unenforceable judgments against individuals. Importantly, a personal bankruptcy law should balance the interests of both creditors and debtors. There should be robust measures in place to prevent abuses by individuals who engage in reckless economic behaviour (for example, gambling, or excessive spending on a luxurious lifestyle beyond one's financial means) or wilful debt evasion.⁴⁰

Aside from the law, the establishment of additional related infrastructure—such as personal bankruptcy courts, a personal bankruptcy registry and official receivers (to administer bankruptcy processes, which can stretch for a few years from the award date of the bankruptcy order to final release of the bankrupt status of the individual)—are also critical to the success of an effective personal bankruptcy regime.

On 1st March 2021, the Shenzhen Special Economic Zone rolled out the first Personal Bankruptcy Law in China.⁴¹ Although this law applies currently only to Shenzhen residents, the working group still views this as a positive first step.⁴²

Recommendation

- Adopt a personal bankruptcy law and develop a proper personal bankruptcy system throughout China.

³⁹ China's Social Credit System (*shehui xinyong tixi*) is a government programme being implemented nationwide to regulate citizens' behaviour based on a point system. Under this system, citizens are ranked according to their economic and social reputation.

⁴⁰ *China's first personal bankruptcy authority established in Shenzhen*, Ministry of Justice, 12th March 2021, <http://en.moj.gov.cn/2021-03/12/c_602179.htm>

⁴¹ Ibid.

⁴² *Bankruptcy Law protects honest debtors*, Shenzhen Government Online, 3rd September 2020, viewed 25th April 2021, <http://www.sz.gov.cn/en_szgov/news/latest/content/post_8056555.html>

Abbreviations

AFC	Auto Finance Company
AMC	Asset Management Company
AOR	Assignment of Receivables
CBIRC	China Banking and Insurance Regulatory Commission
CFC	Consumer Finance Company
COVID-19	Coronavirus Disease 2019
DMV	Department of Motor Vehicles
ELC	Equipment Leasing Company
FYP	Five-year Plan
HQ	Headquarter
ICT	Information and Communications Technology
MOFCOM	Ministry of Commerce
NPL	Non-performing Loan
OEM	Original Equipment Manufacturer
P2P	Peer-to-Peer
PBOC	People's Bank of China
SAFE	State Administration of Foreign Exchange
SALB	Sales and Leaseback
SAMR	State Administration for Market Regulation
SME	Small and Medium-sized Enterprise
VAT	Value Added Tax
VSME	Very Small and Micro-sized Enterprise



Insurance Working Group

Key Recommendations

1. Speed up the Issuing of Insurance Licences to Foreign Applicants 2

- Communicate official receipt of application materials in accordance with regulations in a timely manner and process application approvals according to the stipulated timeframe as soon as the applicant deposits an application file.

2. Allow Foreign-invested Insurers to Build Better Distribution Networks by Applying for Branch Licences in Batches, and Simplify Requirements at the Provincial and Sub-provincial Levels 19

- Allow foreign-invested insurance companies to apply at any time for approval licences to open new branches in as many provinces as they believe necessary and to apply for branch licences in batches.
- Ensure that provincial licences can cover the whole province without any further requirements at the sub-provincial level.
- Train, support, and empower local China Banking and Insurance Regulatory Commission (CBIRC) offices in handling licence applications from foreign-invested insurers.

3. Clarify that Foreign Shareholders Can Exercise their Equity Right Proportional to their Equity Shares

- Clarify the degree of application of the *Guidelines for Corporate Governance of Banks and Insurance Institutions* to foreign-invested insurance companies in JVs.

4. Build a Comprehensive Regulatory Level Playing Field that Encompasses Different Insurance Business Models

4.1 Build a Regulatory Level Playing Field for Online Insurance which Encourages Product Innovation

- Implement a level playing field for insurers of any size, as well as between insurers and online intermediaries, to ensure undistorted competition and fair treatment of consumers, as well as to support ongoing product innovation.
- Clarify how to obtain an online insurance licence, to help insurance companies prepare long-term strategies.
- Ensure equal access to online distribution, with no nominal thresholds that disadvantage small insurers.
- Allow life insurers to sell online not only traditional life, annuity and pension products, but also products with profit participation and unit-linked products.

4.2 Allow Foreign Insurance Group Companies to Invest in Insurance Intermediaries

- Accelerate the issuing of the *Implementing Measures for Administrative Licensing and Record-filing for Insurance Intermediaries* and re-initiate the approval of insurance broker/agency licences, concurrent agency licences and cross-selling licences within insurance groups.



5. Create More Opportunities for Foreign Insurers to Contribute to China's Pension Reform 7

- Invite foreign insurers to participate in future pension pilots in the second and third pillars, like that announced for Chongqing and Zhejiang.
- Encourage foreign-invested insurers to have more flexibility in leveraging their overseas expertise in managing asset portfolios.

Introduction to the Working Group

The Insurance Working Group is the voice of Europe's insurance industry in China. It was the first of the European Chamber's working groups to be set up. It represents leading European insurers, brokers and other service providers engaged in life, non-life, reinsurance, and specialty insurance. 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 key element for economic freedom, as it enables companies and households to deploy 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 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 they 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

Although China's insurance sector is strong and grows fast, there is still significant growth potential

considering insurance penetration in China remains low compared to the EU or the United States. The working group believes that the Chinese Government aspires to develop a more integrated insurance market, with competition being a good way to deliver growth and improved services. Changes in the industry are also resulting from the coronavirus disease 2019 (COVID-19), which accelerated the transformation of traditional insurers' business models by pushing them to partner with technology companies.

As part of facilitating China's innovation push, the 14th Five-year Plan (14FYP) encourages the development of financial products, including insurance products, that are tailored for companies pursuing technological and scientific research and development, and commercialisation. In addition to commitments on social reform made in the 14FYP, China has pledged to further open its insurance sector, and deepen connectivity between Chinese and foreign financial markets. This includes expanding interconnections between the respective financial markets in Mainland China, Hong Kong and Macau, and improving the existing regime for qualified foreign investors.

Ensuring financial stability through China's regulatory framework is also an objective set forward in the 14FYP, and, as such, the working group expects China to continue with its incremental approach to reform and opening up to strengthen its financial sector, while emphasising strict compliance with regulatory requirements. Regulators are still grappling to contain hidden risks within the sector: during 2020, the China Banking and Insurance Regulatory Commission (CBIRC) seized control of four domestic life insurance companies and two domestic trust companies over concerns that could only be "forcibly dealt with through

¹ Buckley, Chris, *Xi Jinping Thought Explained: A New Ideology for a New Era*, The New York Times, 26th February 2018, viewed 15th April 2021, <<https://www.nytimes.com/2018/02/26/world/asia/xi-jinping-thought-explained-a-new-ideology-for-a-new-era.html>>



administrative measures and regulator takeover”.²

Implementation of opening-up

Since 2019, there have been three key changes in opening up of the Chinese insurance market: (i) the requirement that foreign insurers must have operated for at least 30 years prior to entering China has been removed; (ii) the foreign ownership cap of 50 per cent for life insurance joint ventures (JVs) with a Chinese partner has been removed (allowing wholly foreign ownership); and (iii) rules on the establishment of branches and management that previously applied specifically to foreign insurers have been removed.

However, the persistence of indirect barriers render opening-up incomplete. This is illustrated by the fact that the combined market share of China's four biggest insurance companies—Ping An, China Life, People's Insurance Company of China (PICC) and China Pacific—is an impressive 60 per cent, compared to the combined 7.8 per cent share of foreign-invested insurers (2.56 per cent in non-life insurance and 10.3 per cent in life insurance).³ This is significantly lower than in similar economies, where market shares are much more evenly distributed among competing companies.

Foreign insurers in China continue to be plagued by long administrative and bureaucratic procedures to establish a business and build a regional network. After obtaining an insurance licence, regional regulatory requirements need to be met. If the company wishes to set up business in a Chinese province, autonomous region or municipality other than their initial domicile, a provincial licence must be obtained before an application can be approved by the provincial CBIRC. Past cases indicate that if, for example, a company is planning to set up business in more than 10 Chinese provinces, the whole process, from licence application to establishing local branches and sales offices, will take a minimum of seven to ten years.

Furthermore, an estimated additional three to five years are required to build up a direct sales/agent network. Many foreign insurers have tried to overcome this long-

standing barrier by forming a JV with a Chinese state-owned enterprise (SOE) and taking advantage of their existing network and resources. However, as of mid-2021, these JV partnerships have generated few successful cases. The working group believes the main difficulties have been the restriction on ownership caps (which makes it challenging for the foreign insurer to manage the JV) and internal rotation of management (which hinders the formation of a consistent and sustainable business strategy).^{4&5}

Opening-up measures have also led foreign insurers to try to increase their shareholding in existing JVs, or even to establish wholly or majority foreign-owned companies through acquisitions, and new partnerships and JVs. However, because of the challenges of buying out a Chinese SOE from a JV partnership—SOEs may not be so willing to sell their shares due to strategic considerations and, even if they are willing to sell, a high purchase premium may be demanded—some foreign insurers remain ‘stuck’ in unproductive partnerships. While it is preferable in principle to establish a wholly foreign-owned insurance company, the time needed to obtain regulatory approvals and build sales networks makes it less attractive in practice. An alternative is to buy a domestic insurance company; however, due to the complex and fragmented shareholding structures of domestic insurance companies, negotiations and acquisitions may easily be stalled or take up to a year to complete. During 2020, at least three foreign-owned insurance companies and one foreign-owned reinsurance company increased their shareholding in existing JV partnerships in China

Key Recommendations

1. Speed up the Issuing of Insurance Licences to Foreign Applicants 🌐 2

Concern

In the past two years, no new insurance (property and casualty (P&C) or life) nor reinsurance preliminary licences have been approved or issued to foreign applicants, despite some European Chamber members

² Weinland, Don & Ju, Sherry Fei, *Chinese State Seizes Control of 9 Insurers, Trusts and Brokers*, Financial Times, 17th July 2021, viewed 6th April 2021, <<https://www.ft.com/content/d9d25a72-bec2-4b6b-95d0-b2e6ee782d7b>>

³ *Premium Ranking of Insurance Companies in 2020*, QRZ Insurance Net, 22nd February 2021, viewed 20th April 2021, <<https://mp.weixin.qq.com/s/LsOOWkFFZw6sSUI5RfHT7w>>

⁴ British HSBC Insurance (Asia) bought the remaining 50 per cent in HSBC Life China from its Chinese JV partner The National Trust; German ERGO Group acquired 24.9 per cent in Taishan P&C Insurance; and Belgian Ageas acquired 25 per cent of Taiping Re through partnership with China Taiping Holdings.

⁵ Tjaardstra, Andrew, *China, Hong Kong M&A 2020 Review*, Insurance Asia News, 22nd December 2020, viewed 6th April 2021, <<https://insuranceasianews.com/china-hong-kong-ma-2020-review/>>





reporting that the timeline for approval has expired since they applied.

Assessment

Since March 2018, China has announced and published a series of measures regarding further opening of the market for foreign insurers, to facilitate a greater number of overseas insurance and reinsurance companies to enter the Chinese market. To the working group's knowledge, several foreign applicants have already submitted their documents to the CBIRC. However, members report that they have neither received official acknowledgement that the application materials have been received, nor have their applications been approved within the timeframe stipulated by the regulations. Too often, the practice of the CBIRC is to refuse to formally accept the application file, for reasons that are not made clear to the applicant. This leaves the applicant in a legal limbo, where it is impossible to make the application progress.

Recommendation

- Communicate official receipt of application materials in accordance with regulations in a timely manner and process application approvals according to the stipulated timeframe as soon as the applicant deposits an application file.

2. Allow Foreign-invested Insurers to Build Better Distribution Networks by Applying for Branch Licences in Batches, and Simplify Requirements at the Provincial and Sub-provincial Levels

Concern

Because foreign insurers are restricted to applying for licences one province at a time and in practice once per year, their ability to build a comprehensive network with operational capabilities and economies of scale is severely constrained.

Assessment

Today, the regulatory treatment of domestic and foreign insurance players is equal on paper, but because the China market is perceived to be a very expensive investment, the number of new market entrants is low. In addition, the insurance market is still quite dominated by large domestic players that have the advantage of established branch networks. This is a significant

disincentive for new entrants, which, at an average of one branch per year, face a seven-to-ten-year waiting period just to be able to cover less than one third of all Chinese provinces. Most companies that have already entered the China market found it more profitable to build their network with a Chinese partner, however, this may lead to other challenges, as the appetite for risk and profit between the two partners in such a JV is often different.

These dynamics impact the opening-up and reform of China's insurance sector, because if foreign insurers do not perceive the Chinese market to be profitable, the overall growth rate of the market will slow down. If foreign-invested insurers could apply for branch licences in batches, instead of one province at a time, more players would be encouraged to enter the market, which in turn would help to foster a competitive landscape. Once an insurance company has obtained a provincial licence, it would also be positive for China's insurance industry if this licence could cover the whole province without any further requirements at the sub-provincial level, such as the opening of sub-branches.

For insurance companies already based in China, part of the problem in expanding branches is that local CBIRC offices lack experience in dealing with foreign-invested insurers. This has an impact on licence applications and business development. Additional requirements at the sub-provincial level further impede market access or make it economically difficult for small insurers, including all foreign ones. As of July 2021, the CBIRC has delegated powers and authorities regarding the supervision of P&C and life insurance companies to its provincial bureaux. In December 2020, the CBIRC issued the *Circular on Deepening the Reform of Streamlining Administration and Delegating Power, Improving Regulation and Upgrading Services and Optimising the Business Environment in the Banking and Insurance Industries*.⁶ However, based on the working group's observations over recent months, local CBIRC offices were not familiar with the procedures and had to consult with headquarters before making decisions, which has prolonged the approval process and added more ambiguities and uncertainties for applicants. The working group therefore recommends

⁶ *Circular on Deepening the Reform of Streamlining Administration and Delegating Power, Improving Regulation and Upgrading Services and Optimising the Business Environment in the Banking and Insurance Industries*, CBIRC, 30th December 2020, viewed 16th June 2021, <http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=956594&itemId=928&generalType=0>





training, supporting and empowering local CBIRC offices in the handling of licence applications from foreign-invested insurers. The working group also recommends the CBIRC and its local offices further clarify their powers and authority, based on which the local offices publish guidelines in relation to administrative licensing/ approval management, and make efforts to accelerate the approval process.

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 necessary, and to apply for branch licences in batches.
- Ensure that provincial licences can cover the whole province without any further requirements at the sub-provincial level.
- Train, support, and empower local CBIRC offices in handling licence applications from foreign-invested insurers.

3. Clarify that Foreign Shareholders Can Exercise their Equity Right Based on their Equity Shares

Concern

Under the recently published CBIRC *Guidelines for Corporate Governance of Banks and Insurance Institutions (Guidelines)*, it is unclear whether foreign shareholders will be able to exercise their full right to nominate directors for the board or independent directors and supervisors based on their proportion of equity shares.

Assessment

The recently published *Guidelines* stipulate that one shareholder, including its affiliates, shall not nominate directors for more than one third of all board seats, and imposes similar limitations on nominations for independent directors and supervisors.⁷ This means, for foreign life JV insurance companies with foreign shareholders' holdings equal to or higher than 50 per cent, the foreign shareholders will not be able to exercise their equity right based on the proportion of equity shares they hold.

⁷ China Banking Regulatory Commission issues Corporate Governance Guidelines for Bank Insurance Institutions, CBIRC, 8th June 2021, viewed 23rd June 2021, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=989067&itemId=915&generalType=0>>

This limitation imposed on director nomination rights is consistent with the requirement that one shareholder shall not hold more than one third of equity shares for local insurance companies as stipulated in the *CBIRC's Administrative Measures for the Equity of Insurance Companies (Measures)*.⁸ However, following reforms to China's financial sector, foreign shareholders can now hold up to 100 per cent of shares of a foreign-invested life or P&C insurance company. Therefore, the newly-proposed limitation in the *Guidelines* is not consistent with rules stipulated in the CBIRC's *Circular on Clarifying the Time Point for Removing the Foreign Shareholding Percentage Limit on Joint Venture Life Insurance Companies (Circular)*.⁹ The working group therefore suggests that the regulator further clarify whether foreign-invested insurance companies in JVs are excluded from the limitations imposed on director (as well as independent director and supervisor) nominations for shareholders.

Recommendation

- Clarify the degree of application of the *Guidelines for Corporate Governance of Banks and Insurance Institutions* to foreign-invested insurance companies in JVs.

4. Build a Comprehensive Regulatory Level Playing Field that Encompasses Different Insurance Business Models

4.1 Build a Regulatory Level Playing Field for Online Insurance which Encourages Product Innovation

Concern

Insurance companies are having to adapt their business models due to increased digitalisation, yet the current regulatory framework indirectly prevents foreign-invested insurers from capitalising on this.

Assessment

Insurance companies are having to change their business models due to increased digitalisation. This is reflected in the CBIRC's recently promulgated *Measures for Internet Insurance Business*, in which

⁸ *Administrative Measures for the Equity of Insurance Companies*, CBIRC, 2nd March 2018, viewed 15th April 2021, <<http://www.cbirc.gov.cn/cn/view/pages/governmentDetail.html?docId=272998&itemId=880&generalType=1>>

⁹ *Circular on Clarifying the Time Point for Removing the Foreign Shareholding Percentage Limit on Joint Venture Life Insurance Companies*, CBIRC, 6th December 2019, viewed 15th April 2021, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=858344&itemId=928&generalType=0>>





insurance companies using online platforms are included. Members of the Insurance Working Group increasingly see different types of insurance models being established, with a particular trend in insurers partnering up with technology companies. This has reshaped the value chain, with disruptive innovations and big data now enabling smarter solutions for processes and automation. This poses a challenge for both the regulator, which must draft and promulgate many dedicated regulations, and for insurance companies, which must comply with a growing number of regulations that are sometimes contradictory.

The access to online distribution for all insurance product categories should be identical for insurers of all sizes, i.e., qualitative prerequisites and any financial ratio thresholds should be the same. There should be no nominal thresholds, such as a minimum solvency capital, because this would exclude small and medium-sized insurers—potentially including most or all European insurers—from important segments of online distribution, especially on the life insurance side. Insurers which are small in terms of premium income, profit, nominal solvency capital or other key performance indicators should not be excluded from online distribution of certain types of products. The product scope should reflect the recent low interest rate environment and differentiated consumer needs. Furthermore, life insurers should be allowed to sell online not only traditional life, annuity and pension products, but also products with profit participation and unit-linked products while providing full transparency to consumers on what is guaranteed and what is not. Most European life insurers have developed relevant expertise and a track record in their home markets to help mitigate the impacts of lower interest rates on clients. Based on this experience, they can contribute to the further development of the Chinese life insurance market.

Recommendations

- Implement a level playing field for insurers of any size, as well as between insurers and online intermediaries, to ensure undistorted competition and fair treatment of consumers, as well as to support ongoing product innovation.
- Clarify how to obtain an online insurance licence, to help insurance companies prepare long-term strategies.
- Ensure equal access to online distribution, with no

nominal thresholds that disadvantage small insurers.

- Allow life insurers to sell online not only traditional life, annuity and pension products, but also products with profit participation and unit-linked products.

4.2 Allow Foreign Insurance Group Companies to Invest in Insurance Intermediaries

Concern

There are no effective regulations that allow foreign group companies to act as the chief shareholder of foreign-funded insurance intermediaries, while insurance broker licences and concurrent agency licence applications are pending approval until the *Implementing Measures for Administrative Licensing and Record-filing for Insurance Intermediaries (Draft)* has been promulgated and taken effect.

Assessment

In May 2018, CBIRC Chairman Guo Shuqing announced that foreign insurance groups would be allowed to establish wholly foreign-owned entities in China.¹⁰ On 19th March 2021, a new amendment to the *Implementing Rules for the Administrative Regulations of the People's Republic of China on Foreign-funded Insurance Companies* allowed foreign insurance group companies to be the major shareholder of an insurance company in China.¹¹ This was welcome news to the working group. However, to build up the necessary value chain and create a supporting ecosystem, it is common practice for both domestic and foreign insurance group companies to establish insurance intermediaries while investing in insurance companies. Currently, domestic insurance groups can wholly own an insurance intermediary, while a draft regulation allowing foreign insurance group companies to invest in intermediary companies in China is yet to be released publicly.

In addition, to the working group's knowledge, no new insurance broker licence has been issued since 2018, and the approval of insurance concurrent agency licences is still pending. Following informal consultations regarding the approval process, the working group believes that the regulator will not start to approve broker licences, insurance concurrent agency

¹⁰ For more details on the so called '12 Opening-up Measures', please refer to the *Insurance Working Group Position Paper 2020/2021*, p. 394.

¹¹ *Implementing Rules for the Administrative Regulations of the People's Republic of China on Foreign-funded Insurance Companies*, CBIRC, 19th March 2021, viewed 15th April 2021, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=971698&itemId=928>>





licences or cross-selling licences for insurance groups, or even accept new applications, until the *Implementing Measures for Administrative Licensing and Record-filing for Insurance Intermediaries (Draft)* has been promulgated and taken effect.¹²

Meanwhile, other traditional financial services players such as banks, consumer finance and automotive finance companies are also interested in running concurrent insurance agency business, by acting as agents of insurance companies. Banks are currently selling insurance on the side of their primary business quite successfully in China. However, consumer finance companies and automotive finance companies do not qualify for concurrent insurance business licences, which prevents them from selling insurance products, because the regulator perceives this type of insurance as wealth management.¹³ In the opinion of the Insurance working group, whoever can cross-sell insurance should comply with regulations; however, under the current regulatory landscape, it is not clear why an insurance company cannot sell insurance products to its sister company, but a bank and a technology company can.

Recommendation

- Accelerate the issuing of the *Implementing Measures for Administrative Licensing and Record-filing for Insurance Intermediaries* and re-initiate the approval of insurance broker/agency licences, concurrent agency licences and cross-selling licences within insurance groups.

5. Create More Opportunities for Foreign Insurers to Contribute to China's Pension Reform 7

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

It is concerning that, while the longevity of China's population is increasing, the pension market remains under-penetrated. Since 2014, the Chinese Government and the CBIRC have shown that they are committed to reforming 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).

In the 14FYP, China has set ambitious goals for managing its projected demographic challenge. During the 14FYP period, it is estimated that China's elderly population will exceed 300 million, and the country's first generation of only-child parents will enter middle and senior age. But while the COVID-19 outbreak has put healthcare and life science in the spotlight, China's social insurance system¹⁴ has been impacted by the cost of COVID-19 relief efforts, with the country's social insurance fund reporting an annual deficit for the first time ever in 2020.¹⁵

In his *Government Work Report 2021* (GWR), Premier Li Keqiang noted that social security premiums had been cut or exempted by Chinese yuan (CNY) 1.7 trillion. The fall in revenues was due to a temporary COVID-19 relief policy, which allowed for reduced company contributions to the fund.¹⁶ In addition, the GWR 2021 stated that the Chinese statutory retirement age is to be raised in phases, and that coverage of basic old-age insurance is set to reach 95 per cent of the population, although by when was not clearly defined. Moreover, unemployment insurance scheme coverage is expected to be expanded while premiums will be reduced.¹⁷ However, China's working-age population is projected to decrease going forward, with state pension funds projected to run out by 2035 as a result.¹⁸

¹² *Implementing Measures for Administrative Licensing and Record-filing for Insurance Intermediaries (Draft)*, CBIRC, 18th August 2020, viewed 15th April 2021, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=923473&itemId=925&generalType=0>>

¹³ For more information, please see the *Non-banking Financial Institutions Position Paper 2021/2022*, p. 384, <https://www.eurochamber.com.cn/en/publications-archive/854/Consumer_Finance_and_Non_banking_Financial_Institutions_Working_Group_Position_Paper_2020_2021>

¹⁴ In China, provincial-level governments run their own social insurance funds for pensions, health, unemployment, work-related injuries and maternity leave. Contributions mostly come from individuals and companies, with some additional funding in the form of government subsidies.

¹⁵ Cheng, Siwei & Guo, Yingzhe, *China's Social Insurance Funds Report First Deficit on Record*, Caixin Global, 8th March 2021, viewed 6th April 2021, <<https://www.caixinglobal.com/2021-03-08/chinas-social-security-funds-report-first-deficit-since-2000-101672601.html>>

¹⁶ *Two Sessions 2021: Highlights of Premier's Government Work Report*, Caixin Global, 5th March 2021, viewed 6th April 2021, <<https://www.caixinglobal.com/2021-03-05/two-sessions-2021-highlights-of-premiers-government-work-report-101671410.html>>

¹⁷ *Report on the Work of the Government 2021*, State Council, 5th March 2021, viewed 12th April 2021, <<http://english.www.gov.cn/2021special/govtworkreport2021>>

¹⁸ *Charts of the Day: China's Pension System Is Out of Pocket*, Caixin Global, 19th April 2019, viewed 6th April 2021, <<https://www.caixinglobal.com/2019-04-19/charts-of-the-day-chinas-pension-system-is-out-of-pocket-101406390.html>>





With the first pillar under such strain, there is huge potential in China for private insurance. Moreover, only 34 per cent of Chinese millennials (aged 18 to 34) expect to rely on a public pension as the main source of their retirement income.¹⁹ The majority expect to rely on their own cash savings or deposit accounts. If foreign-invested insurers could have more flexibility in leveraging their overseas investment expertise in managing asset portfolios, they could better contribute to the non-public pillars of China's pension system.

On 15th May 2021, the CBIRC released the *Notice on Launching the Pilot Programme of Exclusive Commercial Pension Insurance*. The year-long pilot was launched on 1st June 2021 in Zhejiang Province (including Ningbo) and Chongqing. The insurers participating in the pilot are PICC, China Life, Taiping, China Pacific Insurance Company, Taikang and New China Life.²⁰ This type of third-pillar pilot programme is exactly what would be valuable for foreign insurers to participate in to offer their expertise and develop product innovation.

Finally, as interest rates in China have significantly decreased, the current emphasis on traditional guarantees makes it difficult for insurance companies to invest in asset classes with upside potential compared to fixed income.

Recommendations

- Invite foreign insurers to participate in future pension pilots in the second and third pillars, like that announced for Chongqing and Zhejiang.
- Allow foreign-invested insurers more flexibility in leveraging their overseas expertise in managing asset portfolios.

Abbreviations

14FYP	14 th Five-year Plan
CBIRC	China Banking and Insurance Regulatory Commission
CNY	Chinese Yuan
COVID-19	Coronavirus Disease 2019
GWR	Government Work Report
JV	Joint Venture
P&C	Property and Casualty
PICC	People's Insurance Company of China
SOE	State-owned Enterprise

¹⁹ *China Retirement Readiness Survey*, Fidelity International & Ant Financial, September 2019, viewed 15th April 2021, <<https://www.fidelityinternational.com/editorial/article/chinas-thirdpillar-pension-challenge-08ff76-en5/>>

²⁰ *Notice on Launching the Pilot Programme of Exclusive Commercial Pension Insurance*, CBIRC, 15th May 2021, viewed 21st May 2021, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=983946&itemId=915>>

6

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 seminars on topics 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/government relations, corporate governance and compliance, human resources, the environment, and health and safety.

In October 2020, China released a draft 14th Five-year Plan, which includes new government missions such as low-carbon development, rural vitalisation and realising prosperity for all. These targets not only provided corporates with ideas on social responsibility activities for the next stage of their development, but also directed the Corporate Social Responsibility Forum's events.

The forum promotes best practices already established by European companies and emphasises the importance of a strategic and innovative approach to CSR. In addition, it fosters CSR collaboration and co-innovation between the European Chamber, Chinese government agencies, professional organisations and local nongovernmental organisations.

The concept of CSR is engrained in the DNA of European Chamber member companies. This was clearly demonstrated through the support they provided to China in the early stages of the COVID-19 outbreak, when over 120 member companies made donations—financial support as well as medical supplies and devices—with the total value exceeding Chinese yuan (CNY) 1 billion. Similarly, when the situation in Europe rapidly deteriorated, the Chamber launched a call to members to cooperate with the European Union (EU) Emergency Response Coordination Centre in order to donate medical equipment.

Throughout 2020 and into early 2021, the forum held 21 activities in both Beijing and Shanghai. Regular forum meetings covered a wide range of topics, such as corporate sustainable strategy planning in pandemic crisis conditions, women's empowerment, carbon neutrality implementation, circular supply chain management and the Zero Plastic Campaign.

The European Chamber held its fourth Sustainable Business Awards and its seventh CSR Awards in 2020, and continues to host dialogues on topics related to CSR through its Corporate Social Profitability CEO/VIP Talk series. These dialogues 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 has established strong partnerships with governmental stakeholders, such as the EU Delegation to China, the Dutch, Swedish and German embassies, and the Norwegian Consulate General Shanghai, to help encourage CSR in the broader business community.

In 2021/2022, the Corporate Social Responsibility Forum will continue to foster dialogue between European Chamber member companies and Chinese stakeholders in order to promote the best European CSR practices and explore new, innovative ways to act sustainably.





European Chamber
中国欧盟商会

Government Affairs Forum

Established in 2011, the Government Affairs Forum consists of government affairs (GA) professionals from European Chamber 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 meetings frequently, featuring speakers from academia, industry and the Chinese Government. As a result, the forum 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.

In 2020, the forum analysed and translated key documents promulgated by the Chinese Government, with the aim of subsequently making the translations available to all European Chamber members. These documents included the *Proposals of the Communist Party of China (CPC) Central Committee on Formulating the 14th Five-Year Plan for National Economic and Social Development and the Long-Range Objectives Through the Year 2035*, the *Communique of the Fifth Plenary Session of the 19th Central Committee of the CPC*, and the *Government Work Report 2020*, among others. Supporting research and analysis was also conducted on topics such as the *Catalogue of Encouraged Foreign Investment Industries*, China's 'dual circulation' strategy, the Corporate Social Credit System and the process for investing in China.

By connecting members with the Chinese Government at all levels, the Government Affairs Forum helps them to keep abreast of key policy changes in China. In 2020, due to the coronavirus pandemic, the Government Affairs Forum organised a series of online discussions and events to help member companies resume business operations. For example, the forum invited a representative from the China Council for the Promotion of International Trade and an independent legal professional to explain '*force majeure*' from the perspective of the People's Republic of China's general rules on the Civil Law and Contract Law. These kinds of events provided much-needed support and information to the European business community in China during a critical period.

Exchanges are organised on a quarterly basis, and in 2020 covered hot topics such as GA crisis management as well as developments like the United States-China trade conflict, the European Union (EU)-China relationship, the EU-China Comprehensive Agreement on Investment, China's economic outlook and the Corporate Social Credit System.





Marketing and Communications Forum

The Marketing and Communications Forum is comprised of marketing and communications professionals from a wide range of industries. They represent nearly 400 member companies based in the European Chamber's Beijing, Shanghai and South China chapters. Through regular activities such as meetings, seminars and training sessions, the forum provides a platform to exchange information, experiences and best practices among members on the best use of marketing and communications to achieve business objectives in China.

The most prevalent topic of 2020 was the coronavirus disease 2019 (COVID-19) pandemic. Although it was a crisis of global proportions, and resulted in severe disruptions to business operations, the outbreak also forced enterprises to accelerate their digitalisation processes in a 'socially-distanced' world and to adapt their business models to capture new growth opportunities.

The Marketing and Communications Forum's events were organised against the backdrop of COVID-19, with many providing a platform to discuss emerging trends with member companies, and provide suggestions and best practices. The forum's first post-outbreak webinar was held in March 2020, covering strategic views on, and the practicality of, business transformation and digitalisation. A further event was held in April 2020, to explore how brands could prepare to rebound from COVID-19 by analysing consumer and market trends since the outbreak, and to provide guidance on effective communication.

China's already rapidly growing e-commerce market was further accelerated in 2020 by the pandemic, due to a major shift in consumer behaviour away from shopping in bricks-and-mortar stores. The forum organised an event on e-commerce trends in April to help members understand the changing e-commerce landscape and to seize opportunities as the market grew.

One of the notable changes in this industry over the past year was the significant growth of live-streaming on e-commerce platforms. This resulted in the General Administration of Market Supervision issuing on 29th July the *Guidance on Strengthening the Supervision of Live-streaming Marketing Activities (Draft for Comments) (Guidance)*, with the intention of protecting the rights and interests of consumers through stricter monitoring of the live-streaming market. In September 2020, the forum invited the China Advertising Association to share the regulatory background to the *Guidance*, and to interpret the key provisions of the regulation and their potential impact on enterprises.

The forum also organised an experience-sharing session for manufacturing companies in South China in September 2020, while training courses on content marketing, social media, crisis management, video marketing and live-streaming were provided across all Chamber chapters.

Following on from the success of previous events on engaging with international media, in December 2020, the forum organised a session on how to engage with media and the impact that COVID-19 has had on corporate media communications. This session was the first to have a journalist from Chinese media join the session panel.

In the first half of 2021, the forum hosted three webinars—one on marketing trends, one on crisis communication and professional development, and another on the benefits of project management tools and mindset for marketing—and, in addition, a discussion session was held to review 2020 and forecast the outlook for 2021.



Manufacturing Forum

Since its establishment in November 2012, the Manufacturing Forum has kept pace with the ever-changing challenges faced by European manufacturing companies in China.

The forum is comprised of around 150 member companies that cover a wide range of industries, such as automotive, consumer goods, electronics, energy, healthcare, machinery, petrochemicals and telecommunications. It functions as a platform for sharing practical information between members and supporting their operations in China.

Throughout 2020 and into 2021, the forum organised many events including meetings, factory tours, seminars and training courses. Topics covered included: the 'smart factory' and digital manufacturing; innovation; lean management (Kaizen); attracting and retaining talent within the manufacturing industry; the Guangdong economic eco-system; and environmentally-conscious manufacturing; among others.

The forum also has a WeChat group for members that allows them to share timely information and exchange experiences and ideas in a convenient and efficient manner. Issues that emerged for discussion via the WeChat group include:

- local regulation updates;
- industry information;
- human resources concerns;
- requests for help from the European Chamber; and
- requests for help from other members.

The Manufacturing Forum created a Healthcare Manufacturing sub-group in 2019, which continues to meet and discuss relevant issues. Members of the sub-group met with the Guangdong Provincial Health Commission in November 2020 to advocate for the removal of the 'Buy China' policy, which encourages Chinese hospitals to buy domestically-branded medical products over foreign ones. This sub-group aims to support members in the healthcare, medical device and pharmaceutical industries by organising events on regulatory issues as well as seminars to generate discussions on specific topics.

In 2021/2022, the Manufacturing Forum will continue to engage members, organise more interactive activities and provide information on industry-related topics such as manufacturing innovation, supply chain management, regulations and tax incentives. Innovation and environmental regulation compliance will be the areas of particular focus for the forum over the coming year.

The forum will also focus on the potential future opportunities for European enterprises in respect to new technologies (such as artificial intelligence, 5G, autonomous driving) and decarbonisation (such as 'cleantech'—environmentally friendly practices and technologies—and energy efficiency).



Small and Medium-sized Enterprise Forum

Comprised of more than 250 European small and medium-sized enterprises (SMEs), the European Chamber's Small and Medium-sized Enterprise Forum was established in 2005 to provide a platform for members to share experiences and gain practical information on how to successfully operate in China. 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.

SMEs face numerous challenges in China's increasingly competitive markets. In 2020, the top issue was securing domestic and international supply chains in order to maintain production while dealing with the fallout from the COVID-19 pandemic. Travel restrictions in 2020 also posed additional hurdles for SMEs, as a high number of foreign professionals were stranded outside China while many companies were unable to get foreign talent on board. This remains an issue in 2021.

However, China continues to encourage development of the SME sector, most recently with commitments in the 14th Five-Year Plan to improve the business and innovation environment for small businesses, as well as support in the context of strengthening China's middle-income group. Nevertheless, to help European SMEs overcome their challenges, the Small and Medium-sized Enterprise Forum maintains a strong network for companies to share resources and insights on the regulatory environment. The forum also works closely with relevant European Chamber working groups to ensure that specific SME requirements and concerns are voiced in any advocacy activities.

In 2020, the Small and Medium-sized Enterprise Forum organised many events in the European Chamber's Beijing, Shanghai and South China chapters. These events focussed on areas including policy environment, China's E-commerce Law, technology transfer, regional business opportunities and digital marketing, among others.

In 2021/2022, the forum will remain a source of regular policy updates, as well as insights on topics such as talent management, best-practice sharing, and new regulations and guidelines that may impact SME operations. The forum will also continue to provide a platform and opportunities for European SMEs to share solutions to common problems and to foster success.

7 Section Seven

Appendix

Abbreviations

°C	Degrees Celcius
14FYP	14th Five-year Plan
3Rs	Reduce, Reuse, Recycle
5G	Fifth Generation
A&C	Autonomous and Controllable
ABS	Asset Backed Securitisation
ACI	Auto Climate Index
AD	Automated Driving
ADR	Alternative Dispute Resolution
AET	Automatic Early Termination
AFB	Agriculture, Food and Beverage
AFC	Auto Finance Company
AFSL	Anti Foreign Sanctions Law
AI	Artificial Intelligence
AICM	Association of International Chemical Manufacturer
AMC	Asset Management Company
AML	Anti-money Laundering
AML	Anti-monopoly Law
AMR	Administration for Market Regulation
AOR	Assignment of Receivables
AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
ASEAN	Association of Southeast Asian Nations
ATA	Temporary Admission
ATC	Air Traffic Control
ATM	Air Traffic Management
ATMB	Air Traffic Management Bureau
AUCL	Anti-unfair Competition Law
B2B	Business to Business
B2C	Business to Consumer
BASA	Bilateral Aviation Safety Agreement
BCI	Better Cotton Initiative
bcm	Billion Cubic Metres
BCS	Business Confidence Survey
BEV	Battery Electric Vehicles
BRI	Belt and Road Initiative
CAAC	Civil Aviation Administration of China
CAAM	China Association of Automobile Manufacturers
CAC	Cyberspace Administration of China
CAFC	Corporate Average Fuel Consumption
CAI	Comprehensive Agreement on Investment
CALCP	China Automobile Low Carbon Action Plan
CANSI	China Association of the National Shipbuilding Industry
CASME	China Association for SMEs
CBI	Confidential Business Information
CBIRC	China Banking and Insurance Regulatory Commission



CCC	China Compulsory Certification
CCDR	Central Comprehensively Deepening Reforms Commission
CCER	Chinese Certified Emission Reduction
CCP	Central Counterparty
CCPS	Classified Cybersecurity Protection Scheme
CCS	Carbon Capture and Storage
CCS	China Classification Society
CCUS	Carbon Capture, Utilisation and Storage
CD	Certificate of Deposit
CDMD	Consumable and Disposable Medical Devices
CDPF	China Disabled Persons' Federation
CDS	Customs Declaration Sheet
CFC	Consumer Finance Company
CFDA	China Food and Drug Administration
CFETS	China Foreign Exchange Trade System
CFSA	Centre of Food Safety Risk Assessment
CGHC	China Gas Heating Specialty Committee
CIBM	China Interbank Bond Market
CIDAS	China In-depth Accident Study
CIT	Corporate Income Tax
CM2025	China Manufacturing 2025
CMDE	Centre for Medical Device Evaluation
CNCA	Certification and Accreditation Administration of China
CNIPA	China National Intellectual Property Administration
CNIS	China National Institute of Standardisation
CNS	Chinese Nutrition Society
CNY	Chinese Yuan
CO ₂	Carbon Dioxide
CO ₂ E	Carbon Dioxide Equivalent
COCIR	European Coordination Committee of the Radiological, Electromedical and Healthcare
COMAC	Commercial Aircraft Corporation of China
CoO	Country of Origin
COP	Conference of the Parties#
CORSIA	Carbon Offsetting Scheme for International Aviation
COVAX	COVID-19 Vaccines Global Access
COVID-19	Coronavirus Disease 2019
CPC	Communist Party of China
CPCIF	China Petroleum and Chemical Industry Federation
CPPCC	Chinese People's Political Consultative Conference
CRR	Capital Requirements Regulation
CSA	Coordination and Support Actions
CSAR	Cosmetics Supervision and Administration Regulations
CSCS	Corporate Social Credit System
CSIS	Center for Strategic and International Studies
CSL	Cybersecurity Law
CSP	Construction Service Provider
CSRC	China Securities Regulatory Commission
CSRM	Cybersecurity Review Measures
CT	Computed Tomography
CTE	Coal-to-electricity

CTG	Coal-to-gas
CV	Commercial Vehicle
DDR	Deposit Deviation Ratio
DES	District Energy Systems
DG MOVE	Directorate General for Mobility and Transport
DHA	Docosahexaenoic Acid
DIP	Diagnosis-intervention Packet
DMV	Department of Motor Vehicles
DOJ	Department of Justice
DRC	Development and Reform Commission
DRC	Development Research Centre (of the State Council)
DRG	Diagnosis-related Group
DVFA	Danish Veterinary and Food Administration
EASA	European Union Aviation Safety Agency
ECECP	EU-China Energy Cooperation Platform
ECHI	Europe China Heating Initiative
ECL	Export Control Law
ECMO	Extracorporeal Membrane Oxygenation
ECN	European Competition Network
EDS	Express Delivery Services
EDV	Essentially Derived Varieties
EFSA	European Food Safety Authority
EHS	Environment, Health and Safety
ELC	Equipment Leasing Company
EPB	Environmental Protection Bureaus
EPR	Extended Producer Responsibility
ESCO	Energy Service Company
ETS	Emissions Trading Scheme
EU	European Union
EUR	Euro
EUROCONTROL	European Organisation for the Safety of Air Navigation
EV	Electric Vehicle
FAO	Foreign Affairs Office
FCEV	Fuel Cell Electric Vehicle
FCM	Food Contact Materials
FCPA	Foreign Corrupt Practices Act
FCV	Fuel Cell Vehicle
FDA	Food and Drug Administration
FDI	Foreign Direct Investment
FI	Financial Institutions
FICLS	Foreign-invested Company Limited by Shares
FIE	Foreign-invested Enterprise
FIL	Foreign Investment Law
FIT	Feed-in Tariff
FOP	Front of Package
FSMP	Food for Special Medical Purpose
FTA	Free-trade Agreement
FTZ	Free Trade Zone
G7	Group of 7
GA	General Aviation



GAC	General Administration of Customs
GB	Guobiao
GBA	Greater Bay Area
GCW	Gross Combination Weight
GDP	Gross Domestic Product
GDPR	General Data Protection Regulation
GFMA	Global Financial Market Associations
GHG	Greenhouse Gas
GI	Geographical Indication
GLP	Good Laboratory Practice
GM	Genetically Modified
GMM	Genetically Modified Micro-organism
GPL	Government Procurement Law
GPS	Global Positioning Satellite
GPSD	General Product Safety Directive
GRAIN2	Greener Aeronautics International Networking 2
GW	Gigawatts
GWR	Government Work Report
HAD	Highly Automated Driving
HC	Hazardous Chemicals
HD	High Definition
HFC	Hydrofluorocarbons
HFO	Hydrofluoroolefins
HNTE	High and New-technology Enterprise
HQ	Headquarters
HQLAAR	High-quality Liquid Asset Adequacy Ratio
HR	Human Resources
HS	Harmonisation System
HSA	Health Security Administration
IATA	International Air Transport Association
IC	Integrated Circuit
ICAO	International Civil Aviation Organization
ICCA	International Council of Chemical Associations
ICT	Information and Communication Technology
ICV	Intelligent and Connected Vehicle
IDC	Internet Data Centre
IDF	International Dairy Federation
IEC	International Electrotechnical Commission
IECSC	Inventory of Existing Chemical Substances in China
IFRS	International Financial Reporting Standards
IFU	Instructions for Use
IIT	Individual Income Tax
IMF	International Monetary Fund
IMO	International Maritime Organization
IMT	International Mobile Technology
IOC	International Oil Company
IoT	Internet of Things
IP	Intellectual Property
IPi	International Procurement Instrument
IPO	Initial Public Offering

IPR	Intellectual Property Right
IP-VPN	Internet Protocol Virtual Private Network
IRC	Internet Resources Collaboration
ISO	International Standardization Organization
IT	Information Technology
ITU	International Telecommunication Union
IV	Intelligent Vehicle
IVD	In-vitro Diagnostics
JV	Joint Venture
Kg	Kilogram
km	Kilometre
KR	Key Recommendation
kW	Kilowatt
LCA	Life Cycle Assessment
LDR	Loan to Deposit Ratio
LMR	Liquidity Matching Ratio
LNG	Liquefied Natural Gas
ITU	International Telecommunication Union
M&A	Mergers and Acquisitions
m ²	Square Metres
MAD	Mutual Acceptance of Data
MAH	Marketing Authorisation Holder
MARA	Ministry of Agriculture and Rural Affairs
MEE	Ministry of Ecology and Environment
MEM	Ministry of Emergency Management
MEP	Ministry of Environmental Protection
MERICs	Mercator Institute of Chinese Studies
MFA	Ministry of Foreign Affairs
MIIT	Ministry of Industry and Information Technology
MLPS	Multi-level Protection Scheme
MNC	Multinational Corporation
MNR	Ministry of Natural Resources
MOA	Ministry of Agriculture
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	Macro-prudential Assessment
MPS	Ministry of Public Security
MRV	Monitoring, Reporting and Verification
MTM	Mark-to-Market
MWR	Ministry of Natural Resources
NBS	National Bureau of Statistics
NDC	Nationally Determined Contributions
NDRC	National Development and Reform Commission



NEA	National Energy Administration
NEV	New Energy Vehicle
NAFMII	National Association of Financial Market Institutional Investors
NG	Natural Gas
NHC	National Health Commission
NHFPC	National Health and Family Planning Commission
NHSA	National Healthcare Security Administration
NIA	National Immigration Administration
NMPA	National Medical Products Administration
NOx	Nitrogen Oxide
NPC	National People's Congress
NPCSC	Standing Committee of National People's Congress
NPL	Non-performing Loan
NSR	National Security Review
OE	Original Equipment
OECD	Organisation for Economic Co-operation and Development
OEM	Original Equipment Manufacturer
P&C	Property and Casualty
P2P	Peer-to-Peer
PaaS	Platform-as-a-Service
PBOC	People's Bank of China
PD	Primary Dealer
PET	Polyethylene Terephthalate
PEV	Pure Electric Vehicles
PHEV	Plug-in Hybrid Electric Vehicle
PICC	People's Insurance Company of China
PN	Particle Number
POA	Power of Attorney
PPA	Power Purchase Agreements
PPP	Purchasing Power Parity
PRC	People's Republic of China
PSB	Public Security Bureau
PTE	Purchase Tax Exemption
PUE	Power Usage Effectiveness
PV	Photovoltaic
Q&A	Question-and-answer
QSS	Quality and Safety Services
R&D	Research and Development
RCEP	Regional Comprehensive Economic Partnership
RE	Real Estate
REACH	Registration, Evaluation, Authorisation and Restriction of Chemicals
RMB	Renminbi
ROP	Refined Oil Product
rPET	Recycled Polyethylene Terephthalate
RWD	Real-world Data
RWE	Real-world Evidence
S&T	Science and Technology
SaaS	Software-as-a-Service
SAC	Standardisation Administration of China
SAF	Sustainable Aviation Fuel

SAFE	State Administration of Foreign Exchange
SAIC	State Administration of Industry and Commerce
SALB	Sales and Leaseback
SAMR	State Administration for Market Regulation
SAT	State Administration of Taxation
SC	Standing Committee
SCA	Standards and Conformity Assessment
SCA	State Cryptography Administration
SCH	Shanghai Clearing House
SCS	Social Credit System
SDG	Sustainable Development Goal
SDO	Standards Developing Organisation
SEC	Securities and Exchange Commission
SESEC	Seconded European Standardization Expert in China
SF6	Sulphur Hexafluoride
SHE	Safety, Health, and Environment
SME	Small and Medium-sized Enterprise
SMEDI	SME Development Index
SOE	State-owned Enterprise
SPB	State Post Bureau
SPC	Supreme People's Court
SPP	Supreme People's Procuratorate
SSE	Shanghai Shipping Exchange
STA	State Taxation Administration
SUV	Sport Utility Vehicle
TBL	Tender and Bidding Law
TBT	Technical Barriers to Trade
TC	Technical Committee
TC260	National Information Security Standardisation Technical Committee
TC485	National Technical Committee on Communication
THC	Terminal Handling Charge
TIC	Testing, Inspection and Certification
TIER	Technology Import and Export Administrative Regulation
TIP	Technical Implementation Procedures
TP	Transfer Pricing
TPA	Third Party Access
TTC	Threshold of Toxicological Concern
UAS	Unmanned Aircraft System
UAV	Unmanned Aerial Vehicle
UDI	Unique Device Identification
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States
USD	US Dollars
UTM	Unmanned Aircraft System Traffic Management
V2X	Vehicle to Everything
VAT	Value-added Tax
VATS	Value-added Telecoms Services
VBP	Volume-based Procurement



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VSME	Very Small and Micro-sized Enterprise
VUCA	Volatility, Uncertainty, Confusion and Ambiguity
WFOE	Wholly Foreign-owned Enterprise
WFOCE	Wholly Foreign-owned Construction Enterprise
WHO	World Health Organisation
WHT	Withholding Tax
WIPO	World Intellectual Property Organization
WSC	World Semiconductor Organization
WTO	World Trade Organization
XUAR	Xinjiang Uyghur Autonomous Region
YRD	Yangtze River Delta



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